CHAPTER 1

INTRODUCTION

1.1 Background

The capital market, representing the institutional sources of long-term funds, is the barometer of any country’s economic development. The structure of the capital market consists of the primary market or primary securities market or new issue market and the secondary market. The primary market deals in only new securities which were not previously available and are offered to the investors for the first time. It does not have any organizational set-up located in any particular place. The primary market acts as a link-pin between savers and investors and creates the opportunity to put the savings of the investors’ to the corporate houses and ultimately helps to promote economic growth. The secondary market is a market which depends on the existence of the primary market. Because the instruments or products created in the primary market are generally traded in the secondary market and the price of the security partially depends on the price in the primary market.

The size and character of primary market has undergone a rapid transformation and expansion since mid-eighties. Since the liberalization of Indian economy a large number of companies select this market for raising capital. It is now the single most important source of corporate financing. The average annual capital raised in the primary market was Rs.70 crore during 1960-70 and Rs.90 crore during 1970-80. Before liberalization of the Indian economy, resource mobilization from the primary market was low but in the early nineties it gradually increased as many big projects were launched after the liberalization. This increasing trend persisted up to 1995-96 because of ‘bubble like’ situation. But the primary market dried up in the late 1990’s due to various reasons. During 1996-98, 229 companies raised fund through the primary market and subsequently they were disappeared. During the period from 1997-98 to 2001-02, number of Initial Public Offers (IPOs) and offer for
sale declined sharply and number of rights issue also declined due to market manipulation and price rigging. The revival of primary market started in 2003-04 and resource mobilization was showing increasing trend, except the year 2008-09, due to global financial crisis. The numbers of issues decreased and the average size of the issue increased from Rs. 10.864 crore in the year 1991-92 to Rs. 682.64 crore in the period ended March 2012, out of which average equity issues increased from Rs. 13.146 crore to Rs. 252.09 crore from 1993-94 to 2011-12.

After establishment of the Securities and Exchange Board of India (SEBI), major reforms in the primary market took place and investors’ grievances declined after some time. To attract primary market to the common investors, the SEBI has taken some important measures. Some of these are merit-based regime to disclose-based regime, pricing of public issue determined by the market and implementation of proportionate allotment of share system. Now banks, financial institutions, public sector undertakings (PSUs) are allowed to raise funds from primary market. Foreign Institutional Investors (FIIs) are allowed to invest in the primary market within the sectoral limits, allocation to retail investors increased from 25 per cent to 35 per cent. The process of reforms and liberalizing the economy is still going on.

1.2 Problem Analysis
The growth of Indian primary market is increasing, but a large number of investors in India still prefer bank deposits, postal savings, life insurance instruments and mutual funds due to the scams in the capital market and volatility of the secondary market. There is no doubt that the performance of primary market is linked to the performance of secondary market. According to the survey of SEBI and the, National Council of Applied Economics Research, (NCAER, June 2000)¹ 21 million household investors participated in the equity and debt market either directly or indirectly during 2000-01 and household investors participation increased to 24.5 million, which constituted 11 % of total household as per NCAER survey July 2011². According to this survey 11-
25% of total households invest in postal savings and more than 16% of highly educated and as well as 16% of the middle and upper income groups feel that non-participation due to the non-safety of returns. SEBI has taken various measures to protect the interest of the investors, but the problems still persist in the market because of the scam-prone environment, volatility of the secondary market, speculation and the grey market operation restrict the household sector to enter in the primary market.

The primary market was not able to mobilize adequate savings from the public. According to RBI annual report 2000-01, 7.5% - 8.5% gross financial savings of the household sector was directly invested in shares and debentures of private corporate sector during the boom period of 1992-93 to 1994-95 but the percentage declined steadily thereafter to a mere 1.6% in 1997-98 and 1.5% in 1998-99. During IT boom period, it rose to 3.4% but declined to 1.3% during 2005-06 and again slipped to 0.1% during 2011-12. Primary market also suffers from functional and institutional gaps, in terms of new instruments. The problems of the primary market in present days include withdrawal of IPOs, inappropriate allocation of shares, cornering of shares and grey market activities (i.e. IPOs are traded long before they appear for public subscription).

In the present market scenario, resources mobilization from primary market became tough when the stock market is in bearing stage, as there is a chance of under-subscription of public issue. Creation of a favourable investable environment to attract retail and middle class investors is required for the economic development of our country.

