Title: **POST LISTING PRICING BEHAVIOUR OF SECURITIES**

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Purpose: For years Banks and Financial Institutions were main players of resource mobilization, for savings and allocation in Indian Economy. Due to pressure of globalisation and slow growth of economy the process of economic liberalisation and deregulation was initiated in the year 1980, but gained momentum from 1992. It resulted into expansion and growth of Indian Capital Market both at primary and secondary segments level. There was a clear shift away from banks and other financial institutions towards equity participation. It was an entirely new experience for general public to invest their savings in new equities and was an opportunity for entrepreneurs as well as bunglers/ squanders to mobilize resources for their new ventures. Present paper is concerned with post listing pricing behaviour of some of the equities listed on NSE and BSE.

Objective: In the present investigation it have been attempted to discover in general the rates and trends of returns, both short term and long term on the sampled IPO's listed on India's prime stock exchanges .i.e. National Stock Exchanges and Bombay Stock Exchange.

Methodology: 1. Rate and patterns on IPO's

(i) At the end of first trading day

(ii) At the end of the first trading month

(iii) At the end of each financial year

2. Comparisons of IPO returns

Expected Contribution: The paper is expected to appraise the readers about the rate and patterns between the issue price and post listing price

Full Paper

POST LISTING PRICING BEHAVIOUR OF SECURITIES

Objective

The Indian economy is growing at a very fast pace. Within the Asian region it is the second fastest economy and has become the investment hub for the large global companies and countries. With a robust currency and a consistent growing GDP the buying power of the people has increased as well as the credit cycle has elongated. This research aims at discovering the rates of returns on sample IPO's listed on India's Prime Stock Exchanges i.e. NSE and BSE during the period of 15 years between 1993 and 2007. All other findings have been based upon these rates on returns on IPO's. Thus, results have been divided into two parts:

I. Rate and patters of returns on IPO's

(i) Returns on the end of first trading day

(ii) Returns on the end of first trading month

(iii) Returns on the end of each calendar year (December ending or last trading on a particular year).

All other findings have been based upon the above and have been analyzed on the basis of comparisons between the followings:

II. Comparisons of IPO's returns.

(i) Among different sectors of economy.

(ii) Between par and premium issues.

(iii) Between issues sizes.

(iv) Between number of times issues oversubscribed.

(v) In the long run and short run.

(vi) With secondary market (NSE Nifty index).

Research Methodology

Out of the list of IPOs for various years obtained from Prime Data Base (Prime Directory of various years from 1993-2007 on an average two IPOs have been selected for each sector year wise on the basis of the availability of price quotes for the scripts at the time of taking the samples. Lower frequency of trading i.e. scrip's found to be trading for less than 20% of the trading days has been discarded. Two upcoming and growing sectors of economy has be chosen. These are:-

Sectors	No. of companies/IPOs
(i) Telecom sector	07
(ii) Pharma sector	11
(iii) Chemical Sector	10

Total	**28**

Procedure :

First of all price quotes of respective IPO obtained from NSE and BSE websites (www.bseindia.com, www.nseindia.com) have been tabulated for the first day, first month calendar year(s) closing (31^{st} January or the earliest date to this on which the scrip has been traded). After that price appreciation/depreciation in percentage has been calculated with respect to issue price. The formula used for this calculation is as under :-

$$\% \text{ Appreciation/Depreciation} = \frac{Px-1p}{1p} \times 100 \text{ where}$$

Px = Closing price on first trading day/month end/year end.

This provide the percentage returns in plus or minus for the closing of first day, first moth and for closing of respective calendar year(s) for each scrip. Sector wise average percentage returns of all the scrip's have been calculated for the first day, first month and calendar year ending.

From the day of listing/trading of the IPO's daily returns have been calculated from the price quotes obtained from the NSE/BSE websites. The formula to be used for calculation of daily returns is as under:-

$$Rt = \frac{Pt-Pt-1}{Pt-1} \times 100 \quad \text{where}$$

Rt = Return t^{th} day

Pt = Return t^{th} day

Pt = Return t^{th} – 1 day (previous trading day)

The obtained result has been multiplied by 100 to calculate the percentage return on the day for each scrip.

After calculating the daily return average yearly return have been calculated for each scrip using the following formula:-

$$RYAVg = \frac{1}{n} \sum_{t=1}^{n} Rt \quad \text{Where}$$

RYAVg = Average yearly return

Rt = Return on t^{th} day

T = Number of days in a year for which trading was done in a year for the particular scrip.

In the same way daily returns have been calculated and from that average yearly returns have been calculated for the bench mark Index (SPCNX NIFTY) 50 scrip's.

After calculating average yearly returns on daily basis for all the scrip's and the index, the adjusted yearly mean returns have been calculated because the absolute return on IPO's does not tell whether the particular IPO has over performed or under performed in comparison to the secondary market.

To know about this mean daily return has been calculated on the yearly basis for the IPO's for three consecutive years and average cumulative returns till September 2007 from the date of listing. Similarly, the mean daily returns on yearly basis have been calculated for the benchmark NIFTY from 1 January 2007. The difference between these two (RYAVg-RIAVg) will give the mean adjusted returns this will tell if the investors has done wisely by investing in IPO's in lieu of investing in secondary market.

The standard deviation will also be calculated for the return on index and returns on IPO's for three consecutive years and for return up to September, 2007. The standard deviations thus calculated will tell about the volatility of the returns on IPO's as compared to volatility of the secondary market.

Rest of the comparisons has been done on the basis of obtained returns.

Indian Capital Market

Capital Market Efficiency

The capital market is a place where the suppliers and users of capital meet to share one another's views, and where a balance is sought to be achieved among diverse market participants. The securities decouple individual acts of saving and investment over time, space and entities and thus allow savings to occur without concomitant investment. Moreover, yield- bearing securities makes present consumption more expensive relative to future consumption, inducing people to save. The composition of savings changes with less of it being held in the form of idle money or unproductive assets, primarily because more divisible and liquid assets are available.

