CHAPTER NO. IV
ISSUES IN SHARE PREMIUM FIXATION-REFLACTIONS BY SELECTED MERCHANT BANKERS

CHAPTER NO. 4

4 1 PRICING AN ISSUE - A PUZZLE YET TO BE SOLVED

After the abolition of the office of C C I , there has been a debate on the pricing of issues What is the justified price for a issue is a question and will remain to be so According to Shri M.R Mayya, "The premium is generally justified on the basis of projected profiles and assumed P/E ratio The pricing of issue is not so simplistic as there are other factors like debt-equity ratio, net worth of the company etc. which also have to be taken into account. Even if these factors are taken care of, it may still be difficult to proximate the actual likely price that may prevail after issue "

High premium issues do not reward investors overwhelmingly and immediately since the offerprice would be near to the market price of the share The share premium is a low cost funds to the company, it will permit rapid growth and eventually reward the shareholders As with the increase in premium, the reserves improve, debt comes down and low cost of borrowings add to higher profits, that eventually makes the market prices go up benefitting the shareholders

In this context Prof Raghunathan points out that " the high premium of an issue does not necessarily imply a lower cost of capital for the company It is naive to assume that an investor puts his money in the capital market for lower return when he can get a much higher return from a bank savings account"

But, the point is whether premium charged by companies on their new, further and right issues are fair and reasonable ?

Certainly, in most of the cases, it is not. Therefore the companies should understand it clearly that situation like this is not expected to continue for long. Hence, companies coming out with issues must understand that while pricing a issue not only historical factors and NAV are taken into account but also expected earning capacity and current prices are given due attention Further, the price that the underwriters are ready to accept in case of undersubscription is also considered. Pricing an issue is a complex excercise Factors like intrinsic value of equity share, net worth, demand and supply, marketing strategies, liquidity in market, economic set up of the economy, strength of the industry, investors need etc are to be considered, thus it needs expert investment appraisal and visualisation beyond the horizon to make price more nearer to future market price. Now companies are realising that pricing is an important feature of marketing mix since Indian investors normally look for capital appreciation rather than dividends. Pricing has to be friendly towards the investors

4.1.1 SAFTY - NET ARRANGEMENT[1] :

The safety-net arrangement is a total win-win situation in which the promoters and the project get what they want and the small investors are protected against eroision and that is precisely the duty of the merchant bankers. This will make the merchant bankers appraise as well as price the issue more seriously and sensibly. Seeing the mad rush to go public in the Indian market, this concept should be made mandatory So that we have only quality issues adequately priced and the investor's confidence in the market remain intact.

4.1.2 CURRENT PRICING PRACTICES:

The means of justification of the offer price currently in vogue include interalia : the discounted cash flow method, the EPS-P/E ratio method, the NAV method etc. However, in the absence of uniformity of approach, it has been extremely difficult for the investors to properly evaluate the merits of an offer Even the requirement of mentioning the "C C I Premium" in offer documents as stipulated by SEBI has not mitigated the problem It is also observed that the issuers do not give details of criteria on the basis of which they have asked for the premium in the letter of offer or prospectus

4 2 UNDERPRICING OF SHARES.

4.2.1 INTRODUCTION :

The price to be charged on new issues is a major problem particularly for companies first going public as they have no market price to follow Moreover, investors

[1] SAFTY NET-AN INSULATOR FOR THE INVESTOR-CFA/JUNE 95/P 31

donot know the strengths and weaknesses of a new company. In such cases the underwriters and issuers, to play safe underprice the shares. Underpricing is also resorted to by existing company to make the issue a success

There can be various reasons for underpricing of new issues. Greater degree of risks in new issues, success of the issue, investor's satisfaction and unpredictable future market are some of the factors which lead to underpricing of new issues. Some amount of underpricing is a good feature and it is necessary also to attract the customers But too much underpricing is harmful to the interest of existing shareholders and also to the issuers It has an adverse effect on a number of important financial measures like E P S., D P S and net asset value On the other hand, it provides larger positive returns to the allottees of these issues.

