# REFORMS IN INDIAN PRIMARY MARKET – A VIEW

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## ABSTRACT

The emerging significance of the securities markets is expanding rapidly in the form if quantum of funds raised and number of investors in the primary market, as also increase in the number of stock exchanges and listed stocks speedy rise in market capitalization and volume of trade, entity of sophisticated investors like the foreign institutional investors and mutual funds. The Structure of both the segments of the market i.e., primary and secondary has witnessed significant changes. The Primary market intermediaries' organization, pre and post issue procedures activities are indeed undergoing reform process. The security market(stock market) having more activities like intermediaries, trading and settlement, futures and options market, cash market, regulatory part etc are under went reforms.

The basic task of securities market to help in process of capital formation in the economy, this can only is possible by services of systematic measures which would build their confidence in the systems and process and protect investor's interest fully. The rising of capital issues were controlled by the office of the Controller of Capital Issues (CCI) under the Capital Issues Control Act (CIA) 1947. The CIA 1947, repealed office of the controller of capital issues abolished and initial share pricing decontrolled. In 1991-92 Finance minister announced the repeal of the act and transfer of power from CCI to SEBI from control to disclosure based regulation. Since then SEBI put some reforms in the primary market operations in India.

The present paper discusses the reforms introduced in Indian primary market over a period of time which includes special focus on Book Building Mechanism, Green Shoe Option and Application Supported by Blocked Amount.

**Keywords :** Securities and Exchange Board of India, Controller of Capital Issues, Green Shoe Option, Application Supported by Blocked Amount, Book Building Process, Controller of Capital Issues

## INTRODUCTION:

Since adoption of Liberalization, Privatisation and Globalisation and launching of economic policy in the year 1991, the Indian financial system has been characterized by profound transformation. Major economic policy changes such as delicensing, trade liberalization, privatisation and reforms in financial sector are being gradually introduced in India financial sector reforms were initiated in 1992-1993 with the aim of promoting an efficient, well-diversified and competitive financial system. The role of the Government in the distribution of finance and credit is marked by a considerable decline and emergences of capital market oriented reforms are seen. Since the introduction of financial sector reforms, the capital market emerged as the main body for allocation of resources and all segments of the Indian economy like the public sector, private sector and state governments are competing to raise capital in the capital market. The result of these developments is that the Indian financial system integrated with the savings pool in the domestic economy. Notable developments in the organization of the Indian financial system during these two decades are privatization of financial Institutions, reorganization of institutional structure and investor protection with reference to capital market participants.

The reforms in financial sector are a process. A broad based organizational structure of the Indian financial system has emerged in response to the requirements of the emerging industry. The present organizational structure of the Indian financial system comprises of three interdependent components named a) Financial Markets b) Financial Institutions c) Financial Assets. One significant component of the organization of the financial system in India comprises of financial markets which perform a crucial function in the savings-investment process as facilitating organizations. They are not source of finance but they are link between the savers and investors. Based on nature of funds the financial markets are classified into (i) Money Market and (ii) Capital Market/ Securities Market.

A Segment of the Indian financial system while has witnessed the more reforms is the securities market/ capital market. The emerging significance of the securities markets is expanding rapidly in the form if quantum of funds raised and number of investors in the primary market, as also increase in the number of stock exchanges and listed stocks speedy rise in market capitalization and volume of trade, entity of sophisticated investors like the foreign institutional investors and mutual funds. The Structure of both the segments of the market i.e., primary and secondary has witnessed significant changes. The Primary market intermediaries' organization, pre and post issue procedures activities are indeed undergoing reform process. The security market(stock market) having more activities like intermediaries, trading and settlement, futures and options market, cash market, regulatory part etc are under went reforms. The present paper in the following sections discusses the reforms in primary market in India. Before discussing the above let's look at growth of Indian Capital Market.

## INDIAN CAPITAL MARKET-GROWTH:

The Indian Capital market has been broadening significantly and the volume of saving and investments has shown steady improvement. According to Central Statistical Organization's estimates, the gross domestic saving rate was 8.6 percent in 1950-1951 and the same is about 35 percent in 2006-07. Another indicator of growth of the capital market is the growth of corporate entities. In 1951 there were about 28,500 companies with a paid up capital of Rs.775 crore in 2000, there were 70,000 companies with a paid up capital of over Rs.2, 00,000 crore. The growth of number of registered companies paid up capital and growth of investment is phenomenal between 2000 to till date.