Given the significance of capital market and the need for the economy to grow at the projected over 8 percent per annum, the managers of the Indian economy have been assiduously promoting the capital market as an engine of growth to provide an alternative yet efficient means of resource mobilization and allocation. Further, the global financial environment is undergoing unremitting transformation. Geographical boundaries have disappeared. The days of insulated and isolated financial markets are history. The success of any capital market largely depends on its ability to align itself with the global order.

To realize national aspirations and keep pace with the changing times, the capital markets in India have gone through various stages of liberalization, bringing about fundamental and structural changes in the market design and operation, resulting in broader investment choices, drastic reduction in transaction costs, and efficiency, transparency and safety as also increased integration with the global markets. The opening up of the economy for investment and trade, the dismantling of administered interest and exchange rates regimes and setting up of sound regulatory institutions have enabled this.

The wave of economic reforms initiated by the government has influenced the functioning and governance of the capital market. The Indian capital market is also undergoing structural transformation since liberalisation. The chief aim of the reforms exercise is to improve market efficiency, make stock market transactions more transparent, curb unfair trade practices and to bring our financial markets up to international standards. Further, the consistent reforms in Indian capital market, especially in the secondary market resulting in modern technology and online trading have revolutionized the stock exchanges. The debt market, however, is almost non existent in India even though there has been a large volume of Government bonds trading. Banks and financial institutions have been holding a substantial part of these bonds as a statutory liquidity requirement. A primary auction market for Government securities has been created and a primary dealer system was introduced in 1995. Recognizing the importance of increasing investor protection, several measures were enacted to improve the fairness of the capital market. There have been significant reforms in the regulation of the securities market since 1992 in conjunction with overall economic and financial reforms. In 1992, the SEBI Act was enacted giving SEBI statutory powers as an apex regulator. And a series of reforms were introduced to improve investor protection, automation of stock trading, integration of national markets and efficiency of market operations. SEBI in 1993 initiated a significant move which involved the shift of all exchanges to screen-based trading being motivated primarily by the need for greater transparency. The first exchange to be based on an open electronic limit order book was the National Stock Exchange (NSE), which started trading debt instruments in June 1994 and equity in November 1994. In March 1995, Bombay Stock Exchange (BSE) shifted from open outcry to a limit order book market.

The capital markets in India were underdeveloped, opaque, dominated by a handful of players, and concentrated in a few cities. Manipulation and unfair practices were perceived to be widespread and rampant, prompting an overseas researcher to describe it as a “snake pit”. The transformation of the Indian securities markets was initiated with the establishment of the Securities and Exchange Board of India (SEBI) in 1989, initially as an informal body and in 1992 as a statutory autonomous regulator with the twin objectives of protecting the interests of the investors and developing and regulating the securities markets over a period of time. SEBI has been empowered to investigate, examine, visit company premises, summon records and persons and enquire and impose penalties commensurate with misconduct. The first and foremost challenge for the fledgling regulator was to create a regulatory and supervisory framework for the market, a job that proved formidable, because vested interests resisted every new step.

However, with the designing and notification of 32 regulations/guidelines (amended many times over), during a decade and half of its existence, the apparatus steadily evolved and has come to grips with the situation.

Indian Capital and Stock Markets

The capital market acts as a brake on channeling savings to low- yielding enterprises and impels enterprises to focus on performance. It continuously monitors performance through movements of share prices in the market and the threats of takeover. This improves efficiency of resource utilisation and thereby significantly increases returns on investment. As a result, savers and investors are not constrained by their individual abilities, but facilitated by the economy’s capability to invest and save, which inevitably enhances savings and investment in the economy. Thus, the capital market converts a given stock of invest able resources into a larger flow of goods and services and augments economic growth. In fact, the literature is full of theoretical and empirical studies that have established causal robust (statistically significant) two-way relation between the developments in the securities market and economic growth.

I have used the high frequency data for the index S&P CNX NIFTY from January 1999 to December 2003. S&P CNX Nifty is a benchmark stock index based on the selected stocks traded at National Stock Exchange (NSE). It is owned and managed by India Index Services and Products Ltd. (IISL), which is a joint venture between NSE, India's most advanced and leading Stock Exchange and CRISIL, India's leading Credit Rating Company. IISL is the first specialized company in the county focused upon developing the stock indices as a core product. It has a consulting and licensing agreement with Standard & Poor's (S&P), who are world leaders in index services. The average total traded value of all Nifty stocks is approximately 77% of the traded value of all stocks available for trading on the NSE. The S&P CNX Nifty stocks represent about 61% of the total market capitalisation as on August 31, 2006. The impact cost of S&P CNX Nifty for a portfolio size of Rs.5 million is 0.10%. Liquid derivative products on S&P CNX NIFTY are available for trading in NSE. S&P CNX Nifty is computed using market capitalization weighted method, wherein the level of the index reflects the total market value of all the stocks in the index relative to a particular base period. The method also takes into account constituent changes in the index and importantly corporate actions such as stock splits, rights, etc without affecting the index value. The base period selected for S&P CNX Nifty index is the close of prices on November 3, 1995, which marked the completion of one year of operations of NSE's equity market segment. The base value of the index has been set at 1000 and a base capital of INR2.06 trillion. Companies eligible for inclusion in Nifty must have a six monthly average market capitalization of Rs.5000millions or more during the last six months. Companies eligible for inclusion in S&P CNX Nifty should have at least 12% floating stock. For this purpose, floating stock shall meant stocks which are not held by the promoters and associated entities (where identifiable) of such companies. A new company with a fresh IPO is eligible for inclusion in the index, if it fulfills the normal eligibility criteria for the index like impact cost, market capitalization and floating stock, for a 3 month period instead of the usual requirement of 6 month.

In order to control the effect of market wide factors from international markets as well as in the domestic market, I have to introduce additional independent variables in the equation. Fortunately for the Indian stock market I have another index, the CNX Nifty Junior that comprises stocks for second rung liquid stocks. The 50 stocks in the CNX Nifty Junior are filtered for liquidity, so they are the most liquid of the stocks excluded from the S&P CNX Nifty are included in this index. The maintenance of the S&P CNX Nifty and the CNX Nifty Junior are synchronized so that the two indexes will always be disjoint sets; i.e. a stock will never appear in both indexes at the same time. Hence it is always meaningful to pool the S&P CNX Nifty and the CNX Nifty Junior into a composite 100 stock portfolio. CNX Nifty Junior represents about 10% of the total market capitalisation as on August 31, 2004 and the average traded value for the last six months of all Junior Nifty stocks is approximately 8% of the traded value of all stocks on the NSE and the impact cost for CNX Nifty Junior for a portfolio size of Rs.2.50 million is 0.30%. The lagged S&P500 index return is used as an independent variable to remove the effects of worldwide price movements on the volatility of the Nifty Index return. For example, if the Indian market is influenced by US markets, this have been reflected through the lagged S&P500 return.