When public issue are underpriced, they are oversubscribed and appear to be successful, but in reality they are not On the other hand, these oversubscribed offering are generally at loss Because, if the same amount of funds is to be raised at moderate level of underpricing than the number of shares to be issued would be less For the investors the small number of shares (in case of allotment) means a given level of net income would produce higher E.P S Moreover, net asset value per share improves. In short the amount of underpricing has a serious effect on a number of important financial measures A low issue price enhance the chances that the issue will be sold out, but it has a negative effect on the number of shares, EPS, DPS, and net asset value

Asymmetric information is the core problem underlying IPO underpricing. India's IPO market is unique by world standards for it allows the direct marketing of IPOs to millions of lay investors all over the country However, such an IPO market is a very poor one, because it emphasises reaching out to uniformed investors in so far as these ununiformed investors cannot discriminate between "good" and "bad" IPOs, the good IPOs have to strongly underprice themselves in order to stay attractive

IPO underpricing would diminish if we could move away from such an IPO market towards one where most shares are sold to the relatively informed institutional investors, who would in turn sell mutual fund paper to the lay investors Indian IPO market is characterised by high degree of underpricing I P.O underpricing is not healthy It means penalising unlisted companies with high cost of capital In case of listed companies too underpricing (in case of further issues) is not desirable This is unlikely to be a criterion along which the efficiency of resource allocation is maximised

IPO underpricing is structural It is caused by basic problems of the micro economics of uncertainty and information It also affects the cost of capital IPO underpricing is not a market inefficiency There are forces at play which can keep the system trapped in the wrong equilibrium. An important factor is oversubscription risk Owing to the oversubscription risk, many subscribers do not get allotment In such a situation, IPO underpricing has to be enough attractive to invite investors bear oversubscription risk In such a situation, public policy can help to produce a superior outcome

We propose four policy alternatives which are primarily aimed at decreasing the extent of IPO underpricing We propose

a) Improvement to the quality of disclosure at the time of a public issue,

b) giving firms greater freedom to choose the offer price close to the issue date,

c) An auction based strategy of operation in the primary market,

d) a way to legitimise the gray market and bring it with in the fold of the institutional framework governing financial markets of the country.

4.2.2 INFORMATION DISCLOSURE:

Better mechanism for information discloures are a direct way of addressing the difficulties caused by asymmetric information The listed firms should be required to show five years of audited annual reports when they go public Audited annual reports are crucial to understanding the track record of a company as distinct from the fragmentary information currently shown in the prospectus. A monitoring mechanism should be in place for assessing the quality of projections contained in the prospectus to compare actuals against those previously predicted

The most important effect of the monitoring mechanism of this nature take place at the desk of mechant banker The merchant bankers have to carefully verify the projections of the issuer company because his reputations would be based on achievements of the projected figures With such a system, the merchant banking would become a crucial project appraisal stage for companies going public and the track record of the merchant banker would be a major factor in placing issues with minimal underpricing Better norms need to be created for the presentation of accounting and stock market ratios in the prospectus

4.2.3 OFFER PRICE CHOICE :

Under the current institutional framework of public issues, the offer price must be defined when the prospectus is given to SEBI for clearance The correct role of the regulatory agency is to ensure truthful disclosure of comprehensive informations by the issuer, which would enable proper valuation in the market The regulatory agency should have no role in price setting Thus the issuers need not set a price when obtaining SEBI approval In this case, the issuer would set the price few days before the issue opens This would reduce the risk of market wide price luctuations.

4.2.4 THE AUCTION BASED ALTERNATIVE :

This system is based on Japanese system The system works as follows. Half of the total issue (number of shares) are sold through an auction The public issue take place after the auction is completed The auction works as follows

- Employees of the issuing company and similar interested parties are prohibited from participating in the auction Bids cannot exceeds 5000 shares.

- At the auction, there is no "offer price" or "suggested price". Participants are required to select a price for the company using their own information and analysis

- The bids are sorted by price and shares are allocated to the bidders at the price they quoted, until the auctioned portion of shares are exhaused The non-auctioned shares are priced at the weighted average price of the auctioned. With in this constraint, the underwriter is free to place the unauctioned parts as he pleases

In this system, price discovery takes place through the auction The restriction disallowing bids above 5000 shares reduces the role for strategic behaviour at this auction. Once the auction is complete a market determined price is known. Once auction is permitted as one way in which firms can access the primary market, the issuer companies would prefer this mode The SEBI would have to design operational procerdures to supervise the correct functioning of the auctions