1.3 Literature Review
Several studies were conducted on primary market in India and abroad by academicians, researchers, the primary market advisory committees and others. Many scholarly books and articles have been brought during the last two decades. We have divided the existing literatures on primary market mainly in two segments. Table 1.1 shows literatures related to Indian context and Table 1.2 shows literatures related to international context.
### Table 1.1: Literatures on Indian Primary Market

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Issues</th>
<th>Authors / Researchers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Securities scam and financial regulation</td>
<td>Barua and Varma (1993); Haldea (2004); Supreena (2004); Sinha and Nath (2003); Sahoo (2003)</td>
</tr>
<tr>
<td>3</td>
<td>Pricing of securities, new instruments</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Investor protection, sentiment</td>
<td>Swarup (2003); Nayak (2006); Subbarao (2006);</td>
</tr>
<tr>
<td>5</td>
<td>Miscellaneous issues</td>
<td>Patil (1986); Desai (2000); Ghosh (2004);</td>
</tr>
</tbody>
</table>

Source: Compiled by researcher

### Table 1.2: Literatures on International Primary Market

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Issues</th>
<th>Authors / Researchers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Role, growth and activity of primary market in corporate finance and economy</td>
<td>Henderson (1948); Glen and Madhavan (1998); Aylward and Glen (1999); Ritter (2002); Jang, Kim and Ko (2010)</td>
</tr>
<tr>
<td>2</td>
<td>Stock market condition and other determinant of primary market</td>
<td>Samuel (1996); Pagano, Panetta, and Zingales (1998); Lowry (2003); Brau and Fawcett (2006); Ivanov &amp; Lewis (2008); Derrien and Kecskés (2009); Blum (2011)</td>
</tr>
<tr>
<td>3</td>
<td>Disclosures norms and other issues</td>
<td>Doidge C, Karolyi G. A. and Stulz R. M (2011),</td>
</tr>
</tbody>
</table>

Source: Compiled by researcher
1.3.1 Evidence on Indian Primary Market

Chandra (1990; 1991)\(^3\), Gupta (1987)\(^4\) and Bhole (1995\(^5\); 2004)\(^6\) analyzed major trends, problems and the different perspectives relating to primary and secondary market over a period of forty years and suggested various reforms for the development of the Indian capital market. Most of those studies pointed out that Indian capital market was underdeveloped and dominated by the players, like brokers, jobbers, intermediaries etc.

Role, growth and activity of primary market:

Khan (1977\(^7\), 1978\(^8\)) studied the role of new issues in financing the private corporate sector during 1961 to 1973 and identified two distinct phases, viz (i) 1962-1967 and (ii) 1968-1973. He also showed that underwriting becoming almost universal, institutions like the LIC and the UTI were becoming major players.


Khan\(^13\) (2006) opined that the primary market can contribute tremendously to capital formation and growth of the economy if foreign participation in equity is further liberalized across all the sectors. Avadhani\(^14\) (2006) pointed out that new issue market could not mobilize adequate savings from the public and the market also suffers from functional and institutional gaps.

Modi\(^15\) (2006) showed the three distinct phases of primary market in respect of growth and sluggishness between 1991-92 and 2005-06 and pointed out first phase of accelerated growth from 1991-92 to 1994-95, followed by a

Mohammad\textsuperscript{16} (2007) analyzed the growth of new issue market and evaluated the objectives of issues for raising fund. Gopalshamy\textsuperscript{17} (2007) opined that a proper development of primary market is critical to the growth of the corporate sector.

**Securities scam, regulation and stock market condition:**

Barua and Varma\textsuperscript{18} (1993) analyzed how the securities scam originated, how it happened and its aftermath. Soneji\textsuperscript{19} (2003) discussed the effects of reforms of the capital market. Sinha and Nath\textsuperscript{20} (2003) examined the different market segment, market design and the regulatory framework. Sahoo\textsuperscript{21} (2003) analyzed the regulatory system prevailing in the securities market and the regulatory gaps.

Haldea\textsuperscript{22} (2004) concluded that due to series of scams, confidence of retail investors had diminished. Narayanan and Supreena\textsuperscript{23} (2004) examined the securities scams in 1991 and 2001 and the regulatory measures adopted after 1991 and why securities scam back again in spite of such measures and concluded that the failure of corporate governance and financial regulation were the main reasons behind these scams.

