Blemishing IPO Market

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Abstract
Deteriorating quality of the offering has led to the poor performance of IPO market in recent years. Dubious objectives, high pricing and questionable end usage of IPO proceeds by promoters has combined to rob the investors of the returns they expected. It is appearing that the Indian IPO market is drying up as retail investors interest seems to be waning. The investors stay away from the IPO market because of high volatility, risk, IPO scams, shrinking return on financial assets, complaints, etc. Many companies failed in IPOs due to poor response from the investors. This paper focuses on the blemishing IPO Market and why retail investors shift their investment on physical assets rather financial assets and also suggest measures to overcome these loopholes.

Key words: IPO, SEBI, Savings, Financial assets, Physical assets, Capital market, etc.

Introduction:

The Indian IPO market seems to be drying up as retail investors interest is waning gradually. Now, IPO’s are far from their glory days. Capital raised by the Indian Companies is down to a drop. The amount of fund raised by Indian Companies through this route has been diminishing since 2008 (except (2010). The investor confidence on the primary market has diminished and driving companies to avoid the primary equity market and raise capital in the debt market instead. Indian companies raised fund three times more through bond issuance then in the equity market between 2003-04 and 2013-14. The stock market in India has been particularly volatile in the past few years. The present situation points to a perilously dwindling investor population that has pushed the IPO market almost inactive. The corporate sector finds it extremely difficult to raise equity capital.

The report published by Ernst and Young Global IPO trends 2011, India bagged 4th place in raising of capital, capturing 3.7% of global IPOs. While, Chinese companies were raised substantial amount of capital sharing around 47% of global capital raised through IPOs. Chinese Companies amount of capital raised during 2008-10 has increased by 250%, but, in our country the increase was very negligible. It implies that Indian capital market has been losing its sheen in the post-crisis financial world and China is increasingly becoming popular with respect to attracting foreign capital.

Exhibit 1: Yearly IPO Report

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of IPOs</th>
<th>Amount Raised (in Crore)</th>
<th>Issue Succeeded</th>
<th>Issue Failed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>108</td>
<td>33946.22</td>
<td>104</td>
<td>4</td>
</tr>
<tr>
<td>2008</td>
<td>39</td>
<td>18339.92</td>
<td>36</td>
<td>3</td>
</tr>
<tr>
<td>2009</td>
<td>22</td>
<td>19306.58</td>
<td>21</td>
<td>1</td>
</tr>
<tr>
<td>2010</td>
<td>66</td>
<td>36362.18</td>
<td>64</td>
<td>2</td>
</tr>
<tr>
<td>2011</td>
<td>40</td>
<td>6043.57</td>
<td>37</td>
<td>3</td>
</tr>
<tr>
<td>2012</td>
<td>27</td>
<td>6865.94</td>
<td>25</td>
<td>2</td>
</tr>
<tr>
<td>2013</td>
<td>39</td>
<td>1645.87</td>
<td>37</td>
<td>2</td>
</tr>
<tr>
<td>2014</td>
<td>47</td>
<td>1497.68</td>
<td>45</td>
<td>2</td>
</tr>
<tr>
<td>2015*</td>
<td>15</td>
<td>1297.44</td>
<td>15</td>
<td>0</td>
</tr>
</tbody>
</table>

*Partial year
Above exhibit clearly shows that the Companies taping IPO market has gradually been diminishing yearly. The poor response from the investors led to waning IPO market. The fund raised through this route is just Rs. 1497.68 crore in 2014.

Lack of domestic capital, Indian companies forced to eye on external commercial borrowing and foreign investors to fill the widening gap between the demand for capital and its availability. Foreign capital inflow was equivalent to 4.5 per cent of GDP in 2011-12 and it accounted for 12 per cent of capital formation that year, the highest level in 23 years.

Household savings distribution patterns in India

In India, Households are India’s biggest contributor of savings, accounting for nearly three-fourths of all savings (72.7 per cent) in 2012-13. The private corporate sector accounts just under a quarter (23.4 per cent) and the rest came in from the public sector. The substantial portion of household savings is being parked in physical assets such as real estate, jewelers, etc.

The rate of savings has gradually been declining and it touched to 30.1% in 2013-14 from 36.8% in 2007-08.

Investors shift in favour of physical assets has largely been on account of lower returns from financial assets and the sharp rise in inflation which effectively battered the real return.

A study conducted by National Council of Applied Economic Research on household savings has revealed that out of India’s 227 million households just 24.5 million households invest in equity, debt, mutual funds and derivatives.

About 40% of households said that they lacked sufficient information that markets were not transparent. Majority of the respondents felt that equity was unsafe.

Exhibit 2: Trust in financial savings has eroded

As the exhibit above shows, the share of household savings in financial assets like stocks, bonds, mutual funds, bank deposits and pension and insurance funds, has fallen (as a % of total savings) since 2008. As of today, nearly two thirds of household savings are in physical assets like Gold and Real Estate.