New Issue Market

Primary market is a market where fresh securities are issued whether debt or equity. Primary market for equities is further divided in public issues and rights issues. Public issues can be from existing listed companies or those companies which are approaching public for the first time which are popularly known as IPOs. Since 1991-92, the primary market has grown fast as a result of the removal of investment restrictions in the overall economy and a repeal of the restrictions imposed by the Capital Control Issues Act. In1991-92, Rs.62.15 billion was raised in the primary market. This figure rose to Rs.276.21 billion in 1994-95. Since 1995-1996, however, smaller amounts have been raised due to the overall downtrend in the market and tighter entry barriers introduced by SEBI for investor protection. More recently, the number of companies that approached public through IPOs has almost vanished in the first quarter of 2000-2001. The declining trend of IPOs continued in 2001-2002 and also in 2002-2003 only after the success of Maruti IPO, a number of IPOs is scheduled for the financial year 2004-20050. During 2005-06, a sum of Rs. 273 billion, as against Rs. 232.71 billion in 2003-04, and the amount raised was next only Hong Kong and way ahead of Japan, Korea & Singapore through primary market. In fact, the corporate sector and governments (Centre and States) together raised a total of Rs. 3.75 trillion from the securities market during 2005. Thankfully, so far, no major mishap has been noticed in the recent times.

Some research studies have shown the performance of the primary market for equities is very often linked to the performance of equities on secondary markets. If the stocks in the market are booming there has been a rush to issue fresh shares in primary market and vice versa. The impact of the fall in stock markets on primary issues can be clearly seen on the listing price of the IPOs from April 2000 to March 2001. During this period the statistics revealed that as many as 15 issues [out of total of 25] listed on NSE traded during the same period, were well below its issue price on the first day of listing. Even some mega issues are no exception during the same period. This result can be interpreted that the corporate enterprises started using the private placement market for tapping their resources.

There is a paucity of research done in the new issue market in India. What is worse is that much of whatever little work has been done, dates back to the late 1970's and early 1980's prior to the qualitative transformation that took place in the Indian equity markets in the 1980's. Moreover, the advent of free pricing in 1992 has changed the dynamics of the new issue market almost beyond recognition. All this means that the bulk of the work being reviewed here is of doubtful relevance in today's context.

It also means that the new issue market is one of the areas where substantial research needs to be done in the years ahead. One redeeming feature for researchers in this field is the vastly improved quality and coverage of commercially available databases. Data which earlier had to be painstakingly pieced together from hundreds of prospectuses is now available in machine readable form. This would, I hope, spur an increasing amount of research on this important area.

Anshuman and Chandra (1991) examine the government policy of favouring the small shareholders in terms of allotment of shares. They argue that such a policy suffers from several lacunae such as higher issue and servicing costs and lesser vigilance about the functioning of companies because of inadequate knowledge. They suggest that there is a need to eliminate this bias as that would lead to a better functioning capital market and would strengthen investor protection. With proportional allocation being advocated by SEBI, a shift in the policy is already evident.

However, there appears to be some re-thinking on proportional allocation after the recent experiences which clearly demonstrate that such a policy could result in highly skewed ownership patterns.
Bhatt (1980) makes certain general observations on the merchant banking function. According to him, the most important merchant banking functions are promotion, financing and syndication of loans for projects in the country including for foreign collaborations; investment advisory services, investment management and advice on joint ventures abroad. Such merchant banking institutions can also assist non resident Indians in investing their funds in shares of new companies in India, bonds, securities etc.

The primary market, which at one time was flooded with a number of issues floated by dubious promoters, depriving gullible investors of their life-time savings has since been transformed. The changes in this area have been epoch-making and include detailing of complete profile of promoters, comprehensive disclosures, the existence of tangible assets and a track record of profit as also reporting end uses of funds to the Company Board as a part of corporate governance, etc. Sometime back when the story of Google's IPO was being flaunted around the world in various sections of media as one of the greatest innovations of recent times in raising risk capital, the Financial Times, London, carried the following observation: "The World's Biggest Democracy can show Google how to conduct an online IPO"
In India you cannot apply on the web but investors can access one of the world's largest financial networks with 7000 terminals scattered around 350 cities. And every step of the book building process is public. The Indian system is a refreshing example of a transparent IPO market but it is also a rare one, especially in the insider-friendly Asian markets."
All the IPOs since the reforms started have been a success and barring a few exceptions are trading at a premium over the issue price. The regulatory framework has been modified to provide options to Indian firms for raising resources either domestically, or globally, or through both. This helps in price discovery and reducing the cost of funds. A number of Indian firms have raised money through American Depository Receipts (ADR), Global Depository Receipts (GDR) and External Commercial Borrowings (ECB). Two way fungibility has been permitted to enhance liquidity.