4.2.5 LEGITIMISING THE GRAY MARKET :

The gray market is grassroot organisation of economic agents which benefit from speculative activity in a risky environment in exactly the same sense that the first uninstitutionalised financial markets grew out of trading in agricultural commodities many centuries ago

The gray market operates on trust It stands outside the legal framework of society The gray-market activities are offbalance-sheet and outside the purview of taxation The speculative efforts of myrid gray market participants are a mechanism of price discovery To some extent, this is already taking place, the trading activity at first listing is very much a carryover from the gray market If we can create better institutions governing the gray market, then

a) more agents can participate in the gray market. Thus, improving the information processing on this market and,
b) the price discovery efforts on the gray market will become a public good through publicly disclosed price quotes

The sketch of policy options, through which the gray market can flourish in a legal manner, while contributing to price discovery between issue date and listing date, is given in Annexure No 9

4.2.6 CONSEQUENCES OF UNDERPRICING:

The underpricing of the securities is a world wide phenomena As stated earlier underpricing of the issue affect economy as a whole The chart showing result of underpricing is given at Page No 296. The underpricing of issues results in oversubscription, as majority of the investors accept oversubscription risk The relation between underpricing and oversubscription is direct and positive i.e more the underpricing more the oversubscription The oversubcription has also two effects. Owing to heavy oversubscription the capital would be locked in for two to three months on one hand and on the other, the cost of refunding the money would be high.

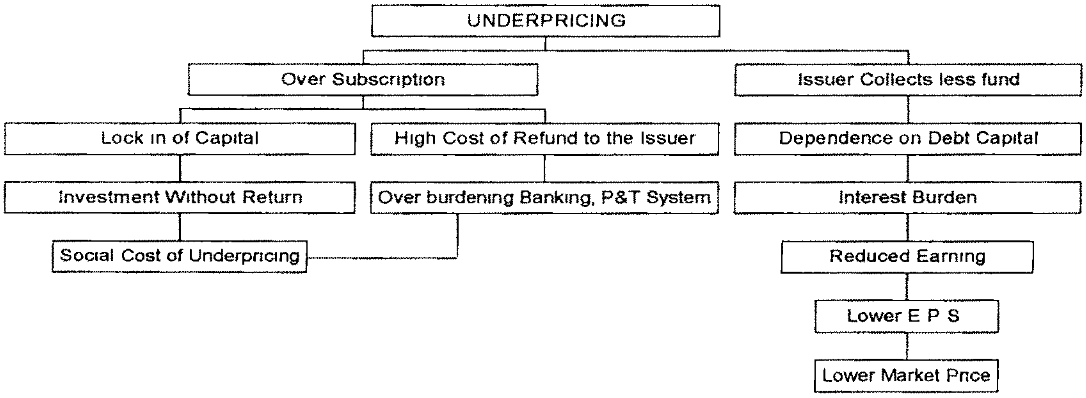
Owing to the oversubscription work load of banking system, Post and Telegraph department would increase unnecessarily and disproportionately At the same time, the issuer company would get less amount of fund per share. Hence dependence on debt capital would increase. Higher debt capital in the capital structure of the company will enhance interest burden, which in turn reduce the total earnings. The reduction in earnings will lower the earning per share. The lower EPS and lower overall earnings will affect market price of the share negatively

So heavy underpricing of the issue is not at all desirable as it will increase social cost For the subscribers to the issues who do not get allotment, the investment would not generate any return Hence, underpricing of the issue has serious implications

4.2.7 STANDARD PRICING MECHANISM (SPM):

The possible means of evaluating the offer price could be a combination of quantitative methods such as the Discounted Cash Flow Method, the Capital Asset Pricing Model, the Replacement Value Method, The P/E Method, the Dividend Capitalisation Method etc However, all such quantitative methods would be largely incomplete without inclusion of a properly indexed value of the qualitative factors listed above A suitable grading systems should be evolved for various qualitative factors like the promoters, the management, the project, the market scenario, the product etc Each factors may be assigned an appropriate weightage on the basis of which a 'Z-score' may be arrived at This particular "z.score" may determine the percentile diversion of the offer price from the face value.

However,till such standard pricing mechanism of valuation is developed, the fixation of the offer price has to be largely done by the merchant bankers and they have to play crucial role of safeguarding the interest of the investors.



