CHAPTER 2
GROWTH AND REGULATION OF IPO MARKET IN INDIA

An Initial Public Offering (IPO) is a significant juncture in the evolution of a public company. It is a route of resource mobilization that provides a greater access of capital and flexibility in financing to the company. Apart from the company, an IPO holds importance for investors as well as for economy at large. The high returns in the issue make it an attractive investment opportunity for investors, whereas transferring resources from the surplus units to the deficit units facilitates the economic development of a country (Sehgal and Singh, 2008). Considering all such relevance of an IPO, an attempt has been made in this chapter to outline the development of Indian IPO market and understand its regulatory framework. Further, when it comes to survival of IPO, it is essential to comprehend the delisting norms that are prevalent in India. Hence, such guidelines have also been discussed under this chapter.

2.1 TRENDS IN INDIAN IPO MARKET

The Indian primary market has witnessed many ups and downs in the past two decades. Recounting the history over the last 20 years is like watching a movie from the climax\(^1\). The period of 90s was the most significant decade for the Indian capital market as the number of new policies and initiatives were introduced during this period. Liberalization, Privatization and Globalization changed the whole facets of Indian capital market (Murthy and Singh, 2013). Earlier there was the iron hand of the Controller of Capital Issues (CCI) that ruled the primary market, which required the issuers to price their shares strictly as determined by CCI. But one of the commendable reforms of abolition of CCI and allowance to free pricing of issues led to a paradigm shift in the structure and functioning of Indian stock market. Free pricing mechanism allowed the good companies

\(^1\)http://www.thehindubusinessline.com/features/how-the-primary-market-lost-the-fizz-but-gained-flavour/article4348439.ece
to come up with their issue at the right price which were earlier denied. This transformation of the Indian securities markets was initiated in 1992 with the establishment of the Securities and Exchange Board of India (SEBI) as a statutory autonomous regulator. This body has been constituted with the aim to protect the interests of investors, to regulate the securities market and to facilitate the smooth functioning of entire capital market. Keeping in view these statutory objectives, SEBI has confined its strategic targets into four spheres, i.e. investors, issuers, intermediaries and regulatory regime.

Overall, this decade was dominated by number of reforms such as formulation of new industrial policy, introduction of free pricing mechanism, establishment of SEBI, participation by FIIs and many more (Murthy and Singh, 2013). Further, the establishment of NSE (National stock exchange) in 1994, OTCEI (Over the counter Exchange of India) in 1995 and the book building mechanism in 1995, provided the access to high-technology enterprises to raise finance for new product development in a cost-effective manner and provided a transparent and efficient trading system to investors. All this brought a sea change in the entire primary market and its effect is evident from the trends in IPO market during the period 1992-1996. As shown in figure 2.1, a momentous growth has been observed in Indian IPO market from 1992 till 1996, wherein the real growth picked up both in terms of numbers as well as capitalization. During this period, India experienced a commendable boom as far as number of IPOs is concerned that crossed three digit level and reached to its maximum in 1995. Issuers were eager to tap the market, investors were willing to invest, Sensex touched new heights and domestic companies went for overseas issues that led to a boom in the entire market. But at the same time, several malpractices, discretionary allotments and fly by night operators also flourished. In addition to this, the entire growth was halted by South East Asian crisis in 1997. Due to the crisis, foreign investors shifted their portfolio from the market
which created negative sentiments among domestic investors as well. Figure 2.1 clearly exhibits that the market remained flat from 1997-1999 as investors preferred to invest in banks rather than in shares\(^4\). Thereafter, the market was hit by the internet bubble boom in 1999-2000 wherein a large number of software companies entered the primary market and received tremendous response from the investors. Figure 2.1 shows the slight upward movement during this period, but overall the market remained bearish.

