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Euro Issues & Indian Primary Securities Markets: An Empirical Study

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Abstract:

Before liberalization of the Indian economy, resource mobilization from the primary market was low but in the early nineties it gradually increased as many big projects were launched. Many reforms were taken place in the primary market after establishment of SEBI in 1992. After that Indian firms are allowed to raise capital from international markets from 1992 in the form of ADR, GDR AND ECBs. At the same time it has an impact on domestic issues also. The main objective of this paper is to examine the explanatory power and the impact of EURO ISSUES on primary securities market activities in India during the post- reform period. Annual data from 1992-93 to 2013-14 have been used in case of variables EURO Issues and resource mobilized form the domestic primary market, through the issue of IPO, FPO, CCPs and debts. For the purpose of the analysis of the date correlation coefficient and regression equation is estimated through ordinary least square methods. Analysis revealed that internationalization of Indian capital market enables Indian firms to raise capital from abroad. It has been found that there is a positive impact of EURO issues on the development of domestic market. The value of R^2 (0.403) and adjusted R^2 (0.373) are significantly different from zero and the parameter of explanatory variable is significant at 1% level. It shows that more than 37% variation in the dependent variable is explained by EURO issues.

Keywords: New Capital Issue, EURO Issue, SEBI

1. Introduction

The main function of primary market is to facilitate the transfer of resources from savers to entrepreneurs for starting a new enterprise or for the expansion or diversification of the existing one. It does not have any organizational set up in any particular place and is recognized only by the specialist institutional services that it renders to the borrowers of capital funds at the time of any particular operation. New issues can be classified in various ways. The first categories of new issues are by new companies and old companies. This classification was suggested by R.F. Henderson (1951). The distinction between new also called initial and old also known as further, does not bear any relation to the age of the company. The securities issued by companies for the first time either after incorporation or conversion from private to public companies are designed as initial issues, while those issued by companies which have stock exchange quotation, either by public issue or by rights to existing shareholders are referred as further or old (Khan, 2005). Indian capital market received a special attention under the new economic policy. Reforms in the securities market, particularly the establishment of SEBI, abolition of Controller of Capital Issues (CCI), market-determined allocation of resources, market-determined interest rate structure have greatly improves the regulatory framework and efficiency of the Indian primary market. The trend towards the internationalization of financial markets has started after establishment of SEBI. The term 'Euro Issue' denotes that the issue is made abroad through foreign currency denominated securities and the securities are listed on any overseas stock exchange. Therefore, Indian firms are allowed to raise capital from international markets from April, 1992 in the form of American depository receipt (ADR), Global depository receipt (GDR) and foreign currency convertible bonds (FCCBs). Many companies have been looking beyond their domestic financial markets, in an effort to enhance their global presence. International capital market played an important role for financing the growth of the emerging market economics¹. At the same time, it has an impact on domestic issues also.

Indian companies, who are interested in raising funds through foreign listing, must obtain prior permission of the Department of Economic Affairs, Ministry of Finance, and Government of India. An issuing company seeking such permission was required to have a consistent track record of good performance for a minimum period of three years. However the mandatory requirement of three years track record was relaxed for infrastructure sectors, such as power generation, telecom, airports, roads etc. These motivated foreign listing during 1996-97.

In this paper an attempt has been made to investigate the impact of EURO issues on domestic new issue market in India. The study is divided into seven sections. Objectives of the study are pointed out in section 2. Databases are mentioned in section 3. Methodology is

¹ Emerging markets - International capital raising trends, 2010

discussed in section 4. Section 5 is highlighted the primary market scenario. Empirical results are shown in section 6. Section 7 concludes the study.

2. Objectives of the Study

The main objective of this paper is to examine the explanatory power and the impact of EURO ISSUES on primary securities market activities in India during the post- reform period.

3. Database

The study depends exclusively on secondary data. Secondary data are collected from the SEBI Bulletin and Annual Reports, Hand Book of Statistics on Indian Economy of RBI, RBI Annual Reports and various reports published in financial journals, financial magazines and NSE & BSE websites. In this study, annual data from 1992-93 to 2013-14 have been used in case of variables EURO Issues and resource mobilized form the domestic primary market, through the issue of IPO, FPO, CCPs and debts.