4 3 PREFERENTIAL EQUITY OFFERS - PRICING

Earlier on, the price of shares - preferential offer was fixed by the issuer themselves as per SEBI guidelines But now these guidelines do not exist

The price is determined as per norms fixed by the financial institutions Under these norms, preferential offer of equity shares should be pegged at the highest of the prices computed on the basis of the following three criterias

a) The preferential offer should be priced at the lowest market price after adjustment for bonus and rights issues,if any,recorded at a recognised stock exchange during the preceding twelve months from the date of consideration of proposal by the company management,

OR

- The net asset value calculated on recognised formula based on the latest accounts of the company which should now be the benchmark for fixing the price of the equity shares,

OR

- The price of the last rights equity offer in the preceding twelve months after giving effects of conversion of debentures,if any

Based on the above norms, the highest price will be taken as preferential offer price. The investment institutions have demanded that preferential offer of equity shares should have minimum lock-in-period of three years from the date of allotment

The Investment institutions have further stipulated condition that promoters or foreign collaborators seeking prefential allotment should not have sold any of their holdings in the preceding twelve months prior to the announcement of such proposal In addition, the promoters or collaborators cannot dilute their holdings between the announcement of proposal of preferential offers and allotment of shares. The financial Institutions have pointed out that pricing of preferential offer could not be finalised without consent from the major shareholders

4 4 MODELS FOR PRICING NEW ISSUES

During C C I regime, a company had to go through a cumbersome process before going to the public and that too at an issue price far below it's intrinsic value. With a view to ensure poroper disclosure and investor protection, SEBI has issued certain guidelines for due observance by the companies making issue of capital.

The C C.I priced the new issues of capital by existing companies on the basis of average of their net worth per share and profit earning capacity per share.The pricing policy of the C C I had been unduely conservative and had valued shares far below their ruling market price

The arithmetic reason for the underpricing of new issues during C C.I regime was as under

a) While working out the net worth per share, the CCI took in to account the additional share capital arising out of the new issue This unduely deflates the "Net Asset Value" which even without the deflator is usually much lower than the market value of the shares.

b) Another reason for underpricing is the rate of capitalisation of earning used. This rate is arbitrarily fixed at 15% or 12% owing to which assessed price works out ridiculously low Also the rate of capitalisation was not based on the rate at which the stock market capitalise earnings as reflected in the P/E ratio.Thus when the average market P/E ratio is in the range of 20 to 30, it implies an earning capitalisation rate of 5% to 3 33% Hence, an administered rate of 15% is obviously too conservative 9

There are pitfalls in the free pricing of shares particularly in our markets where the scope for manupulation is wide. It is in this context that the Pherwani Committee put up the cap on the permissible issue price as the last 6 month's average of the market price

The SEBI guidelines have been formulated and announced in hurry to provide for working mechanism on pricing of capital issues after exit of the C C I The model presented here under are framed with the objective to ease the practical difficulties experienced in it's implementations The model may be issued as one of the methods with the help of which new issues may be priced

4.4.1 MODEL - I :-

As per this model, the valuation of shares should take into account the following four factors

a) Net Asset Value,
b) Profit Earning Capacity Value,
c) Market Value,
d) Fair value

It is worth to note that the guidelines for valuation of equity shares issued by CCI in 1990 also considered the above factors but the calculation of the above factors were quite different from these model Now let us see each component in detail

(A) Net Asset Value :-

While calculating the NAV, the face value of the fresh issue of equity capital used to be added to the "net worth" But this does not amount to realistic estimate of the future net worth of the company because the premium elements is an assured addition to net worth Thus, the fresh issue must be added at the price which is inclusive of premium. A question which definitely arise is, at what price this new issue could be added to the net worth as the whole excercise is undertaken to determine the price itself Thus, while calculating the NAV, this amount can be termed as 'X' for the purpose of working out the questions

(B) PECV :-

The crux of estimating the PECV lies in assessment of the future maintainable stream of earnings that is of greater significance in the process of valuation For the purpose, the future liability for taxations, incentives and allowances that will be available for next three years has to be worked out. Also consider the average profit after tax on the basis of data of past three years as well as the profit proposed for the next three years Consider the P/E ratio of last six months. While considering P/E ratios, do not take into account a market period where there is a sudden boom or bull Take the average capitalisation rate as the average P/E ratio as determined above

(C) MARKET PRICE :-

The market price should be taken as an average of the monthly high and low for last two years. Compare the market price with the book value of the company (at the end of year) for two years

(D) FAIR VALUE :-

To compute the fairvalue, take the average of NAV and PECV and equate them to 'X' which is the amount at which the issue would be priced.