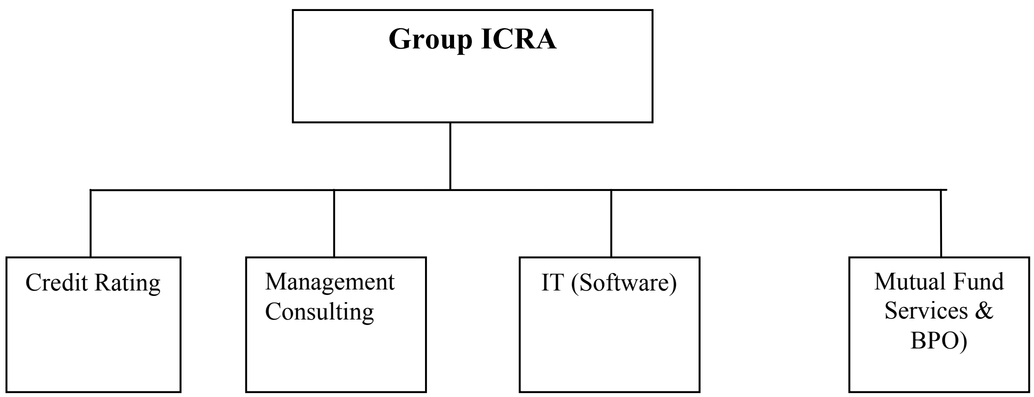
SEBI

Securities and Exchange Board of India (SEBI) was set up as an administrative arrangement in 1988. In 1992, the SEBI Act was enacted, which gave statutory status to SEBI. It mandates SEBI to perform a dual function: investor protection through regulation of the securities market and fostering the development of this market. SEBI has been vested most of the functions and powers under the Securities Contract Regulation (SCR) Act, which brought stock exchanges, their members, as well as contracts in securities which could be traded under the regulations of the Ministry of Finance. It has also been delegated certain powers under the Companies Act. In addition to registering and regulating intermediaries, service providers, mutual funds, collective investment schemes, venture capital funds and takeovers, SEBI is also vested with the power to issue directives to any person(s) related to the securities market or to companies in areas of issue of capital, transfer of securities and disclosures. It also has powers to inspect books and records, suspend registered entities and cancel registration.

SEBI's efforts in the direction of investor protection are varied and unlimited. The measures brought in by SEBI broadly cover measures for allocative efficiency in the primary market with fair degree of transparency, reforms in the secondary market for visible and mutual funds, regulation of various market intermediaries and above all for the protection of the investing public.

ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional Investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.



Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

Background

ICRA's Grading of Initial Public Offerings (IPOs) is a service aimed at facilitating assessment of equity issues offered to the public. The Grade assigned to any individual IPO is a symbolic representation of ICRA's assessment of the "fundamentals" of the issuer concerned on a relative grading scale. IPO Grades are assigned on a five-point point scale, where IPO Grade 5 indicates the highest grading and IPO Grade 1 indicates the lowest grading, i.e a higher score indicates stronger fundamentals. An IPO Grade is not an opinion on the price of the issue, pre- or post-listing.

The Grading Process

ICRA starts the IPO Grading process on receipt of a formal request from the issuer company. ICRA then sends a questionnaire seeking information on the company's existing operations as well as proposed project(s). This is followed by site visits and discussions with the key operating personnel of the company concerned. Apart from officials of the company, ICRA also meets its bankers, auditors, merchant bankers, and appraising authority (if any). If the case so merits, ICRA also obtains the views of independent expert agencies on critical issues like , for instance, the technology proposed to be used . Once all the required information has been obtained, ICRA's team of analysts presents a detailed Grading Report to ICRA's Rating Committee which then assigns the Grade. Usually, the assignment of Grade takes three to four weeks after all the necessary information has been provided to ICRA. Once the Grade is assigned, the issuer company is required to disclose the same and also publish it in the Red Herring Prospectus (RHP), which is filed with the Securities and Exchange Board of India (SEBI) and other statutory authorities. ICRA does not carry out any unsolicited Grading; the process involves the full co-operation of, and interaction with, the issuer company concerned. IPO Gradings are a one-time exercise, not subject to subsequent surveillance.

Grading Methodology

The emphasis of the IPO Grading exercise is on evaluating the prospects of the industry in which the company operates , the company's competitive strengths that would allow it to address the risks inherent in the business(es) and effectively capitalise on the opportunities available as well as the company's financial position. In case the IPO proceeds are planned to be used to set up projects, either greenfield or brownfield, ICRA evaluates the risks inherent in such projects, the capacity of the company's management to execute the same, and the likely benefits accruing from the successful completion of the projects in terms of profitability and returns to shareholders. Due weightage is given to the issuer company's management strengths and weaknesses and issues , if any, from the corporate governance perspective. Accordingly, ICRA's IPO Grading methodology examines the following key variables:

Business and Competitive Position

Industry prospects: Typical factors which are assessed here includes the growth prospects of the industry, the extent of cyclicality, competitive intensity, vulnerability to technological changes and regulatory risks inherent in the business.

Market position: A company's market position is indicated by its ability to increase/ protect market share, command differential pricing and maintain margins at par with, or superior to its peers. Factors evaluated would include the sources of competitive advantages like brand equity, distribution network, proximity to key markets and technological superiority.

Operating efficiency. The emphasis here is on evaluating the factors which could give rise to operational efficiency, depending on the industry where the company is operating and typically includes areas like access to raw material sources, superior technology, favourable cost structure and so on.

New Projects—Risks and Prospects

Key issues evaluated here are the company's ability to successfully execute the project that is being undertaken and the potential upside to the shareholders on completion and commissioning of the project. ICRA carries out a detailed risk assessment of the project with respect to issues like availability of finances, technology tie-ups in place, ability to execute the project without time or cost overrun , market risks arising from capacity additions and the mitigants in place to counter those risks.

Financial Position and Prospects

Ability to generate sustained shareholders' value as reflected by trends in profitability margins , EPS growth, Return on Capital Employed (ROCE) and Return on Net Worth (RONW) are evaluated by ICRA. While the absolute levels and the trends are important, ICRA also compares it with peers operating in the same industry to understand a company's relative position. Complementing this is an analysis of the company's ability to generate free cash flows in the long term . The capital structure of the company is evaluated from a perspective of balance between the cost of capital for shareholders' and financial risks associated with higher leverage.

Management Quality

The assessment is designed to evaluate a company's management depth, the profile of its key operating personnel, the adequacy of the organisation structure and systems in place as well as the management's stated plans and policies towards earnings growth and shareholder returns. ICRA also evaluates the management's approach towards risk and long term business plans in place.

Corporate Governance practices

While IPO grading is not intended to be a detailed evaluation of a company's corporate governance practices, broad issues like apparent quality of independent directors, quality of accounting policies and type of transactions with subsidiaries and associates is looked into.