The average annual return has from financial assets declined from 33.9% in 2007-08 to 2.9% in 2013-14 and average annual real returns on gold went up from 8.6% 2007-08 to 12.5% in 2013-14. This shows that the physical assets return has been increasing against financial assets return. Household financial savings rates continued to remain low at 7.2 per cent of GDP in 2013-14 amid sticky inflation.
Household savings in deposits rose to Rs. 1 trillion (17 per cent) in the year to Rs. 6.91 trillion in 2013-14 as against 5.91 trillion in 2012-13. Household savings in deposits constituted about 59 per cent of the gross financial savings, of which about 53 per cent constituted bank deposits. Share of household savings in shares and debentures plunged 22 per cent to Rs 33,700 crore in 2013-14, from Rs 43,000 in 2012-13. It is evident from the fact that only 1% to 2% of household’s savings are in shares and debentures. Mutual funds savings by individuals (through shares and debentures plunged 40 percent to Rs. 21,000 crore in FY14 from Rs. 35,000 crore in previous fiscal. While savings in currency plunged 9 percent to Rs. 1.02 trillion in FY14 from Rs. 1.12 trillion in FY13. The savings rate dipped to the lowest in the past nine years and has accentuated the macroeconomic imbalances. The physical assets saw a rise from Rs 10,246 billion in 2010-11 to Rs 12,842 billion in 2011-12. However, the financial assets saw a dip of Rs 888 billion during the reporting period, but gross domestic capital formation for households sector rose to Rs 31,415 billion in FY13 from Rs 8,716 billion in FY12. The household financial savings plunged sharply from 12 per cent in 2009-10 to 7.1 per cent in 2012-13.

**Why Investors stay away from the Capital market?**

- Transaction cost in India is very high compared to other countries. The cash market total cost is 0.444% (Delivery) and 0.141% (Intraday). Derivative total cost is 0.054% (Future) and 0.729% (Option exercised).
- BSE has received 1,237 complaints from clients and NSE has received 4854 complaints from clients during 2014-15. There is no quick mechanism to resolve the disputes between clients/investors and the brokers. High risk and Volatility.
- High volatility and risk. The return from financial assets has diminished drastically. The average annual return has declined from 33.9% in 2007-08 to 2.9% in 2013-14.
- Shares of 25 companies (6 per cent) that raised money through IPOs between 2004 and 2013 have been suspended either for procedural lapses or as a penal action.
- Over 70 per cent of the companies reported lower net profit margins and return on equity ratios in the subsequent year compared with the financial year in which the shares had been listed.
- Investors shy away from the public issue market due to huge wealth erosion in issue price.
The IPO scam starts with the promoters who are primarily driven by selfish motives. No clarity on tax laws such as GAAR, Transfer pricing, etc. Poor knowledge about stock market.

**Reforms need to be initiated in Capital Market**
Indian Capital market regulators and Government should initiate measures to strengthen the width and depth of the market and positive sentiment among investors community.
- Government should rationalize the taxation laws.
  - Removal of STT
  - Removal of CTT
  - Removal of Dividend distribution tax
  - Clarification on certain tax issues such as GAAR, Transfer Pricing, etc.
- Initiate tax incentive plans for investment.
- Govt should ensure that there is a mechanism to protect the interest of the investors.
- Govt should reduce transaction cost.
- Govt should initiate financial literacy among investing community.
- SEBI should initiate a step for speedy redressal of grievances of the clients.
- SEBI should ensure that there is a single investor protection fund rather multiple protection funds.

**Conclusion:**
Undoubtedly, Market regulator (SEBI) has done a lot to increase the retail participation in the capital market. However, there are several areas where action needs to be initiate, such area are reduction in the capital market transaction tax, withdrawal of STT & CTT (Security Transaction Tax and Commodity Transaction Tax), withdrawal of stamp duty, investor protection mechanism, making available demat account at free/nominal costs, etc.

According to IMF paper, globally speaking the total cost of trading is in the range of 9 basis points to 30 bps of the traded value. However, in India, with 27 bps, the trading costs are at the higher end of the range after China and Hong Kong. Reduction of these taxes can be done with a little loss to the exchaquer, since the growth in volumes by this move can compensate for the reduction in revenues. The genuine investors in India have been losing the money invested by them in capital market due to one or other kind cases of IPO scams, price manipulation, insider trading, etc. SEBI should create a conducive environment for retail investors.

The share of household savings in the total saving is significant. Market regulator should initiate a mechanism to bring positive sentiment and protection measures. A stable government after the election, which should be able to end the policy paralysis and remove some of the hurdles in doing business, will be a major enabling factor in reviving the IPO market.

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