While working out the issue price, the capitalisation rate may be based on industry average capitalisation rate. Such rate will be different for different industries. After deriving value of "X", the issue price may be worked out. Compare the issue price arrived at with average market price and determine such a issue price which would be accepted by the market and investors.

In case of the fresh issue of new companies, which are allowed to freely price their issue, the P/E ratio is not available In such cases, the rate of capitalisation should be taken as 12% or 15%, whichever is felt just; keeping in mind the rate of earning of the company

4.4.2 MODEL - II :

This model aims solely at educating the investors and make them well informed about the type of investment they are going in for This also helps the company to understand the mind of investors which would help them to price the issue appropriately This model does not indicate that the price arrived at must be the issue price but only states that, while working out the price, the attitude of the investors must be considered

The sole purpose of the investment of uninformed investors is to receive (i) a regular and increasing flow of dividend and (ii) to receive capital gain at appropriate time As per this model following elements needs to be considered

a) Earning Per Share (E P.S)
b) Dividend Per Share (D P.S.)
c) Discounting Factor
d) Present Value

Whenever a company plan to raise finance from the capital market for it's project it generally apply for term loans to financial institutions.While submitting the application to financial institution the companies have to give details of future projections From this projections, EPS and DPS can be worked out for three years. An average rate of return expected by the investor should be taken as the discounting factor. The rate of discounting would depend on the following

a) Current rate of earning that the investors receives from different companies falling with in the same industry,
b) Average expectation of investors from a particular type of company and/or industry,
c) The rate of dividend that a company offers

The D P S of every year should be discounted for five years At the end of five years the amount which would be expected by the investors as the sale proceeds should also be discounted The Net Present Value arrived at should be the price at which the investors would be wiling to buy

In case of existing companies the period of five years for calculations of DPS could be taken from the data available for past three years and projections of next two years While in the case of new companies which are permitted to issue capital at premium the question of past year's data does not arise Hence the calculations of DPS should be based on the projected figures and statements.

An equilibrium should be maintained between the price obtained with the help of Model-I and Model-II. Both the models are indepedent methods of calculations of premium But at the same time both the models should be considered to arrive at a price which would then maintain an equilibrium between the price at which a company wishes to issue the shares and the price at which the investors are willing to buy Because,the company wants to issue at a maximum possible price while the investor is keen to buy at the minimum possible price. It is, now up to the lead managers and merchant bankers to determine such a issue price for companies which is acceptable to investors, company and SEBI

4 5 IMPLICATIONS OF FREE PRICING

The conservative pricing by the office of CCI conditioned investors to receive fresh securities at deep discount to market prices,in several cases issues being made at 30% to 40% of prevailing market price The allottees of share gained at the cost of the company This was true even for new companies, whose issues were made at par. Such issues were traded in gray market at high premium This later on led to multiple application and consequently massive oversubscription. As a result of underpricing of premium issues oversubscription was also noticed in the issues. This mean that pots of money was locked up and was out of circulation. The banking and share processing system was overstretched The cost of refunding this money was high. Hence, the Government,based on the Narsinham Committee's report, initiated liberalisation measures which gave a free hand to corporate sector in raising fund The higher interest cost (15% to 20%) on debt funds increased dependence on primary market The unchecked ability to raise equity at any price, unleashed the greed of corporate sector to raise equity funds at high premium The corporate sector virtually lined up to pick the investors pocket. Even the companies with losses in their income statement without hesitation approached their shareholders with right issues at premium

The rights which in earlier days were considered as a favour to shareholders as they normally got shares at lower rate than market, such price advantages have been denied to them due to unreasonably high premium. Consequently many companies had to face rough weather with their Right issues Right renounciation forms went abegging even of blue - chip companies. This was the story of public issue too.