Compliance and Litigation History

The IPO Grade assigned is the outcome of a detailed evaluation of each of the factors listed, and is a comment on the fundamentals of the company concerned and its growth prospects from a long-term perspective. The assessment involves combination of both quantitative factors as reflected in financial numbers, market shares etc as well as qualitative factors like risks associated with new projects, or the management's ability to deliver on the promises made.

An ICRA IPO Grade does not comment on the valuation or pricing of the issue that has been Graded, nor does it seek to indicate the likely returns to shareholders from subscribing to the IPO.

ICRA's IPO Grading Scale

ICRA's five-point IPO Grading scale is as follows:

ICRA IPO Grade 5: Strong fundamentals

ICRA IPO Grade 4: Above-average fundamentals

ICRA IPO Grade 3: Average fundamentals

ICRA IPO Grade 2: Below-average fundamentals

ICRA IPO Grade 1: Poor fundamentals

<u>What an ICRA IPO Grade Is Not:</u>

1. It is NOT a recommendation to buy sell or hold the securities Graded
2. It is NOT a comment on the valuation or pricing of the IPO Graded
3. It is NOT an indication of the likely listing price of the securities Graded
4. It is NOT a certificate of statutory compliance

<u>The Deliverables</u>

For the IPO Grading exercise, the deliverables are the Grade itself and a rationale (which is published) highlighting ICRA's key observations against each of the parameters listed in the section titled "Grading Methodology".

Indian Stock Exchanges: BSE and NSE

<u>Stock Exchanges in India – Development and Operations</u>

Any attempt at raising the standard of living of the masses must address itself to the task of producing the right quantity of the right types of goods and have them available for consumption at the right time. This requires large-scale production through coordination of activities of hundreds of people under the same roof even when the product is the simplest to make.

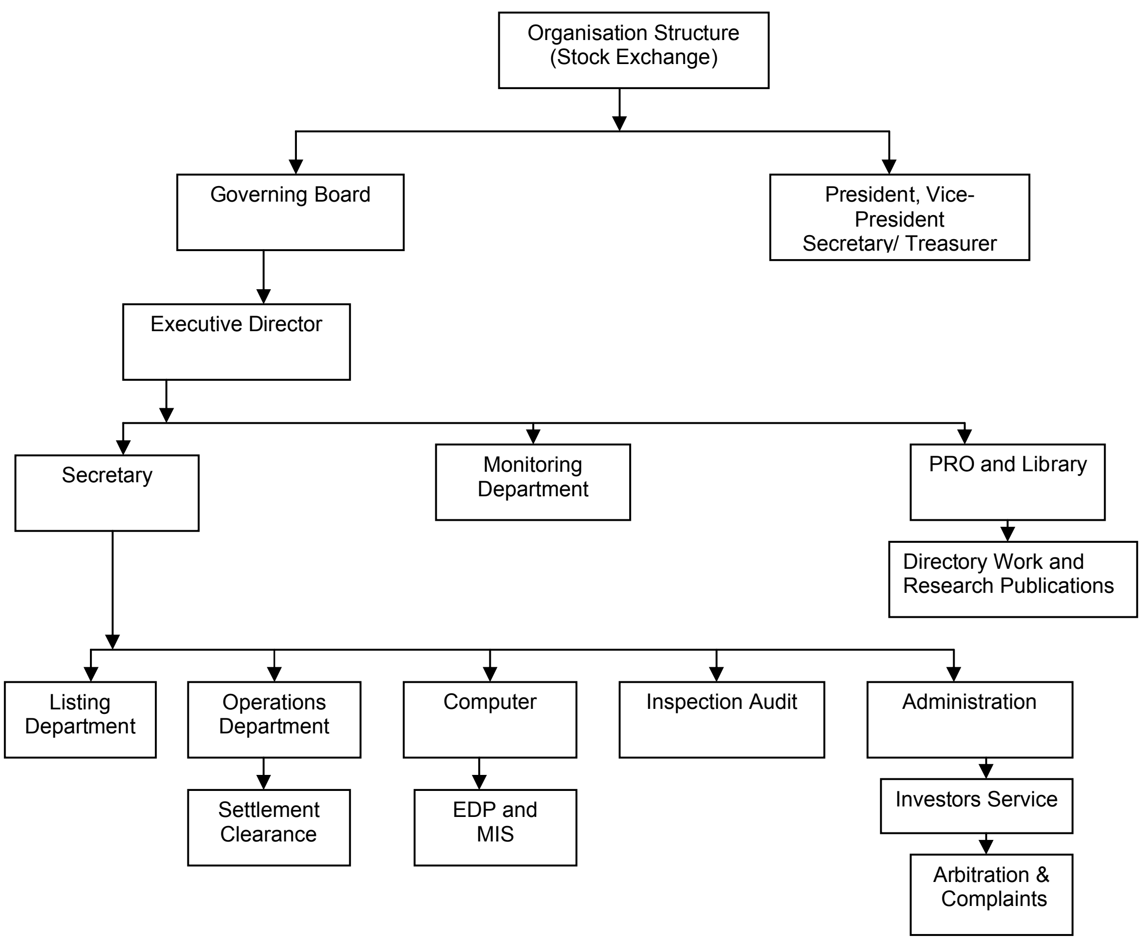
This, however, calls for raising vast amounts of financial resources for the purpose of acquiring land, buildings and equipments, besides purchasing raw materials and employing labour. No one individual or a small group of individuals is rich enough to provide all the capital required by modern business enterprise and savings of hundreds, if not thousands, of people must be mobilized.

The corporate form of organization is well adapted to the task of raising capital from many people. This is done by issuing or offering for sale at cash, different types of securities, that is, shares and bonds, which offer to individual investors a means of productively employing capital/savings suited to his/her needs and temperament.

The need for offering for sale different types of securities is obvious. Some people may desire safety of the amount they have invested and a regular income from their investment. To them the corporation or company may offer debenture bonds- a certificate issued under the seal of the company promising a refund of the loan on a specified date and payment of interest at prescribed intervals.

Organized stock exchange in India are of recent origin. As late as 1933 there were only three stock exchanges – one each at Ahmedabad, Bombay and Calcutta, but trading in securities was in vogue much prior to that year. Of course, no one can tell when the first transaction took place, however, it is generally agreed that business in securities had begun as early as the concluding years of the 18th century, that is, between the years 1790 and 1800 A.D.