In order to clean up several malpractices, new disclosure requirements were made mandatory based upon the recommendations of Y.H Malegam committee in 2002. This made the prospectus more revealing for the potential investors. Further, SEBI made it compulsory for the companies to have three year profit track record at the time of issue in order to raise the bar of new issues\(^5\). Thereafter, a commendable growth reoccurred from 2004 onwards. The proceeds raised from the issues start moving upward, but the number of issues did not increase substantially. This indicates that in recent years lesser number of issues with larger size are being introduced in the market. The resources raised far exceed the number of issues in the year 2007-2008, which witnessed the biggest IPO in Indian IPO market. According to the Global IPO Trends Report 2007 by Ernst and Young\(^6\), India has largest number of both small and mid-cap public companies in the world and in 2006 it ranked eighth in the world in terms of number as well as value of IPOs. In 2007, as far as global IPO activity is concerned, it reached an all-time high of US$287 billion through 1,979 deals. Brazil, Russia, India and China (BRIC countries) accounted for 40% of the global IPO proceeds. While mature markets endure an IPO slowdown, many emerging markets continue to flourish, bolstered by vibrant economic growth (Ernst and Young, 2008)\(^7\).

\(^4\) http://www.thehindubusinessline.com/features/how-the-primary-market-lost-the-fizz-but-gained-flavour/article4348439.ece

In the year 2008 and 2009, a decline has been observed primarily due to global recession hit, but a dramatic recovery has also been witnessed in 2010. This revival has been a domestic consumption led growth story, driven by an influx of capital from western economies as well as a booming local stock market. In 2010, India enjoyed a significant growth in terms of number of IPOs as compared to 2009 (Ernst and Young, 2011).

In nutshell, it can be said that overall the Indian IPO market has lost the glamour over the last 20 years, but certainly have gained in terms of quality and maturity. The Indian IPO market has come a long way since the boom in 1992-1996. Largely, the role of regulators has been admirable due to which an improvement in coming years can be anticipated.

### 2.2 LAWS GOVERNING IPOs IN INDIA

In order to protect the interest of investors and to ensure the smooth working of entire market, several laws have been introduced in the Indian securities market from time to time. When private companies wish to issue their securities in the market, they need to comply with the provision of such laws. The rationale behind these laws is to ensure that only good quality corporate with better prospects should be allowed to enter the market. This would enhance the success of issues in the market and ensure their longer survival on the exchange. Hence, in order to understand the survival of IPOs in the market place it

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is important to have an overview of various laws and acts that governs the securities in India. Their highlights are given below (cited in ISMR, 2013)⁹:

### 2.2.1 Securities Contracts (Regulation) Act, 1956

In 1956, Securities Contracts (Regulation) Act (SCRA) was formulated in order to provide the direct and indirect control over all aspects of trading of securities and running of stock exchanges to central government. It aims to avert undesirable transactions in securities and ensure the control of central government over the stock exchanges through a process of recognition and continued supervision. Since central government got the recognition, all the stock exchanges have to comply with their norms and conditions. The stock exchanges determine their own listing regulations, but they have to confirm to the minimum listing criteria set out in the rules.

### 2.2.2 Securities and Exchange Board of India Act, 1992

The Securities and Exchange Board of India (SEBI) was enacted under SEBI Act, 1992 in order to protect the interests of investors in securities, to promote the development of the securities market and to regulate the securities market. It has the jurisdiction over corporate in the issuance of capital and transfer of securities, as well as over all intermediaries and persons associated with the securities market. It has the power to conduct enquiries, audits and inspection of all concerned, and give a ruling for offences under the act. In other words, SEBI has full autonomy and the authority to regulate and develop an orderly securities market.

### 2.2.3 Depositories Act, 1996

In order to remove the inefficiencies in paper based trading and to ensure the free transferability of securities with speed, accuracy, and safety, the ‘Depositories Act’ came into existence on 10\(^{th}\) August 1996. The main purpose of this act is to make the securities of public limited companies freely transferable by dematerializing it in the depository mode. This act streamlines the settlement process and ensures the transferability of securities in electronic form without moving the securities from one person to another. At

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⁹ [http://www.nse-india.com/research/dynaContent/ismr.htm](http://www.nse-india.com/research/dynaContent/ismr.htm)
present, there are two depositories that regulate the depository system in India, i.e. National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL).