Ghosh\textsuperscript{24} (2004) made a detailed investigation of the boom and slump phase in the Indian primary market during 1993 to 2001 and found that Indian corporate bodies might had depended more on long lasting market sentiments to decide on the timing of their IPOs.

**Pricing of securities, new instrument:**

Barua and Raghunathan\textsuperscript{25} (1986) examined the pricing of securities and maintenance of parity between risk and return both in the primary market and secondary market. Barua, Raghunathan and Varma\textsuperscript{26} (1994) reviewed the Indian capital market during the period 1977-1992. Arwah\textsuperscript{27} (2003) addressed
that primary market was found to be unequivocal and IPOs were offered at a
discount. John and Kumar\textsuperscript{28} (2010) examined the long run and short run
performance of IPO issued during the period of 2004-2008 and concluded that
the public sector IPOs performed better than private sector IPOs.

Lalitha\textsuperscript{29} (1995) analyzed the of new issue market with special reference
to public issue made by private corporate sector and concluded that there is a
need for financial innovations in terms of new instruments to promote the
equity culture. This would help mobilization of fund from rural and semi urban
areas.

**Investor protection, sentiment:**

Swarup\textsuperscript{30} (2003) examined the several measures adopted for the revival of
common investor’s confidence in the primary market. Nayak\textsuperscript{31} (2006)
examined the common investors’ grievances and the regulatory measures
undertaken to provide protection. Subbarao\textsuperscript{32} (2006) examined the common
investor’s confidence in Indian primary market and suggested that regulators
should bring stringent regulations and protect the investors from fraudulent and
unhealthy practices in the market.

**Miscellaneous issues:**

Agarwal\textsuperscript{33} (2000) concluded that Indian primary capital market grown
significantly from the beginning of capital market reforms. But Mexican peso
crisis adversely affected both the segment of Indian capital market.

Desai\textsuperscript{34} (2000) examined the reasons for sluggishness in the primary
market. Dhanda and Sheokand\textsuperscript{35} (2008) analyzed the Indian primary market
from 1997-98 to 2005-06 and opined that the sluggish trend in primary equity
markets needs to be rectify through improving investors confidence in the
market. Patil\textsuperscript{36} (1986) opined that resource mobilization task is going to be
challenging one for the private corporate sector in view of the seventh plan
period. Gangadhar and Begum\textsuperscript{37} analyzed the pattern of capital issues and the role of public and private sector in mobilizing capital from public.

The National Stock Exchange (NSE) newsletter has brought out a large number of research-based articles in recent years and provides significant information regarding recent development in the Indian securities market. Most of these articles showed the effect of liberalization in the capital market.

\textbf{1.3.2 Evidence on International Primary Market}

\textbf{Role, growth and activity of primary market:}
Henderson\textsuperscript{38} (1948) analyzed the importance of the British capital market for the industrial finance. Glen and Madhavan\textsuperscript{39} (1998) analyzed the pattern of financing and developments in the primary market of Peru. Aylward and Glen\textsuperscript{40} (1999) examined aggregate primary capital market activity in a cross section of emerging market and developed countries and concluded that domestic debt issuance was closely linked to international debt issuance, whereas no such link existed in the equity markets and also found that market depth and accounting standards are significant factors in explaining equity issuance activity. Ritter\textsuperscript{41} (2002) examined the IPO activity in the new issue market of the U.S during 1980 to 2001. Jang, Kim and Ko\textsuperscript{42} (2010) examined the utilization of the equity issues as source of financing of Korean publicly traded firm during 2000 to 2007.

\textbf{Stock market condition and other determinants of primary market:}
Samuel\textsuperscript{43} (1996) showed that stock market play a limited role as a source of finance for Indian and U.S firm. Pagano, Panetta, and Zingales\textsuperscript{44} (1998) analyzed the market-to-book ratio of existing public firms in an industry and found that it has been the key deciding factor for IPO decision. Lowry\textsuperscript{45} (2003) found that demand for capital and investors’ sentiments are statistically and economically significant determinants of IPO volume.
Brau and Fawcett\textsuperscript{46} (2006) pointed out that condition of the secondary market is the most influential factor in timing an IPO. Ivanov & Lewis\textsuperscript{47} (2008) found that time variation in business conditions and investor sentiment proved to be economically significant determinants of IPO issue activity. The empirical evidence of Derrien and Kecskés\textsuperscript{48} (2009) showed that the roughly 40 percent variation in equity issuance explained by economic fundamentals of Canadian petroleum industry. Blum\textsuperscript{49} (2011) analysed the US primary capital market and concluded that capital demand, investor sentiment and market condition plays the role of determinant for IPO. Demand for capital increases when the firm expects higher level of economic growth.