4. Methodology

With a view to accomplish the stipulated set of objective of our study, correlation co-efficient is calculated to analyse the relationship between the primary market and EURO issues. Finally the regression equation is estimated through Ordinary Least Square (OLS) method with the help of E-views statistical package.

The regression equations estimated by the OLS method is given as:

$$NCI = \alpha_1 + \beta_1 EURO + \epsilon_1 \text{ ----- (1)}$$

Where,

NCI= Resource Mobilized in the Primary Market,

EURO = Resource Mobilized in International Market, through ADRs, GDRs FCB

α_1 = Constant terms; ϵ_1 = Random Error Terms

Hypothesis:

The testable hypothesis of our research is:

- H_0 : There is a relation between domestic primary market and EURO issues
- H_1 : There is no such relationship between domestic primary market and EURO issues.

5. Primary Securities Market Scenario

Before 1992, Indian firms were required to obtain approval of Controller of Capital Issues (CCI) for raising capital. Only existing companies with substantial reserves were allowed to issue shares at premium whereas new companies were allowed to issue shares at par value only. Abolition of CCI Act in May 1992 allowed firms to price their issues freely. This resulted in a sharp increase of capital mobilized through equity related instruments. The funds mobilized from primary market increase sharply from Rs. 5562.53 crore in 1991-92 to Rs. 27,633 crore in 1994-95. However, the trend declines drastically in the subsequent years are shown in Figure 1.

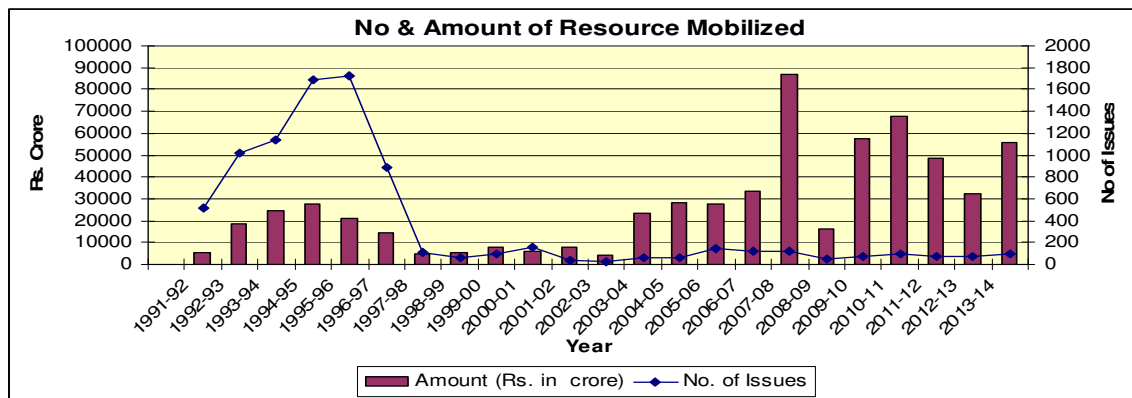


Figure 1: Total Resource Mobilization from Primary Market
Source: Compiled by Author

During the period from 1995-96 to 1997-98, large numbers of companies who raised funds from the capital market subsequently disappeared. As a result, a huge number of investors got lost their investments and confidence over primary market and they preferred in bank deposits, safe retirement instrument insurance schemes. As a result, the number of IPO, rights issue, etc. declined during the period 1997-98 to 2002-03. From 2003-04, onwards resource mobilization from primary market was showing increasing trend, except the year 2008-09, due to global financial crisis, though the total fund mobilized higher than the year 1996-97 to 2002-03.

With the opening up of the financial markets, Indian companies joined the worldwide rush to raise capital by issuing Depository Receipts. The first Indian company who raised fund through issue of GDR was Reliance Industries Ltd. in November 1992, on Luxembourg Stock Exchange.

It has been found from the Chart-2 below that fund raised in domestic market and in foreign market increased in the post liberalization period. Fund raised in international market may have a positive or negative impact based on the development of the domestic market liquidity (Levine and Schmukler, 2006).