2.2.4 Companies Act, 2013

In order to regulate the entire corporate sector of the country, Company Act was formulated in the year 1956. It comprises of various standards of disclosure in public issues of capital, particularly in the fields of company management and projects. However, due to certain inefficiencies in this act, it has now been replaced by the Companies Act, 2013. This act is a more comprehensive in nature and deals with relevant themes such as investor protection, inclusive agenda, fraud mitigation, internal control, director’s responsibility and efficient restructuring. Hence, Indian companies have to closely examine these developments in order to frame a clear strategy for ensuring compliance as per the new requirements\(^\text{10}\).

2.2.5 Prevention of Money Laundering Act, 2002

Money laundering has been a major problem hampering the growth of Indian economy. Hence, this act was passed in the year 2002 in order to prevent money laundering and to allow the confiscation of property derived from or involved in money laundering\(^\text{11}\). This act defined “money laundering” as anyone who acquires, owns, possess, or transfers any proceeds of crime, or knowingly enters into any transaction that is related to the proceeds of crime either directly or indirectly, or conceals or aids in the concealment of the proceeds or gains of crime within India or outside India commits the offence of money laundering. This act not only prescribes the punishment for this offence, but also the other measures for the prevention of money laundering.

Various laws, as discussed above, play a vital role in regulating the entire securities market in India. Hence, the norms and provisions provided in them need to be clearly examined and followed at the time of issuance of securities in India.

\(^\text{11}\) http://finmin.nic.in/law/moneylaunderingact.pdf
2.3 SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009

Several guidelines have been introduced by SEBI for the issuance of capital in the market from time to time. Earlier, SEBI issued ‘Disclosure and Investment Protection’ guidelines, 2000 (DIP, 2000) which was replaced with ‘Issue of Capital and Disclosure Requirements’ 2009 (ICDR, 2009) and the latest one is the SEBI (ICDR) Second Amendment Regulations, 2013. ICDR guidelines are the set of comprehensive rules and regulations that governs the different types of issues such as public issues, right issues, preferential issues, bonus issues, issues by SME and IDR. However, the issues of ADR, GDRs, FCCBs, and debt issues are not covered in its scope. These guidelines provide the overall framework within which a company can bring its new issue in the market. However, the main aim of SEBI (ICDR) regulations is to provide more secured IPO market to the investors. In other words, such guidelines provide the stringent rules and norms for the companies which restrict any fraudulent activities in the market. Moreover, such guidelines keep a check on fly by night operators and ensure that companies with good profile should enter the market. This will not only widen the scope of trading activities in the market but also ensure the better environment for the success of issuers in the market. Hence, the survival of IPOs in the market is highly determined by such guidelines.

The details of areas covered in the guidelines can be checked from SEBI (ICDR) Regulations, 2009 which are available on the official website of SEBI (www.sebi.gov.in). Separate sections covered within the ambit of these guidelines includes a) Eligibility norms, b) Entry routes, c) Pricing, d) Promoter’s contribution and Lock-in requirements, e) Pre-Issue obligations, f) Post-Issue obligations and other norms related to the issue.

The eligibility norms provided in the guidelines ensure that the issuer, its promoter group or directors or persons in control of the issuer should not be debarred from accessing capital market. Moreover, they should not be a promoter, director or person in control of

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any other company which is debarred from accessing capital market. Also, issuer has to make arrangements of finance through verifiable means towards 75 per cent of the stated means of finance excluding the amount to be raised through the issue or the internal accruals. The guidelines clearly state that the issuer can enter the market through two routes, namely profitability route and alternative routes. The profitability route emphasizes that issuer need to have the enough profitability and a proper track record at the time of entering into the market. However, sometimes there are many good companies who may not be able to comply with all the eligibility norms, but they are competent enough to go public. Hence, either of the two other alternative routes is available for them, i.e. ‘Qualified Institutional Buyers’ (QIBs) route or ‘Appraisal’ route.

Special focus has been given in the guidelines as far as the pricing of the issue is concerned. The concept of price band has been introduced which refers to the band within which the investors can bid. It is mandatory that the spread between the floor and the cap of the price band should not be more than 20%. Various factors such as financial position of company, net worth, EPS, profit margin, industry P/E Ratio, reputation of the company in the relevant industry, background of the promoters, future prospect of the company as well as the industry etc. are considered for price determination.