**Disclosures norms and other issues:**
Doidge C, Karolyi G. A.and Stulz R. M\textsuperscript{50} (2011) found that U.S IPO activity was not related with the economic importance of the U.S. they also concluded that IPO activity outside a country are strongly and positively related to the IPO activity of the home country and it also help to promote weak institution in that country.

**1.4 Research Gap**
The above mentioned studies are very useful for understanding the importance of the primary market in an economy. It has been found that resource mobilization from primary market depend on the factors like condition of the secondary market, rate of interest at which corporate sector can borrow their required fund, condition of the overall economy, investors sentiment etc. But, there is no comprehensive study has ever been made connecting all the relevant issues. The present study is an attempt to examine critically the existing system and identifying the areas of its strength and weakness and also aimed at filling the literature gap.
1.5 Research Questions

The study addresses the following research questions:

(i) Is there any relationship between primary securities market economy of the country?
(ii) What is the role of primary securities market in capital formation?
(iii) Is there any impact of going abroad for raising fund in domestic market?

1.6 Objectives of the Study

The major objective of the study is to examine the growth, development and performance of the Indian primary securities market after the liberalization of Indian economy. More specifically the objectives of this study are as follows:

(i) To understand the present scenario of Indian primary market [Chapter 2];
(ii) To acquire a comprehensive understanding of the issue mechanisms of primary market [Chapter 3];
(iii) To examine the pattern of resource mobilization in primary market [Chapter 4]
(iv) To analyze the anomalies and scams in the Indian primary market [Chapter 5];
(v) To analyze the measures adopted by the regulatory authorities to make these market a safe place for investment and for resource mobilization [Chapter 6];
(vi) To examine the impact of various factors on the performance of Indian primary market [Chapter 7];
(vii) To make suggestions, having policy and other implications for improvement of transparent primary market [Chapter 8].
1.7 Data Source
The study is both exploratory and empirical in nature. The exploratory part of the study is based on the current literatures available in the market on this particular issue in the form of books, journal articles, research studies and web materials. This part also covered concepts, theories of the capital market and financing issues.

Data for empirical testing covers the post-liberalization period and is obtained from the Indian Securities Market Review (ISMR), SEBI Bulletin and Annual Reports, RBI Bulletin, RBI Handbook of Statistics on Indian Economy, various reports published in financial journals and financed based magazines and BSE, NSE websites, etc.

In this study, annual data from 1991-92 to 2011-12, in case of variables like, resource mobilization from primary market as reported by SEBI (NCI), Index of Industrial Production (IIP), Prime Lending Rate (PLR), Index of Bombay Stock Exchange Ltd. (BSE SENSEX), Price Earnings Ratio of SENSEX (PE), and Market Capitalization to GDP of SENSEX (MG) have been used. However in case of resource mobilized from international market (EURO), data from 1992-93 and in case of resource mobilized through issue of Equity Shares (EQ), data from 1993-94 have been used. [Details are shown in chapter 7]

1.8 Hypotheses
Four sets of hypothesis have been formulated to examine the impact of various chosen variables on primary securities market activities and on primary equity market activities in the post liberalization period.

(1) First Hypothesis
Null Hypothesis \((H_{01})\) = Primary market activity is not influenced by the overall economic condition of the country.

Alternative Hypothesis \((H_{11})\) = Primary market activity is influenced by the overall economic condition of the country.
(2) Second Hypothesis

Null Hypothesis (H_{02}) = Primary market activity is not influenced by the secondary market activity.

Alternative Hypothesis (H_{12}) = Primary market activity is highly influenced by the secondary market activity.

(3) Third Hypothesis

Null Hypothesis (H_{03}) = There is no such relation between domestic primary market and EURO issues

Alternative Hypothesis (H_{13}) = There is a relationship between domestic primary market and EURO issues.

