

# The Decision to Go Public: Does Business Group Affiliation Matter?\*

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## Abstract

We examine how Business Groups (BG) differ from their standalone counterparts in assessing the costs and benefits of going public using a comprehensive sample of stock market listings from 2000 to 2014 in India. This paper elucidates the dynamics of the going public decision by BGs (with multiple unlisted affiliated firms) as extant theoretical models fail to adequately explain the same. We examine the relative importance of reputation, risk sharing, capital raising and control considerations in the decision to go public. We study the investment behavior of BG firms to changes in investment opportunities subsequent to listing, as compared to listed standalone entities.

**JEL Classification :G30,G32**

**Keywords :Public Offering (IPO), Going Public, Business Groups, Internal Capital Markets, Reputation, Investment Decisions**

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# 1 Introduction

Going public is a landmark event in the life of a firm; often described as the first stage in the sale of the firm (Zingales, 1995). The shares of a company hitherto privately held are quoted on a stock exchange for the first time subsequent to an Initial Public Offering (IPO), and become available for trading in the secondary market. Once listed, the firm is mandated to comply with an extensive set of regulations and disclosure requirements. Thus when the firm chooses to list it allows itself to be subjected to increased compliance costs and heightened scrutiny by capital market participants, in return for access to more avenues of capital raising.

Multiple studies examine the going public decision of firms from the standpoint of costs and benefits of the decision. The major findings inform us that firms go public to lower the cost of capital (Maug (1998)), to increase financial visibility (Mehran and Peristiani (2010)), to enhance reputation, to have a currency for acquisitions (Brau and Fawcett (2006), Bancel and Mittoo (2009)), for the diversification of major shareholders (Chemmanur and Fulghieri (1999), Mello and Parsons (1998)) etc, to name a few. The literature on Business Groups (BG) is also considerably vast, having grown manifold since Khanna and Palepu (2000) defined these entities as ‘a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated action’. Multiple facets of group affiliation, viz., the performance effects (Zattoni et al. (2009)), the tendency to tunnel funds from affiliates (Bertrand et al. (2002)), the provision of financial support in times of distress (Gopalan et al. (2014)) etc. are well documented in literature. In this paper, we seek to bring together these two streams of literature, one pertaining to the going public decision and the other pertaining to Business Groups. We analyze what differentiates a group firm from a standalone firm in its going public decision, and how a group firm selects the affiliate to go public. We intend to address this issue by examining a comprehensive sample of listings that happened in the Indian capital market from 1996-2014.

India’s primary capital market has seen many ups and downs in the past 25 years. Capital mobilization in the post 1991 period received a breather

from the multitude of restricting rules which threatened to stifle growth and development<sup>1</sup>. The post-liberalisation era witnessed a "hot issue" period, with more than 4000 firms accessing the market for the first time and raising capital to the tune of approx. Rs.41319 crores.However,the market collapsed in the period between 1997-2002 (Shah and Thomas (2001)).Major scandals during the period ushered in new Corporate Governance norms in the form of amendments to the listing agreement<sup>2</sup>. The IPO market became vibrant again post-2002,providing more than Rs.2.2 lakh crores over the decade, before experiencing a slump in 2008-09 due to the Global Financial Crisis.Equity fund raising was insipid in the past two financial years<sup>3</sup>,and the markets are again expected to revive in FY 2015-16.<sup>4</sup>

The Indian business environment is characterized by the presence of large business groups of which many are wealthy-family owned entities; marking their presence in areas as diverse as construction and manufacturing and retail and services sector.(Palepu and Khanna (1996);Ghemawat and Khanna (1998)).These firms typically have high concentrated ownership in their affiliates.The facility of taking joint actions enable the groups to exchange financial resources and pool managerial expertise within the group; and to appear as one large entity to the outsider(Granovetter (1995), Ghatak and Kali (2001),Fisman and Khanna (2004)).The internal capital market of Business Groups should thus provide sufficient cushion to BG-affiliated firms,especially in times of distress(Gopalan et al. (2007)).Still,in a survey of top executives of India's business groups,conducted by PricewaterhouseCoopers Pvt.Ltd.(PWC) in October 2013,14% of them had indicated availability

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<sup>1</sup>The Capital Issues (Control) Act,1947 (CCI) which regulated pricing of equities; the Industrial (Development and Regulation) Act, 1951 (IDRA)which mandated licensing of production activity ; the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP)which created barriers to industry consolidation; and the Foreign Exchange Regulation Act, 1973 (FERA) which restricted foreign ownership of Indian firms and Indian firms' internationalisation ; all were significantly diluted or repealed.

<sup>2</sup>The mispriced IPO and market rigging by MS Shoes Ltd,is one such case, which brought BSE to a halt in April 1995,<http://indiatoday.intoday.in/story/rigging-misinformation-by-ms-shoes-brings-india-premier-stock-exchange-bse-to-halt/1/290134.html>,accessed on 13.03.2015

<sup>3</sup>Companies raised a little over Rs. 6000 crores in FY 2012-13, and approx.Rs. 1205 crores in FY 2013-14 respectively.