In order to ensure that promoters should have some vested interest in the issue so that they should not get indulge in any malpractices, ICDR mandates that the promoters shall contribute not less than 20% of the post-issue capital which should be locked in for a period of 3 years. Also, the remaining pre-issue capital should also be locked in for a period of 1 year from the date of listing. Further certain pre-issue obligations with regard to appointment of merchant bankers and other intermediaries, filing of offer document with ROC, obtaining approval from recognized stock exchange, filing draft offer document to the public, opening of issue, underwriting, minimum offer to public and various disclosures required in the offering prospectus have also been clearly stated in the guidelines.

Apart from this, there are several post-issue obligations as well which have to be fulfilled by the company. Post-issue monitoring should be properly ensured by the associated lead
merchant banker, irrespective of the level of subscription. Further, the allotment, refund, and dispatch should be done by merchant banker and they should also monitor the redressing of investor grievances arising from the issue. The fair allotment should be finalized by the Executive Director/Managing Director of the designated stock exchange along with the post-issue lead merchant banker and the registrars of the issue. The lead merchant banker should ensure that the dispatch of the share certificates/refund orders and demat credit is done timely. Also, all the allotment and listing documents need to be submitted to the stock exchange within two working days following the date of allotment. In nutshell, the regulations have taken into account several crucial aspects for ensuring that only the eligible and worthy companies should come up their IPOs in the market. This will not only protect the interest of investors but will also ensure the high survival rate of IPOs in the aftermarket.

2.4 DELISTING OF SECURITIES

Although several norms have been introduced by SEBI for the issuance of securities that aims to enhance the survival prospects of IPOs yet Indian securities market has exhibited a growing trend of delisting of shares from the stock exchanges. This trend of delisting has received a lot of attention from public, media and investors. Moreover, delisting of securities has become a crucial issue to be tackled among various financial regulators and the finance ministry. Several issues enter the market but only few manage to survive well. This certainly indicates that there are certain factors that hinder the survival of IPOs in the market. The present study aims to identify and empirically test such factors that hamper the success of IPOs in the market place. The study defines ‘survival’ as the IPOs that continue to list on stock exchange and ‘non-survival’ that got delisted from the exchange. Since, survival and non-survival of IPOs has been defined in terms of delisting, it is imperative to have a thorough understanding of the concept of delisting, its types, prevalent laws and consequences.

2.4.1 Concept of Delisting

Before understanding the concept of delisting, firstly ‘listing’ should be made clear. Listing refers to the admission of company’s security on a recognized stock exchange.

14 http://www.delisting.in/meaning.php
The objectives behind the listing of securities are to provide the liquidity to the securities, to mobilize the savings for the development of entire economy and to ensure the protection of shareholder’s interest\textsuperscript{15}. However, all these objectives can be achieved only if securities continue to list on the exchange. ‘Delisting’ is just the reverse of listing. It means the removal of company’s security from the stock exchange on which it is registered. Once the company is permanently removed, it would no longer be traded on the exchange.

\textbf{2.4.2 Types of Delisting}

Delisting of securities can be in two forms, namely compulsory delisting and voluntary delisting. Figure 2.2 shows the type of delisting in India:

\textbf{Figure 2.2: Types of Delisting}\textsuperscript{16}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{Types_of_Delisting}
\end{figure}

\begin{itemize}
\item \textbf{Compulsory Delisting}
  \begin{itemize}
  \item Exit price is required
  \end{itemize}
\item \textbf{Voluntary Delisting}
  \begin{itemize}
  \item No exit price is required
  \item Small company (whether listed on any of the exchange)
  \end{itemize}
\item Voluntary delisting from few stock exchange but remains listed on at least one stock exchange having nation wide trading terminal
\item Voluntary delisting from all the stock exchanges
\item No open offer but exit price is there.
\end{itemize}

\textsuperscript{15} \url{http://www.legalserviceindia.com/article/l329-Listing-&-Delisting-Of-Securities.html}

\textsuperscript{16} \url{http://www.delisting.in/how_to_delist.php}
a) Compulsory Delisting: When the stock exchange gives order to the company to delist securities, it is known as compulsory delisting. SEBI has defined some of the common causes for compulsory delisting of securities\(^\text{17}\):