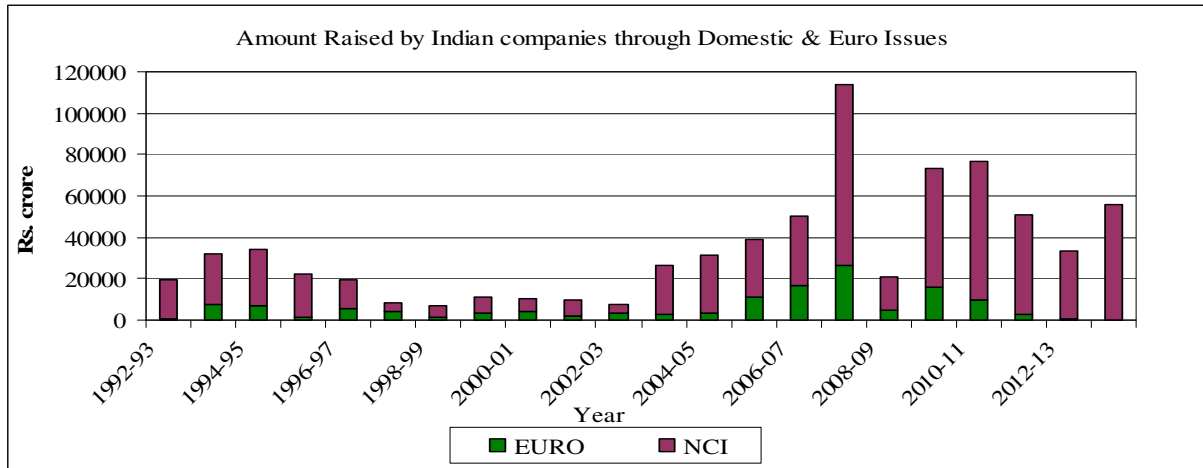


Figure 2: Capital Raised in Domestic and International market
Source: Compiled by Author

6. Empirical Results

In this section, we have analyzed the relationship between the domestic primary market activity (NCI) and EURO issues (EU), based on data for the period from 1992-93 to 2013-14.

Table-2 shows correlation among the variables under study.

		NCI	EU
NCI	Pearson Correlation	1	.634**
	Sig. (2-tailed)		.000
	N	21	20
EU	Pearson Correlation	.634**	1
	Sig. (2-tailed)	.000	
	N	22	22

Table 2: Correlation

** . Correlation is significant at the 0.01 level (2-tailed).

From the above table it has been found that NCI is significantly correlated with the EURO issues and significant at 1% level.

6.1. Regression Analysis

We have examined the primary market activity in India against the resource mobilized from the international market, through regression techniques (mentioned in methodology section).

6.1.1. Findings

Regression Results

Dependent Variable: NCI				
Variable	Coefficient	Std. error	t-statistic	Probability
Intercept	8652.088	4910.895	1.762	0.012
EURO	2.200	0.599	3.673	0.001
R-square	0.403	F-Statistic		49.04
Adjusted R-square	0.373	p-value		0.001

Table 3: OLS estimates

Hence, the parameters of the explanatory variables are significant and signs as desired. The value of R² (.403) and adjusted R² (0.373) are significantly different from zero and the parameter of explanatory variable is significant at 1% level. It shows that more than 37% variation in the dependent variable is explained by EURO issues.

The regression result in this study shows that there is a statistically significant relationship between primary market activities in the post liberalization era with the EURO issues. So, we accept our null hypothesis that the primary capital market activity is influenced by the EURO issues.

7. Conclusion

Resource mobilization from the primary market increases in the post liberalization period. The primary markets were badly affected due to Harshad Mehta scam, Demat scam and companies who tapped investors and raised finance, subsequently disappeared. These were affecting the investors' sentiment in domestic market. The internationalization of Indian capital market, enable Indian firms to raise capital from abroad. In India, there is a positive effect of EURO issues on the development of the domestic market. We conclude that when Indian firms raised fund from foreign market after meeting international disclosure standard, it creates a good impression on domestic market.

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