An important segment of Indian capital market is corporate securities market. Since the adoption of Liberalisation Policy corporate securities market got a tremendous boost in both primary and secondary market. The amount raised through new capital issues by private sector in 1990-91 was Rs.4312 crore. However, resource mobilization by private sector through capital issues was Rs.31600 crore in 2006-07. Apart from this growth in number and capital raised, the primary market also experienced introduction and availability of new instruments in the market for the convenience and/ or option of the investor to invest.

On the other hand, the secondary market in terms of number of stock exchanges rose from 8 in 1975-76 to 22 in 2006-07. The market value of capital rose from Rs.3273 crore in 1975-76 to Rs.3545041 crore in 2006-07. Capital raised as a percentage of gross domestic savings increased from 0.7 percent in 1975-76 to 10 percent in 2001-01, but decreased thereafter and stood 8.5 percent in 2006-07. As a key body of the securities market development and regulatory SEBI practices improved the market conditions. SEBI has drawn up several programs and took initiatives to strengthen the secondary market as well as measures to reform the primary market. The measures includes in primary market are standards of disclosure, procedural norms for the issuers and intermediaries etc.

**NEED AND RELEVANCE**:

The reforms in the capital markets during the 1990s in terms of market microstructure and transactions have ensured that the Indian capital market is now comparable to the capital markets in the most developed markets. The early 1990s saw a greater willingness of the saver to place funds in capital market instruments-on the supply side as well as an enthusiasm of corporate entities to take resource to capital market instruments- on the demand side. After going through the journey of almost two decades the need arose to study how the reforms process went and changes the face of the market. Therefore, the present study focuses on few of the reforms introduced in the Indian primary market in the issue mechanism. The study highlights Book Building Process, Green Shoe Option and Application Supported by Blocked Amount reforms introduced in Indian primary market during the last few years in the process of reforms with the primary objective of investor protection.

**INDIAN PRIMARY MARKET:**

Primary market provides opportunity to issuers of securities, Government as well as corporate, to raise resources to meet their requirements of investments and/or discharge some obligation. Primary market also known as New Issue Market deals with new securities which were not previously available and offered to the investing public for the first time. The primary market enjoys neither any tangible form nor any administrative organizational set-up and is not subject to any centralized control and administration for the execution of its business. It is recognized by the services that it renders to the lenders and borrowers of capital. The main function of primary market is to facilitate the 'transfer of resources' from savers market i.e., channelizing of investible funds, can be divided, from the operational stand- point, into a triple- service function; organization, underwriting and distribution.

**PRIMARY MARKET REFORMS**:

The basic task of securities market to help in process of capital formation in the economy, this can only is possible by services of systematic measures which would build their confidence in the systems and process and protect investor's interest fully. The rising of capital issues were controlled by the office of the Controller of Capital Issues (CCI) under the Capital Issues Control Act (CIA) 1947. The CIA 1947, repealed office of the controller of capital issues abolished and initial share pricing decontrolled. In 1991-92 Finance minister announced the repeal of the act and transfer of power from CCI to SEBI from control to disclosure based regulation. Since then SEBI put some reforms in the primary market operations in India. Following are the important guidelines put by SEBI in the primary market from time to time.

Disclosure and Investor Protection (DIP) guideline:

As per this regulation all the information pertaining to and available with an issue is provided so as the investor takes an informed decision whether to invest or not to invest.

- Eligibility Criteria for Issues: Companies eligible to make an issue can decide on their standard denomination and price of a security. Some parameters that need to be in offer documents are minimum holding by promoters, size of public issue, issue expenses, information disclosure and advertisement etc.
- Free Pricing of Securities: Issuer is free to determine the level of security price. The process of Book- Building helps discover price and assist small investor to take an investment decision.
- Book Building: It refers to the process of ascertaining demand for and price of securities through bids.
- Green Shoe Option: It is the market stabilization mechanism by which stabilizing agent acts on behalf of Issuer Company, buys a merely issued security for the limited purpose of preventing a decline in the new security's open market price in order to facilitate its distribution to the public.
- Application Supported by Blocked Amount (ASBA): Is an application containing an authorization to block the application money in the bank account, for subscribing to an issue.

