India's financial boom: Let's keep progress real

Record funds raised for shareholder exits rather than fresh investment go against the spirit of IPOs. The bigger issue is that the financial world must stay in sync with the real economy

Even as we celebrate the booming market for IPOs (initial public offerings) as yet another mark of a resilient economy, a closer look suggests there is more to it than meets the eye. First the good news. The total amount raised by IPOs in the calendar year so far, about ₹1.53 trillion, is just ₹7,000 crore or so shy of the all-time peak last year, according to Prime Database, a tracker of capital market offerings. This is a strong showing by any yardstick. Except that, of this stellar total, a record figure of nearly ₹96,000 crore—or almost 63%—was raised through the offer-for-sale component of these issues. As these shares are offloaded by existing holders, this part does not raise any fresh capital for the companies getting listed. This goes against the spirit of IPOs, which are meant to tap the market for fresh investment and plough the funds into private enterprise, rather than grant promoters and private-equity investors an exit path. As such exits are a key incentive for investment in startups, we cannot block such paths. But if these exits are at the cost of retail investors, they add to qualms over this boom.

No wonder Chief Economic Advisor (CEA) V. Anantha Nageswaran has cautioned against the trend of IPOs being used as exit routes rather than fundraising tools, thereby undermining the "spirit of public markets." This echoes his caution against celebrating wrong milestones like market capitalization and turnover in the derivatives segment as indications of economic progress. As an issue, this is both less visible and larger. Today, our market-cap-to-GDP ratio is little over 140%, up from around 80% in 2015. The CEA is not the first to warn of the risk of an economy's macro outcomes being distorted by excessive financialization and the sway of financial markets over public policy. Such worries arose a decade-and-a-half ago, after a financial crisis traceable to dud loans hit the US economy hard, causing job losses. In general, it is true that asset prices cannot be divorced from the real economy for too long. But markets can, and often do, run ahead of their economic basis from time to time, even if they must eventually reflect underlying drivers of value. Broadly, that is not the case today. In the US, which sets the global tone for financial markets, asset prices have been rising on the back of an AI frenzy in a scenario of weakening real economic indicators; skewed bets on a few big tech stocks are making investors nervous. Placed in the context of a trade shakeup by the White House, clouds over the US Fed's independence, persistent inflation and America's runaway debt, taut nerves should not surprise us. The IMF has warned that "a potential bust of the AI boom could rival the dot com crash in severity." If the AI story caves in, shudders may be felt beyond the world of finance.

Given the global sprawl of financial links, emerging economies are unlikely to escape the fallout. To the extent that India's macro fundamentals are sound and our stock market has corrected over the past year, even if valuations still rule high *vis-à-vis* global peers, we have less reason to be anxious as US assets wobble. But we must guard against complacency, especially if geopolitics begins to play a bigger role in capital flows. While a robust economy and domestic institutions can form a hardy shield from the excesses of US finance, we must not end up with similar risks of an outsized financial sector that loses touch with the real economy but has the capacity to hurt those with no role in the boom. To that end, we must keep our progress real.