In the month of April,1993, 73 companies approached the public with issues and extended their last date of application, where as, 20 issues adhered to the schedule Over and above, only five issuers could collect whole amount due from public Free pricing has upset, the investor-issuer equilibrium in the market where the latter are out to take unfair advantages of free pricing Undersubscription is the phenomenon getting on nurves of corporate sector and proving a headache for the underwriters

In this set up even low priced premium issues as well as issues at par have devolved on underwriters The underwriters in the absence of sufficient working capital were not in a position to cough up huge sums by way of devolvement

Promoters of companies would not like to cough large premiums to protect their shareholding They would prefer to raise hefty premiums from public instead. Though there is a large body of opinion which favour total deregulation, there is also a modified version of this approach by those who felt that while market based approach should eventually prevail a totally unregulated freedom for issuers in the present market conditions with it's inefficiency, lack of transperancy and prevalance of malpractices would put the investors at considerable risk.

The investor's confidence has touched new abysmal level. The high price at which shares are being issued by promoters has deterred the individual investor Further a section of investor has started suggesting that the CCI like excercise is in the interest of investors. They want SEBI to evolve some formula to ensure reasonable premium. SEBI on the other hand, ensures more and more qualitative information through merchant bankers. Although every issues is vetted by the SEBI,the acknowledgement clearly states the SEBI does not take any responsibility for the contents of the prospectus

This gloom in the primary market is certainly an after effect of a long awaited change These should be taken as problems of transitionary period and as the players of the market mature, balance will automatically strike taking the scene normal

4.5.1 TENDER METHOD OF PRICING :

SEBI has provided for free pricing of shares in it's guidelines, where the issue price is to be determined by the issuing company in consultation with the lead managers However, the guidelines do not permit the use of the tender method under which, instead of fixing the issue price before hand, it is determined by the offers given by prospective shareholders. The tender method involves the following principles

a) In the prospectus no price is fixed, except that a minimum reserve price is indicated.

b) The prospective shareholders send in appications stating the maximum price that they are willing to pay.

The company ranks the applications in the descending order of maximum prices The final price is fixed at that level where the issue is fully subscribed

The tender method will have several advantages The primary benefit is that the issue price will be fixed on the demand and supply and not on the basis of some arbitrary valuation

4 6 PRICING AND MERCHANT BANKERS

4.6.1 INTRODUCTION :

The rationale of the liberalisation is that undue regulation deprives the company from benefiting it's performance.The changes proposed retain the prevailing qualifying norms, while liberalising the issue price and transferring the powers of price fixation to the issuers, who are guided by the advice of the merchant bankers As the onus for fixing the price was vested in the merchant bankers, the success of the merchant banker would be judged on the basis of actual subscription received and percentage of issues handled which quote above the issue price

4.6.2 THE ROLE OF MERCHANT BANKERS :

The role of merchant bankers drew a lot of flack from the industry players. A merchant banker is supposed to be an intermediary answerable to the investors for proper appraisal of the project.

Traditionally, the merchant bankers were willing to ask for as much premium as the company desired since the ultimate deciding authority was C.C.I Having satisfied about the financial and economic soundness of the proposal the merchant bankers are expected to price the issue But things are not going by the books The merchants bankers have shown a definate bias towards the issuer company.

According to G Ramchandran, Vice President of Reliance Capital Ltd "It is very normal for the merchant bankers to show a bias in it's activities as it is issuer company which "rewards" the merchant banker and not the investor". In the absence of requisite capabilities and inaccessibility to information the investor has to bank on the lead manager for proper appraisal of the project A role which the lead manager has failed to play time and again.

It is generally observed that the merchant bankers and lead managers to the issue do not carry out their home work well before accepting the assignment of the public issue It is also seen that the issuer company many a time do not provide detailed financial informations or even if accounting informations are provided, it would be a tailormade or manufactured balancesheets In such case the merchant bankers fail to assess the assignment in first stage.

Aggressive pricing has been problem with the good issues. Issues which have some substances were overpriced by the lead managers at the instance of the issuer company As a natural corollary listing prices were well below the issue price. Since, the underwriters, appraisors and even investors are capable of differentiating between fraud and genuine merchant bankers Hence the merchant bankers have to excercise their full deligence, prudence, expertise and experience while pricing an issue so that their credibility and reputation can be built up and maintain in the capital market. The merchant banker's decision to charge a given amount of premium should be based on financial and technical analysis of the company as well as industry and general environment of the market

It is important to point out that the procedure involved in the issue of shares is very lengthy Only after three months of the ratification of the company's decision of charging a premium in the annual general meeting or in the extra ordinary general meeting, a right issue can be opened Similarly, in the case of public issues, the duration is two months It is very difficult to forecast the movements of share prices at India's imperfect stock market three months in advance.