Apart from all these primary market also had the experience of reforms regarding transparency, financial instruments and compulsory demat account etc.

1) **BOOK BUILDING PROCESS**:

In 1998 SEBI introduced guidelines for issuing shares through the book building process based on the recommendations of the Malegam Committee, 1995. SEBI defines "book building mechanism as a process undertaken by which demand for the securities proposed to be issued by a body corporate is elicited and build up and the price for such securities is assessed for the determination of the quantum of securities to be issued by means of notice, circular, advertisement, document or information memoranda or offer document".

The issuing company should disclose either the floor price of the securities offered through it or a price band along with a range within which the price can move. In case the price band is disclosed, the lead book runner should ensure that the cap of the price band should not exceed 20 percent of the floor. The price band can be revised during the bidding period. The maximum revision on either side should not exceed 20 percent. The book shall be open for a minimum period of five days and not more than ten days subject to a maximum of bidding period of 13 days in the case of the price band is revised. Therefore it appears a little restrictive but book building gives ample opportunities for price discovery.

2) **GREEN SHOE OPTION**:

After listing the IPO, if process in open market falls below the issue price, small investor may start selling their securities their securities to minimize losses. Therefore, there was a vital need of a market stabilizer to smoothen the swing in the open market price of newly listed share, after an IPO. Market stabilization is the mechanism by which stabilizing agent acts on behalf of the issuer company, buys newly issued security for the limited purpose of presenting a decline in the new security's open market price in order to facilitate its distribution to the public. Such mechanism is called Green Shoe Option.

The company shall appoint one of the lead book runners, amongst the issue management team, as the Stabilizing Agent (SA), who will be responsible for the price stabilization process, if required. The SA shall enter into an agreement with the promoters who will lend their shares, specifying the maximum number of shares that may be borrowed from the promoters, which shall not be in excess of fifteen percent of the total size. The stabilization mechanism shall be available for the period disclosed by the company in the prospectus, which shall not exceed thirty days from the date when trading permission was given by the exchange.

3) **APPLICATION SUPPORTED BY BLOCKED AMOUNT** (ASBA):
When investors apply for an Initial Public Offering, they have to pay the entire money upfront to the banker and hence stand to lose returns on the money that is locked until the shares are allotted. The new move, Application Supported by Blocked Amount(ASBA), will protect the money of investors and will also make IPO issue process more efficient and less time consuming. This process enables the banker to block the money in investors' account when they bid for an initial public offerings and the money is released on the basis of number of shares being allotted. The remaining money will be unblocked by the banks. As a result, the initial public offering process is expected to be completed within 15 days of the closing date of the issue.

## CONCLUSION:

The most important segment of capital market is going through a process of reforms in India for the last few years. Every reform that is proposed and implemented is in the interest of investor protection and market development. Book Building process aims at fair pricing of the Initial Public Offering, which is supposed to emerge out of offers. At the same time it is encouraged to have a systematic method to fix the share price band for the book building method. The introduction of Green Shoe Option by SEBI is a positive move. It aims at stabilizing the post-listing share price. But in a situation where there is a free fall in the share prices, the stabilizing agent will also not able to do much as the fund will not be used in a single day. At this juncture, the SEBI must study the usage of fund by the stabilizing agent to give further focus so as to have more clarity to use the fund to reach the desired result.

The newly introduced ASBA method facilitates the investor to invest in an IPO with ease. However, the system suffers from lack of initiative from brokers. According to market sources brokers preventing investors from adopting ASBA, as they feel it kills their IPO funding business. However, the regulatory must take initiative to address the problem of brokers' so that the investors' can avail the facility of ASBA. At present, the financial sector focusing on reforms in legislations and markets. Finally, stakeholders of the financial markets would appreciate if the reforms lead to healthy financial markets and protect their interest.

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