(4) Fourth Hypothesis

Null Hypothesis (H_{04}) = Primary Equity Issue is not depended on the depth of the secondary market, cost of capital, prime lending rate and economic condition of the country.

Alternative Hypothesis (H_{14}) = Primary Equity Issue is depended on the depth of the secondary market, cost of capital, prime lending rate and economic condition of the country.

1.9 Research Methodology

With a view to accomplish the stipulated set of objectives of our study and to analyze the primary market activity, correlation co-efficient is calculated to understand the relationship between the primary market and the chosen variables. Then regression equation is estimated through Ordinary Least Square (OLS) method with the help of E-views statistical package. The empirical analysis is divided in two parts; part 1 shows the analysis regarding primary market as a whole and part 2 shows the analysis regarding primary equity market i.e. equity segment.

The methods used to analyze the data include:-

- Descriptive Statistics
• Correlation Analysis
• Regression Analysis (Bivariate Analysis and Multivariate Analysis)

Following bivariate and multivariate regression equations have been formed in two parts:

Part 1

Analysis of Primary Market

\[ NCI = \alpha_1 + \beta_1 \text{IIP} + u_1 \]  \hspace{1cm} (1)
\[ NCI = \alpha_2 + \beta_2 \text{EU} + u_2 \]  \hspace{1cm} (2)
\[ NCI = \alpha_3 + \beta_3 \text{BSE} + u_3 \]  \hspace{1cm} (3)
\[ NCI = \alpha_4 + \beta_4 \text{PLR} + u_4 \]  \hspace{1cm} (4)
\[ NCI = \alpha_5 + \beta_5 \text{IIP} + \gamma_1 \text{EU} + \delta_1 \text{PLR} + u_5 \]  \hspace{1cm} (5)
\[ NCI = \alpha_6 + \beta_6 \text{IIP} + \gamma_2 \text{EU} + \delta_2 \text{BSE} + \varphi_1 \text{PLR} + u_6 \]  \hspace{1cm} (6)

Where,
\[ \alpha_1 \text{ to } \alpha_6 = \text{Constant terms}; \quad u_1 \text{ to } u_6 = \text{Random Error Terms} \]

Equation (1) represents the relationship between the activity of primary market and economic condition of the country.

Equation (2) shows the impact of resource mobilization from international market on domestic primary market.

Equation (3) has been formed to know the relationship between primary market and secondary market.

Equation (4) tries to analyze the effect of borrowing rate on primary market activity.

Lastly, equations (5) and (6) show the joint effect of explanatory variables on primary market activity.
Part 2
Analysis of Equity Segment

\[ \text{EQ} = \alpha_7 + \beta_7 \text{IIP} + u_7 \quad \text{-------------- (7)} \]
\[ \text{EQ} = \alpha_8 + \beta_8 \text{MG} + u_8 \quad \text{-------------- (8)} \]
\[ \text{EQ} = \alpha_9 + \beta_9 \text{BSE} + u_9 \quad \text{-------------- (9)} \]
\[ \text{EQ} = \alpha_{10} + \beta_{10} \text{IIP} + \gamma_3 \text{MG} + \delta_3 \text{BSE} + u_{10} \quad \text{-------- (10)} \]

Where,
\[ \alpha_7 \text{ to } \alpha_{10} = \text{Constant terms}; \quad u_7 \text{ to } u_{10} = \text{Random Error Terms} \]

Equation (7) is formed to known the degree of dependence of primary equity market on the economic activity of the country.

Equations (8) and (9) are formed to known the degree of dependence of equity issues on the depth of the secondary market and condition of the secondary market.

[Details are shown in Chapter 7]

1.10 Layout of the Study

Keeping with the objectives as well as the research methodology, the study has been segmented into the following chapters:

Chapter 1: Introduction
Chapter 2: Role of Primary Securities Market in Indian Economy
Chapter 3: Analysis of Issue Mechanism
Chapter 4: Pattern of Resources Mobilization in the Post-Liberalization Period
Chapter 5: Anomalies in Primary Market
Chapter 6: Analysis of Regulation of Indian Primary Market
Chapter 7: Analysis and Findings
Chapter 8: Conclusion and Policy Implications
Notes and References

2. SEBI NCAER Survey. (July 2011)
13. (Jun 9, 2006). Primary capital market sets. *Economics Times*