Days are not far off when the merchant bankers will be taken to the task, like in Western Countries when the issue gets either oversubscribed or undersubscribed. No issue manager or merchant banker will be willing to be a party to promote an issue which could bounce in the market due to unreasonable premium. The merchant banker, while undertaking a capital issue has to ensure that the fund being raised are actually needed to the company. Because in times to come the basic relationship between the object of the issue and utilizations of the funds is going to play significant role In the absence of control, 40% of the issues are made to repay existing loans, that is shifting from debt finance to equity finance as the share premium is a low cost fund.

As far as information disclosures through prospectus for Euro issue is concerned, an Indian company came out with 365 pages book disclosing as much informations as it could, but for Indian market the issuer companies reveal as little as possible. Further, SEBI desires that the lead managers should `justify' the premium being charged in the prospectus How far the lead manager has fulfilled these expectations ?

Becasuse, justification of premium is purely subjective one, since no specific model is to be followed while deciding offer price

4 7 SURVEY OF MERCHANT BANKERS

The survey of merchant bankers was carried out with a view to incorporate practical aspects and views for fixation of premium in the study. First of all a questionnaire for merchant banker was desiged The copy of the questionnaire was sent to all the category one merchant bankers/lead managers As none of the merchant bankers/lead managers replied, two reminders were issued to each one. It did not yield any response So a personal visit at Bombay was made with a view to carry out survey

During the course of personal visit, it was observed that except Grindlays Bank, none of the merchant bankers replied immediately Similarly, most of the merchant banking firms located at Baroda was contacted personally, but their replies were not received at all In the same fashion, the copy of questionnaires were also sent to all the merchant bankers stationed at Ahmedabad, New Delhi, Bangalore, Madras etc But the researcher regret to state that the response was very poor

The questionnaire consists of 15 questions, out of which five questions are introductory As the question number six and seven are data demanding, the respodent merchant bankers have not replied the same. The question number eight to fifteen are very much related to the share premium fixation. Hence our interpretation will start from the question number eight only.

The question number eight was related to financial factors which are directly or indirectly important in determination of premium. There were eleven factors to be ranked in order of importance by the merchant bankers All of the merchant bankers unanimously ranked Earning Per Share as the most important factor affecting the share premium. The next most important financial factor affecting the premium fixation is Net Asset Value (NAV) 89 00% of the responding merchant bankers rated NAV as next important factors In order of importance the next important factor was Price Earning Ratio with 67 00% weightage Of the total number of respondent merchant bankers, 55.00% considered consistent dividend records, growth of the company,book value per share and Return on Investment as the most important factors While profit projections, Net Worth, Return on net worth and Return on total assets were considered less important by 33 00% of the merchant bankers.

The question number nine was related to the ranking of non-financial factors which affects determination of premium The foreign exchange earnings of the project/company and export projections were unimportant factors. Promoters group (it's collaborator, equity participating company etc.) and past performance of the company were the most significant non- financial factors affecting determination of premium 78 00% of the merchant bankers were of the view that the next important factors were earning capacity, diversification, modernasation and expansion programme of the company

According to 55.00% of the merchant bankers, corporate image and importance of industry was moderately important. Management Philosophy and maketability of the product were less important factors affecting the premium fixation

In response to a question related to the method or formula used for premium fixation, 67.00% of the respodents replied that they use CCI formula for premium fixation, while 11.00% responded that they use NPV and CAPM method Remaining 22 00% of the merchant bankers did not reply the question.

As regards consulting financial institution or SEBI, while determining premium, more than 50 00% of the merchant bankers replied that they do consult SEBI and financial institutions while fixing the premium. The 33 00% of the merchant bankers do not consult SEBI and/or financial institutions

Replying to the question related to the factors that are being taken into account while fixing the premium for the public issue of new company, Profit projections (10.00%), promoter's background (27 00%), marketing of and demand for the product, existing growth rate of the company etc are considered.

As regards, the criteria for premium fixation for existing companies, financial parameters like Net Worth, Earning per Share,Book Value per Share etc (10.56%), past performance (13 00%), stock market price (10.87%), future profitability (18 70%), marketability and promoter's background(6.50%) are taken in to account.