The Stock Exchange comes close enough to a perfectly competitive market allowing the forces of demand and supply a reasonable degree of freedom to operate as compared to other markets specially the commodity markets. This segment of the factor market can be considered as a perfect or a nearly perfect market. Apart from providing a mechanism for transacting business in stock and shares it generates genuine potential for a new entrepreneur to take up initiative in the private sector enterprises and allows the expansion of investing community by offering gainful development of their otherwise sluggish or shy capital. The Stock Exchange must assume the responsibility of protecting the rights of investors specially the small investors in the Joint Stock Companies.



BSE: India’s Oldest and Largest Stock Exchange

Vision

The vision of the Bombay Stock Exchange is to "Emerge as the premier Indian stock exchange by establishing global benchmarks."

BSE Management

Bombay Stock Exchange is managed professionally by Board of Directors. It comprises of eminent professionals, representatives of Trading Members and the Managing Director. The Board is an inclusive one and is shaped to benefit from the market intermediaries participation. The Board exercises complete control and formulates larger policy issues. The day-to-day operation of BSE is managed by the Managing Director and its school of professional as a management team.

BSE Network

The Exchange reaches physically to 417 cities and towns in the country. The framework of it has been designed to safeguard market integrity and to operate with transparency. It provides an efficient market for the trading in equity, debt instruments and derivatives. Its online trading system, popularly known as BOLT, is a proprietary system and it is BS 7799-2-2002 certified. The BOLT network was expanded, nationwide, in 1997. The surveillance and clearing & settlement functions of the Exchange are ISO 9001:2000 certified.

BSE Facts

- First in India to introduce Equity Derivatives
- First in India to launch a Free Float Index
- First in India to launch US$ version of BSE Sensex
- First in India to launch Exchange Enabled Internet Trading Platform
- First in India to obtain ISO certification for Surveillance, Clearing & Settlement
- 'BSE On-Line Trading System (BOLT) has been awarded the globally recognised the Information Security Management System standard BS7799-2:2002.

(i) Activity in Bombay Stock Exchange

Powers that may be exercised by the Stock Exchange:

The powers of the stock exchange are to be exercised as per provisions in its bye-law. As per SCRA Act any recognized stock exchange may, subject to the previous approval of the[Securities and Exchange Board of India make bye-laws for the regulation and control of contracts. The bye-laws can provide for the exercise of following powers by the stock exchange

a. The opening and closing of markets and the regulation of the hours of trade;

b. Set up a clearing house for the periodical settlement of contracts and differences there under, the delivery of and payment for securities, the passing on of delivery orders and the regulation and maintenance of such clearing house;

c. The regulation or prohibition of blank transfers;

d. The regulation, or prohibition of badlas or carry-over facilities;

e. The fixing, altering or postponing of days for settlements;

f. The determination and declaration of market rates, including the opening, closing, highest and lowest rates for securities;

g. The terms, conditions and incidents of contracts, including the prescription of margin requirements, if any, and conditions relating thereto, and the forms of contracts in writing;

h. The regulation of the entering into, making, performance, rescission and termination, of contracts, including contracts between members or between a member and his constituent or between a member and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer, and the responsibility of members who are not parties to such contracts;

i. The regulation of taravani business including the placing of limitations thereon;

j. The listing of securities on the stock exchange, the inclusion of any security for the purpose of dealings and the suspension or withdrawal of any such securities, and the suspension or prohibition of trading in any specified securities;

k. The method and procedure for the settlement of claims or disputes, including settlement by arbitration;

l. The levy and recovery of fees, fines and penalties

m. The regulation of the course of business between parties to contracts in any capacity;

n. The exercise of powers in emergencies in trade (which may arise, whether as a result of pool or syndicated operations or cornering or otherwise) including the power to fix maximum and minimum prices for securities;

o. The regulation of dealings by members for their own account;

p. The separation of the functions of jobbers and brokers;

q. The limitations on the volume of trade done by any individual member in exceptional circumstances;

r. Fixing the obligation of members to supply such information or explanation and to produce such documents relating to the business as the governing body may require

(ii) **BSE Indices**

BSE SENSEX

• BSE 100 Index

• BSE 200 Index

• BSE 500 Index

• BSE MIDCAP Index

• BSE SMLCAP Index

BSE Dollex Indices:

- DOLLEX-30
- DOLLEX-100
- DOLLEX-200

BSE Sectoral Index:

- BSE Auto Index
- BSE BANKEX
- BSE Capital Goods Index
- BSE Consumer Durables Index
- BSE FMCG Index
- BSE Healthcare Index
- BSE IT Index
- BSE Metal Index
- BSE Oil & Gas Index
- BSE Power Index
- BSE Realty Index

The launch of SENSEX in 1986 was later followed up in January 1989 by introduction of BSE National Index (Base: 1983-84 = 100). It comprised of 100 stocks listed at five major stock exchanges in India at Mumbai, Calcutta, Delhi, Ahmedabad and Madras. The BSE National Index was renamed as BSE-100 Index from October 14, 1996 and since then it is calculated taking into consideration only the prices of stocks listed at BSE. The Exchange launched dollar-linked version of BSE-100 index i.e. Dollex-100 on May 22, 2006.

With a view to provide a better representation of the increased number of companies listed, increased market capitalisation and the new industry groups, the Exchange constructed and launched on 27th May, 1994, two new index series viz., the 'BSE-200' and the 'DOLLEX-200' indices. Since then, BSE has come a long way in attuning itself to the varied needs of investors and market participants. In order to fulfill the need of the market participants for still broader, segment-specific and sector-specific indices, the Exchange has continuously been increasing the range of its indices. The launch of BSE-200 Index in 1994 was followed by the launch of BSE-500 Index and 5 sectoral indices in 1999. In 2001, BSE launched the BSE-PSU Index, DOLLEX-30 and the country's first free-float based index - the BSE TECk Index. The Exchange shifted all its indices to a free-float methodology (except BSE PSU index) in a phased manner.

All BSE-Indices are reviewed periodically by the "Index Committee" of the Exchange. The Committee frames the broad policy guidelines for the development and maintenance of all BSE indices. Department of BSE Indices of the Exchange carries out the day to day maintenance of all indices and conducts research on development of new indices.

