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PUBLIC ISSUE QUALITY TO IMPROVE SIGNIFICANTLY COURTESY NEW SEBI GUIDELINES : PRIME

The first most profound guideline issued by SEBI concerned the introduction of free pricing in 1992 which had subsequently led to a phenomenal growth in the number of issues as well as amount raised. However, in the process, the quality suffered increasingly. According to Mr.Prithvi Haldea, of **PRIME**, the country's leading primary market database, the SEBI guidelines announced last week would now have yet another phenomenal impact on the primary market, this time lowering the number of issues (but not necessarily the amount) and simultaneously **improving their quality**.

Permitting only companies with a proven track record or with an appraisal by a FI/bank spells a demise for the hundreds of half-baked projects, fly-by-night finance companies and over-invoiced projects which were increasingly flooding the market. This would also significantly **kill the malpractice of price rigging**, which has been most rampant in small (and specially finance) issues.

It is also pertinent to note that the secondary markets have also suffered due to the tremendous infusion of poor quality paper, courtesy at least 2000 issues of questionable nature in the past 4 years. The better quality of issues would now also **help the cause of the secondary market** according to Mr.Haldea.

A quantification of the impact of the guidelines on the issues made in 1995-96 has been done by **PRIME** to give an insight into the likely shape of things to come in future. A total of 1428 public issues were made in 1995-96. **If the new guidelines are applied to these issues, only 399 issues would have qualified to enter the market.** However, these 399 issues would have accounted for a high 70% of the year's total public issue amount.

The new guidelines, in a reverse mode, as can be seen will undoubtedly act as a brake on the unbridled growth in the number of issues. **Nevertheless, according to Mr.Haldea, the new guidelines will bring about a sanity in the primary markets and still be able to offer a respectable level of 700-800 public issues in the current year, aided by the fact that many more companies would now go in for appraisals.**

Coming back to the impact of the guidelines on the issues of 1995-96, as far the structure of the primary market is concerned, the **number of IPOs would have fallen significantly by 75% from 1352 to only 344 and the number of below Rs.3 crore issues by 81% from 853 to 159**. Little wonder, the average size of issue would have gone up from Rs. 769 lacs to Rs.1929 lacs.

According to **PRIME, the most affected industry would have been the financial services where the number of issues would have fallen by a phenomenal 88% from 493 to only 59**.

The number of companies with a post issue capital of below Rs.5 crore would have declined by 78% from 650 to 143. **It is worthwhile to mention here that**, **if the Malegam Committee recommendation of Rs.10 crore was accepted, the total number of issues would have fallen from 1428 to a meagre 83**.

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There were 9 debt public issues during 1995-96 and **all these would have qualified to enter the market**. Of the balance 1419 issues, 929 were made by manufacturing companies. Of these, 312 issues were appraised by financial institutions/ banks. However, only **258 of these had debt/equity participation by the appraiser and would have, therefore, qualified to enter the market.** Of the balance, 54 were appraised by FI/banks but without their debt/equity participation. However, of these, **4 had the requisite dividend record and could have, therefore, entered the market.**

As far as the remaining 617 issues from manufacturing companies are concerned, only **73 had paid dividends for 3 out of the last 5 years and, as such, would have qualified to enter the market**.

Putting the above together, only **335 out of 929 manufacturing companies (36%)** could have entered the market during 1995-96, with the balance 594 companies not qualifying as per the **PRIME** analysis.

On the other hand, a total of 490 issues were made by non- manufacturing companies, of which only **55 companies had the requisite dividend record and, therefore, could have entered the market**.

According to Mr.Haldea, an important impact of the guidelines would be on the intermediaries who would now need to improve their services and become more competitive. Of the over 390 SEBI approved category 1 merchant bankers, a total of 261 merchant bankers had lead managed the 1428 issues of the year. For the issues which would have qualified under the new guidelines, as per the **PRIME** report, **only 178 merchant bankers would have handled any assignment** (with as many as 62 of these handling only 1 assignment each and 36 of these handling only 2 assignments each). The mushroom growth of intermediaries would, however, now be curtailed and only the ones offering quality service would be able to survive.

However, the reduced number of offerings (and that too of higher quality) is likely to mark, according to Mr.Haldea, the return of the old days of heavy oversubscriptions (greater demand than supply). Nevertheless, the better quality of offerings should also lead to a healthier secondary market and subsequently to better confidence levels of large institutional investors.

One sore point about the guideline is that it permits issues only if the company has paid dividends for at least 3 out of 5 years. This is a very stiff condition as there are many companies which are profitable but being closely-held have never felt the need for paying dividends and have actually ploughed back the profits back into their business.

According to Mr.Haldea, **this guideline should be modified to <u>profit making</u> for at least 3 out of 5 years or profit making for the last 3 consecutive years. If this is accepted, 396 more companies could have tapped the capital market** and most of these would have been comparatively good grade offers as these were from profitable companies. On the other hand, a scenario exists where a company could have paid dividends for the initial 3 years but not in the next 2 years suggesting its profitability has been being continuously eroded. This may not be the desirable option.

Another point of concern is that appraisals only by FIs/banks implies that all of them are competent of handling objective appraisals. It is well known that several NBFCs who are also Category 1 merchant bankers, as well as some specialised outfits have proven track record and infrastructure for appraisals.

Some confusion also exists. Would service companies (like airlines, software companies, hotels, satellite channels, etc.) and exporters be covered under these guidelines as manufacturing companies or not? There should be a clear definition of manufacturing companies.

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Moreover, would appraisal be considered valid only if it is done by a scheduled commercial bank and financial institution or would it also be valid if done by SIDCs, state financial corporations, state industrial / technical consultancy organisations and venture capital organisations. SEBI should issue a comprehensive list of all institutions/ banks etc. whose appraisals will be acceptable in order to avoid any confusion on this score.

Also, since the extent of dividend has not been mentioned, can companies get away with say a 1 or 2% dividend? Moreover, should equity participation of a bank/ financial institution be necessarily in the fresh offer? If it already has a stake in the existing equity, would it qualify under these guidelines.

As far as the impact of guidelines on the minimum number of shareholders is concerned, of the total 1428 public issues in 1995-96, there were 1404 equity issues. With 24 offers for sale, the total number of such issues comes to 1380. As the basis of allotments of most of the issues of the last quarter of 1995-96 are yet to be finalised, **on the basis of the response data of 932 equity issues presently available with PRIME, as many as 286 public issues (or 31%) would not have qualified for the minimum shareholders clause.**

Unfortunately, this guideline will take the institutionalisation of the market farther away. Moreover, the proportionate system of allotment would need to be dropped/ modified to enable implementation of this guideline. Moreover, this would lead to the practice of bogus/ multiple applications at the time of the issue to reach the target. Also, what would happen when a company's issue fails to garner the minimum number of shareholders? If they are not able to muster enough shareholders even in the given 6 month period, would they be delisted?

Regarding the guideline of payment of interest to applicants after 30 days, Mr.Haldea agrees that this is a good move. However,the number of days for refunds should be in some way linked to the number of applications because, for example, it may be difficult for a mega issue with 15 lac applications to comply with the 30 day requirement.With lesser number of issues and better quality of paper,the response and hence the number of applications is only likely to increase.