- Non-payment of listing fees.
- Non-compliance with provisions of the listing agreement.
- Absence of trading or negligible trading.
- Non-redressal of investors’ complaints despite of repeated reminders.
- Unfair trading practices by the promoters / management.
- Other malpractices such as fake or duplicate share certificates deliberately issued by the management.
- The unknown whereabouts of the company and / or its promoters / directors.
- Decline in the number of public holders of securities.

b) Voluntary Delisting: When a company voluntarily decides to go for delisting and remove its shares from the stock exchange, it is known as ‘Voluntary Delisting’. Some of the common causes for voluntary delisting of securities provided by SEBI are as follows:

- A listed company finds the listing fees payable to the stock exchange burdensome and disproportionate to the benefits accruing to the company and/or its security holders.
- Reduction in the number of public holders of the listed securities (due to private placement issue or otherwise) that does not justify the securities to continue to be listed.
- Regional imbalance of the holders of the securities either due to shifting of the companies registered office and / or location of manufacturing unit, or for any other reason.
- Negligible trading or total absence of trading for a considerably long period of time.

\(^{17}\) http://www.sebi.gov.in/commreport/dlist7.html
The company has either suspended its business or is under closure or has become a sick industrial company.

The capital base of the company is so small that fails to comply with the requirement.

Mergers, demergers, amalgamations, takeovers, etc.

2.4.3 SEBI (Delisting of Equity Shares) Regulations, 2009

SEBI observed several manipulations on the part of companies while delisting of their shares from the market which in turn hampered the interest of investors. Hence, in order to protect investors from such malpractices, SEBI issued the guidelines for delisting of securities from the exchange. Taking a note of the various issues and concerns which underpinned the need to revisit the delisting requirements and the listing conditions, SEBI decided to set up a committee in order to discuss the increasing instances of delisting of companies from the Indian stock exchanges and the probable negative consequences of such delisting so as to come out with the solutions for the same. Earlier, delisting guidelines were issued by SEBI in 1998 which were replaced by guidelines in 2003. Then in 2006, SEBI issued a concept paper on its proposed guidelines on delisting and asked the public to give its comments and suggestions on the same. Finally, SEBI came up with regulations on 10th June 2009 named as ‘SEBI (Delisting of Equity Shares) Regulations, 2009’ which are much broader and convincing in explaining each and every aspect of delisting in detail.¹⁸

These regulations apply to delisting of equity shares of a company from all or any of the recognized stock exchanges where such shares are listed. However, these regulations would not be applicable on delisting made by Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985 or by the National Company Law Tribunal.

¹⁸ Downloaded from www.sebi.gov.in/acts/delisting2009.pdf
The guidelines clearly state that a company cannot apply for delisting in pursuant to a buyback of equity shares, in pursuant to a preferential allotment, unless a period of three years has elapsed since the listing of that class of equity shares on any recognized stock exchange or if any instruments issued by the company which are convertible into the same class of equity shares that are sought to be delisted, are outstanding.

Special provisions have been provided by SEBI for compulsory and voluntary delisting. As far as compulsory delisting is concerned the guidelines mandates the constitution of panel by recognized stock exchange that would take the decision regarding compulsory delisting. However, before making an order of delisting, the recognized stock exchange shall give a notice in the newspaper for informing the investors regarding the delisting of shares. This notice shall also be displayed on the trading systems and website of that stock exchange. After issuing such notice, time period of not less than fifteen working days from the notice shall be given to any person who may be aggrieved by the proposed delisting within which he can make representations to the concerned recognized stock exchange. After considering the representations by company or any other aggrieved persons, the recognized stock exchange would pass an order of delisting.