As regards Investors tendency, 55 55% of the respondents stated that they do consider the same while fixing premium, but more than 30 00% of the merchant bankers did not replied on this aspect One of the mechant banker also replied that they do not pay attention to investor's tendency

In response to the question relating to CCI formula, all of the merchant bankers / lead managers stated that even in free pricing era they do consult CCI formula for premium fixations One of the question was related to Government policy, in response to which 77.00% of the respodent stated that changes in the Government policy do affect share premium fixation, while remaining merchant bankers replied negatively

As regards question on simultenous issue, majority of them stated that, simultenous Public/ Right/ FCD issues of different company/firms do affect the premium fixation for these companies While 33 00% of the respondent stated that it do not affect the share premium fixation.

On the basis of the above survey it can be conclude that certain significant financial and non-financial factors do affect share premium fixation either directly or indirectly Most surprising point is that the repealled CCI formula even though criticised at large hold good to date The shortcomings of the CCI formula can be removed by appropriate amendments.The modified CCI formula can be adopted by SEBI to put a check on disproportionate premium charged by the merchant bankers

4 8 EXPERT'S OPINION[2]

To have the practical views, some of the leading experts engaged in this field were contacted and their views were solicited These are reproduced here.

As far as deciding the offer premium, N J Zaveri, Chairman, I-Sec feels "the lead manager is responsible. The considerations for fixing the premium are fundamentals of the company and the promoters Promoters who have never gone public but have an enviable track racord like Jayanth Dychem and Indian Oxygen had been in existance for the past few decades have firm fundamentals".

The feeling amongst leading merchant bankers are that their community would not like "any company whether new or exlisting one to approach the capital markets unless it's project is appraised by SEBI registered appraisers In order to instill credibility to the appraisals, it is suggested that equity participation in the capital formation by the concerned appraisers,should be for a lock-in-period of atleast one year Shri G C Garg, Managing Director,LLoyd Finance goes a step further and suggests that the institution of an `issue agent' similar to that of an agent in syndicated loans abroad may be developed who would release "quarterly follow-up reports on promises made by the issuer company in the prospectus, the progress in the implementation of the project and other material developments affecting investments"

Neeraj Batra, President, Hinduja Finance states that, "long term price movement of securities and volume of trading should be disclosed in the prospectus"

The right quality of promoters,allied and viable projects, proper applied technology, correct positioning, less exhibitions of futuristic grandeur at the cost of present stands are all critical catalysts in the success of issue

According to N T Vaishnav, Chairman, V.M C Project Technologies,Vadodara, "the pricing should be independently certified by statutory auditors or SEBI appointed auditors" According to Arvind Shah, Underwriter to issues and former president PSE,

[2] Dalal Street Journal,April 17-30,1995 P No 20-21

"Rating of public issue will act as an automatic control on the premium the companies charge"

According to Vinodkumar Gupta, President, PSE,"Pricing should be done closely to the issue time,stipulation that a share must be listed for a minimum period of say 3 to 5 years,must be introduced"

According to Vijay Bhushan of Bhushan & Co.,Delhi,"price rigging prior to an issue is an accepted phenomenon...free pricing has led to unjustified premiums".

According to V K Sharma,Vice President (Merchant Banking) Annagram Finance, Ahmedabad,"Most often companies and marchant bankers make the price look attractive by rosy projections by willfully wilthholding certain vital informations,otherwise,would throw a spanner in the work Hence,merchant bankers are equally responsible for misleading the investors".

According to Lata Chakravarthy, Asstt Vice-president, South Times Guaranty Financials "due to stiff competition, companies select the merchant bankers who accords the highest premium for the issue leading to unrealistic high premia".

Dr Jayantilal Shah, chairman, Market Creator states, "premium does not decide the success of a particular issue but the prevailing market sentiment does A lead manager plays a vital role in fixing the premium but some merchant bankers accept the premium demanded by the client,in order to get larger slice of the cake. They are not only doing injustice to the investors but also ill-advising clients. More than SEBI regulations emphasis should be on investor`s educations".

According to Dr Alok Puranik, Earning Per Share,Net Sales Per Share, Dividend Per Share do influence share price (and share premium). But they are not the only factors ,Infact other illogical and irrational factors do affect sh

are price (and share premium) in Indian context