(ii) **Activity in BSE**

Moved from Open Outcry to Electronic Trading within just 50 days.

In 2002, the name The Stock Exchange, Mumbai, was changed to BSE. BSE, which had introduced securities trading in India, replaced its open outcry system of trading in 1995, when the totally automated trading through the BSE Online trading (BOLT) system was put into practice. The BOLT network was expanded, nationwide, in 1997.

NSE: Technology driven stock exchange

(i) Genesis of NSE

The National Stock Exchange of India Limited has genesis in the report of the High Powered Study Group on Establishment of New Stock Exchanges, which recommended promotion of a National Stock Exchange by financial institutions (FIs) to provide access to investors from all across the country on an equal footing. Based on the recommendations, NSE was promoted by leading Financial Institutions at the behest of the Government of India and was incorporated in November 1992 as a tax-paying company unlike other stock exchanges in the country.

(ii) Objectives of NSE

NSE's mission is setting the agenda for change in the securities markets in India. The NSE was set-up with the main objectives of:

establishing a nation-wide trading facility for equities, debt instruments and hybrids,

- ensuring equal access to investors all over the country through an appropriate communication network,
- providing a fair, efficient and transparent securities market to investors using electronic trading systems,
- enabling shorter settlement cycles and book entry settlements systems, and
- meeting the current international standards of securities markets.

The standards set by NSE in terms of market practices and technology have become industry benchmarks and are being emulated by other market participants. NSE is more than a mere market facilitator. It's that force which is guiding the industry towards new horizons and greater opportunities.

(iii) Emergence of NSE

The National Stock Exchange of India (NSE) was incorporated in November 1992 as a tax-paying company. It is recognized under Securities Contracts (Regulation) Act, 1956 in 1993 as a stock exchange. In June 1994, it commenced operations in the Wholesale Debt Market (WDM). In November, the same year, the Capital Market (Equities) segment commenced operations and the Derivatives segment in June 2000.

(iv) NSE Trading System

Trading at NSE

- Fully automated screen-based trading mechanism
- Strictly follows the principle of an order-driven market
- Trading members are linked through a communication network
- This network allows them to execute trade from their offices
- The prices at which the buyer and seller are willing to transact will appear on the screen
- When the prices match the transaction have been completed
- A confirmation slip have been printed at the office of the trading member

Advantages of trading at NSE

- Integrated network for trading in stock market of India
- Fully automated screen based system that provides higher degree of transparency
- Investors can transact from any part of the country at uniform prices
- Greater functional efficiency supported by totally computerized network

(v) NSE Communication Network

NSE is one of the largest interactive VSAT based stock exchanges in the world. Presently, it supports more than 3000 VSATs. The NSE- network is the largest private wide area network in India and the first extended C- Band VSAT network in the world

The NSE has provided fully automated trading environment with satellite-based communication network. There is dispersal of trading activity from trading ring to brokers' offices in India and large broker-office network is taking shape across the country.

Terrestrial communication network is being implemented as a back-up for the VSAT network. Individual brokers are allowed to develop their own network and Internet-based trading is expected to give a major push to application of technology in capital markets. This would facilitate efficient risk containment for brokers.

(vi) Reduction in Spread and Costs

With establishment of National Stock Exchange, there was a significant change in the level of technology used for the operation of stock market. It led to introduction of Screen Based Trading thereby removing the earlier system of open outcry where prices of securities were quoted by symbols. Now all the transactions happen on computer which is spread across country and connected to National Stock Exchange through VSAT. These two factors combined together helped in reducing the trading and settlement cycle in Indian securities market which got reduced from as long as 22 days to 2 days currently. and also inclusion of more and more stock and liquidity, result into reduction in transaction cost and because of inclusion of more and more stock there is reduction spread between Bid-Ask rate. Which also result into reduction of cost and spread allow more and more investors and traders to trade and invest into the stock market.

(vii) Constitution of NSE

The National Stock Exchange of India Ltd. is the largest stock exchange of the country. NSE is setting the agenda for change in the securities markets in India. The last 5 years have seen us play a major role in bringing investors from 363 cities and towns online, ensuring complete transparency, introducing financial guarantee of settlements, ensuring scientifically designed and professionally managed indices and by nurturing the dematerialisation effort across the country.

NSE is a complete capital market prime mover. Its wholly-owned subsidiaries, National Securities Clearing Corporation Ltd. (NSCCL) provides clearing and settlement of securities, India Index Services and Products Ltd. (IISL) provides indices and index services with a consulting and licensing agreement with Standard & Poor's (S&P), and NSE.IT Ltd. forms the technology strength that NSE works on.

Initial Public Offering (IPO)

The main function of an initial public offer is to facilitate transfer of resources from savers to the users. The savers are individuals, commercial banks, insurance companies etc. the users are public limited companies and the government. The initial public offer plays an important role of mobilizing the funds from the savers and transfers them to borrowers for production function purposes, an important requisite to economic growth. It is not only a platform for raising finance to establish new enterprises but also for expansion / diversification / modernizations of existing units.

Definiton:

Initial Public Offering refers to the selling of shares by a company to the public for the first time. Initial Public offering is a source of funds raised from the primary market. All subsequent public offerings are known as follow-on Public Offerings or Secondary Market Offerings.

The Dutch Auction method for IPOs in India:

The open auction method increases the ability of small investors to participate in the IPO process though it might be difficult for them to price the shares due to lack of information. This information gap could arise since the small investors lack access to the sources that institutional investors have and also because the issuer companies are not required to provide detailed information in this process.

Some time back, the Government asked SEBI's primary market advisory committee to prepare a paper on various price discovery mechanisms, aimed at more efficiency and transparency in the sale of securities. The proposal that came about was to replace the current book building process by a Dutch-auction method of Initial Public Offering.

An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. This Initial Public Offering can be made through methods such as the fixed price method, book building method or a combination of both. Book building is a process introduced in India in 1999, which enables the company to discover the price and demand of its securities.