In order to protect the right of shareholders, the recognized stock exchange would form a panel of expert valuers who would determine the exit price for the shareholders of such delisted company. Based upon the value determined by valuer, the promoter of the delisted company shall acquire equity shares from the public shareholders by paying them the value, subject to their option of retaining their shares. This whole process of compulsory delisting has been presented in figure 2.3. The guidelines strictly enforce that in case of compulsory delisting, the company, its whole time directors, its promoters and the companies which are promoted by any of them, shall not directly or indirectly access the securities market or seek listing of any equity shares for a period of ten years from the date of such delisting.
Similar provisions hold for voluntary delisting. However, as per the regulations, a company may voluntarily delist its equity shares from all the recognized stock exchanges or any one of the recognized stock exchange. If a company delist its equity shares from one or more recognized stock exchanges where they are listed, whereas continue their listing on one or more other recognized stock exchanges, then there is no need to give any exit opportunity to the shareholders. Such process is presented in figure 2.4.

19 http://www.delisting.in/compulsory_process_flowchart.php
However, after the proposed delisting, if the equity shares would not remain listed on any recognized stock exchange having nationwide trading terminals then exit opportunity has to be provided by the company to all the public shareholders holding the equity shares sought to be delisted. The process involved in this situation is presented in figure 2.5.

20 http://www.delisting.in/voluntary_few_process_flowchart.php
Figure 2.5: Process of Voluntary Delisting (with exit opportunity to the shareholders)²¹

²¹http://www.delisting.in/voluntary_all_process_flowchart.php
Hence, these guidelines clearly indicate that it is not an easy task for a company to delist its shares from the exchange. Several rules and regulations have to be abided by the company before moving out of the market. Such removal of company’s stock not only affects its future but also hampers the interest of investors as well as the market at large. Hence, survival of IPOs in the aftermarket is indeed required for benefit of whole market.

2.4.4 Consequences of Delisting

Listing of securities aims to boost up the trade in the securities market that creates a platform for the development of the economy. However, it has been observed that many companies find it difficult to survive longer in the market and get delisted from the exchange. There are number of reasons that are responsible for pulling the companies back from the market. Such phenomenon has great implications for the issuers, investors and the economy at a large. The consequences of delisting are highlighted below:

- When a company gets delisted from the stock exchange, it shrinks the universe of liquid stocks and thus affects the depth and liquidity of the market. It results in loss of investment opportunities for the public, and reduces the wealth of the securities market. Consequently, there is a loss to the entire primary capital market due to such activities.

- Although an exit price is offered to the shareholders, but usually it is not perceived to be commensurate with the company’s fundamentals and its true worth. Further, the minority shareholders feel that they are being compelled to sell their shares at the offer price, even if the offer price is not in their opinion attractive enough, because they run the risk of holding an illiquid investment.

- The way in which delisting takes place at present is perceived as being unfair, both to the investors as well as to the market. In other words, it is argued that present norms are inadequate to protect the interest of investors through the prevailing exit price mechanism. There is no regulatory check on the companies on whether the payment has been made to the shareholders or not in case of compulsory delisting. Moreover, the norms do not mention the penalties or consequences in case the promoters fail to make the payment of the fixed fair value to the public shareholders.
2.5 CONCLUSION

The IPO Market in India has been developing since the liberalization of Indian economy. One of the most important developments was the elimination of the Controller of Capital Issues (CCI) and introduction of the free pricing mechanism. Further, the establishment of SEBI in 1992 as a regulatory body of stock market changed the whole facets of the market. In the post-SEBI era, numerous reforms were introduced in the market that allured large number of new entrants and created a boom from 1992-1996. However, several malpractices, fly by night operators, and South Eastern crisis disrupted the smooth functioning of the market and led to bearish trend in IPO market. In other words, the IPO market in India has gone through number of ups and down in the last two decades. Within this time period, many issues entered the market but only few manage to survive on the exchange. This signifies that failure of IPOs in the market has been a major phenomenon in the post-SEBI era. In order to check such failure and to ensure the longer survival of IPOs, several norms have been introduced in the market from time to time. There are certain laws that govern the new securities in India such as Securities Contract Regulation Act (1956), SEBI Act (1992), Companies Act (2013), Depository Act (1996), Prevention of Money Laundering Act (2002) and SEBI (Delisting of Equity Shares) Regulations (2009). SEBI plays a crucial role in regulating the new issues in the market through these laws. It provides number of rules and regulations for ensuring that only good quality issuers with high profile and good survival prospects should go public. This will not only helps in maintaining liquidity in the market but will also protect the interest of investors.