The Issuer who is planning an IPO nominates a lead merchant banker as a 'book runner'. The issuer company then decides the number of securities to be issued and the price band is fixed and is mentioned in the red-herring prospectus. There is an electronic book which remains open for a minimum of 5 days. During these days bidding takes place, i.e. interested persons make an offer at a price within the price band. The Book Runner and the issuer, after the book building is closed, evaluate the offers and then fix a particular price. The offers below the fixed price are not accepted. Allocation of securities is made to the successful bidders.

An IPO may be through a 100% book building process or a 75% book building process. In the latter, the remaining issue is made through a fixed price method. In this method, the issuer company mentions the fixed issue price of its shares in the prospectus. Here, no bidding takes place.

The book-building process has been working successfully in India. However, the recent IPO made in the United States by Google through a Dutch-Auction method has raised concerns as to the workability of this model in the Indian capital market. In an open auction method, the auctioneer sells the shares of the company to the interested investors by calling out a high price. He then lowers the price till an investor/s agrees to buy shares at that price. He further lowers the price till more investors agree to buy shares and in this manner he keeps lowering the price till all the shares are claimed for.

Now, the investors will get the number of shares they have bid for but at a price the last investor has bid, i.e. the lowest price. In case of oversubscription, allocation is done on a pro-rata basis. This method allows the market to determine the price and not the issuer company.

Comparing the fixed price method to the open auction method, it can be said that the fixed price method is more expensive and also leads to short term gains to the investors but not long term. This is so because the company will hire an agent to estimate how much investors will pay for the shares. Then the company agrees to sell its shares at a fixed price which is *below* this estimate. Generally, the first in line to buy IPO shares can gain profit by immediately selling it for a higher price in the market in the coming few days. While open auction ensures future gains too.

The open auction method increases the ability of small investors to participate in the IPO process though it might be difficult for them to price the shares due to lack of information. This information gap could arise since the small investors lack access to the sources that institutional investors have and also because the issuer companies are not required to provide detailed information in this process.

The drawback of the Book Building Process is that it does not leave it to the market to determine the real price, since the price band is pre-determined by the issuer company.

At present most companies hitting the capital market opt for a private placement just ahead of the IPO. Thus, while institutional investors manage to gain shares at a lower price, retail investors, who buy shares through the IPO, have to pay a higher price. However, as per Prithvi Haldea of Prime Database in an auction method, the issuer gets the right value for shares, institutional investors get shares at a price they want and retail investors can then buy it at the lowest price offered by a qualified institutional buyer.

In a book building process, the investors only have an illusion that they have discovered the price whereas in reality it is the merchant banker who has fixed the price band. As opposed to this, in a Dutch auction method there is no constraint of a book building range. It is entirely on the potential investor to indicate the price of the shares and the quantity he is willing to subscribe for.

Globally the open auction method has shown a huge success rate. However, countries like the United States have not accepted the open auction method over book-building. Critics of this method argue that an open auction leads to a higher risk since neither the issuer company nor the potential investor know exactly how many investors will participate and what price the auction will lead to. There can be a negative effect in case of both the extremes, i.e. if there are too few bidders then the entire auction will lose its meaning and too many bidders may erode the potential profits.

However, the major question for SEBI to answer is whether the Indian investor is mature enough to know what is the best price for him? A good solution for that would be to leave it on each company to decide which method to adopt. The company depending on its area of business, its current net worth, and its current investors can decide whether it wants to rely on the merchant banker or its investors.

]Book Building Process

About Book Building

Book Building is basically a capital issuance process used in Initial Public Offer (IPO) which aids price and demand discovery. It is a process used for marketing a public offer of equity shares of a company. It is a mechanism where, during the period for which the book for the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price. The process aims at tapping both wholesale and retail investors. The offer/issue price is then determined after the bid closing date based on certain evaluation criteria.

The Process:

- The Issuer who is planning an IPO nominates a lead merchant banker as a 'book runner'.
- The Issuer specifies the number of securities to be issued and the price band for orders.
- The Issuer also appoints syndicate members with whom orders can be placed by the investors.
- Investors place their order with a syndicate member who inputs the orders into the 'electronic book'. This process is called 'bidding' and is similar to open auction.
- A Book should remain open for a minimum of 5 days.
- Bids cannot be entered less than the floor price.
- Bids can be revised by the bidder before the issue closes.

- On the close of the book building period the 'book runner evaluates the bids on the basis of the evaluation criteria which may include -
    - Price Aggression
    - Investor quality
    - Earliness of bids, etc.
- The book runner and the company conclude the final price at which it is willing to issue the stock and allocation of securities.
- Generally, the number of shares is fixed; the issue size gets frozen based on the price per share discovered through the book building process.
- Allocation of securities is made to the successful bidders.
- Book Building is a good concept and represents a capital market which is in the process of maturing.

Initial Public Offering:

Corporate may raise capital in the primary market by way of an initial public offer, rights issue or private placement. An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. This Initial Public Offering can be made through the fixed price method, book building method or a combination of both. In case the issuer chooses to issue securities through the book building route then as per SEBI guidelines, an issuer company can issue securities in the following manner:

a. 100% of the net offer to the public through the book building route.
b. 7% of the net offer to the public through the book building process and 25% through the fixed price portion.
c. Under the 90% scheme, this percentage would be 90 and 10 respectively

Difference between Shares offered through Book Building and Offer of Shares through Fixed Price:

Features	**Fixed Price Process**	**Book Building Process**
Pricing	Price at which the securities are offered/allotted is known in advance to the investor	Price at which securities have been offered/ allotted is not known in advance to the investor. Only an indicative price range is known
Demand	Demand for the securities offered is known only after the closure of the issue	Demand for the securities offered can be known everyday as the book is built
Payment	Payment if made at the time of subscription wherein refund is given after allocation	Payment only after allocation

Conclusion: Telecom sector has shown higher returns on the day of listing followed by chemical and pharma. Chemical sector gave higher returns followed by telecom and pharma after one month. However, in the long run Pharama out performed by giving a return of 38.74% followed by telecom sector giving a normal return of 11.72 %, while chemical sector recorded a negative return of 32.96%.

Annexure: Sheet 1 (showing sector wise average returns)

Sheet 2 (showing listing day, 1month and average return till date and Standard Deviation)

Sheet 3 (showing sector wise individual returns)

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