<sup>4</sup><http://profit.ndtv.com/news/corporates/article-indian-companies-garner-rs-1-205-crore-via-ipos-in-2013-14-> accessed on 03.12.2014

of finance as an area of concern<sup>5</sup>. Access to capital figures as a challenge in charting future growth and evolution.

Studies examining various functional aspects of Indian Business Group (BG) firms are abundant, supported by theories of institutional voids or capability development (Carney et al. (2011)), but the literature appears to be relatively silent on how the BG affiliation impacts the going public decision. There is empirical evidence on tunneling and propping in BG-firms (starting with Bertrand et al. (2002); Friedman et al. (2003)), on the existence of internal capital markets and intra-group loans (Gopalan et al. (2007)) and on the strategic motives behind Initial Public Offerings (Larrain and Urzúa (2013); Chemmanur and He (2011); Colak and Gunay (2011); Chod and Lyandres (2011)). But there is paucity of literature in the area of how a dominant shareholder like the BG impacts the going public decision.

The second aspect that we consider in this paper governs the choice of the affiliate to go public. Unlike the entrepreneur taking her (single) company public, the BG has the choice of multiple firms under its umbrella, any of which it may take public. Here we perceive two opposing theories. Given private information about the affiliate firms, the BG may take its best firm public to leave a 'good taste' to the market participants. This is consistent with the argument of why underpricing continues to be the norm in IPOs (Ibbotson, 1975). Gomes (2000) finds that since realization of cash flows and trading of shares will continue to occur in the future for the firm that has gone public, managers with concentrated ownership do not stoop to expropriate the minority investor (once the firm is public), even in countries with weak corporate governance mechanisms. This 'good behaviour' ensures building-up of reputation that helps keep the stock prices up and the threat of expropriation down once the firm has gone public. In a similar vein, Durnev and Kim (2005) predict that firms with better investment opportunities, higher concentration of ownership and greater needs for external financing practice better corporate governance and are significantly more likely to do so in weaker legal regimes. Given that firms are likely to access capital markets multiple times over their lifetime, they would tend to carefully create and pre-

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<sup>5</sup><http://www.pwc.in/publications/family-business-survey/index.jhtml>, accessed on 19.08.2014.

serve their reputation, and are unlikely to take actions that incur the wrath of sources of external financing. [Chemmanur et al. \(2012\)](#) also document that the quality and reputation of a firm's management by virtue of their continued interactions with the financial and labor markets can have a certifying effect on firm value. Since reputation is important, listing the firm with the best opportunities serves to ensure support for subsequent listings of group firms in the near future.

Conversely, it may be argued that it is in the group's best interests to retain the firm (with the excellent investment opportunities) as private, so that the BG can continue to extract private benefits. [Dyck and Zingales \(2004\)](#) document that higher private benefits of control are associated with less developed capital markets and more concentrated ownership. This might indicate that the firm with the brightest prospects would remain private, while a lesser able group-affiliate would find its way to the capital markets.

Examining the impact of group affiliation on the decision to list is important for two reasons. One, business groups dominate the Indian economic landscape ([Marisetty et al. \(2008\)](#)). Two, since the affiliate-firms have access to funds and resources from within the group (which a standalone does not), it is interesting to examine the motivation behind these firms seeking access to capital beyond the group-fold. Also, Indian businesses have been subject to major economic and institutional changes over the years, since the policy reforms of the 1990s ([Bhattacharyya and Rahman \(2003\)](#)). The changes in the institutional framework and the interplay of cash flow and control rights in the group make the problem worth examining.

This paper is divided into five parts. The following section presents an overview of the literature and development of hypotheses, Section III provides the data and methodology and Section IV discusses the preliminary results.

## 2 Literature Review & Hypotheses Development

Traditional corporate finance documents that the primary motive of going public is raising equity capital to fuel growth. Several other explanations including liquidity, visibility benefits, reduction in cost of capital, currency for mergers and acquisitions have also emerged ([Tirole \(2010\)](#)). Empirical studies to investigate the veracity of proposed theories are scarce, owing to non-availability of data on private firms that are eligible to list but choose to remain private ([Albornoz and Pope, 2004](#)). Available evidence on the going public decision is broadly divided into two streams, one involving statistical analysis of financial parameters and macro-economic conditions to understand the motivations of the going public decision and the other, involving managerial surveys to gauge practitioner perspectives on the listing decision. The statistical studies are discussed first, followed by managerial survey papers.

Analyses of financial parameters has typically centered around the benefits and costs associated with listing. The seminal paper that examined the motives of the going public decision is [Pagano et al. \(1998\)](#), where the authors compared 69 firms that listed in the Italian Stock Market between 1982 and 1992 with 12,391 companies that were eligible but chose to remain private during the period. They found that firms list to rebalance their capital structure after a period of high investment and growth and not to obtain financing for growth. The authors found a positive relationship between firm size and stock market valuation of the firm's industry. They also note that the typical Italian firm that undertook an IPO was found to be eight times as large and six times as old as a U.S. firm.

While [Pagano et al. \(1998\)](#) used a probit model to uncover the differences between listed firms and those that remained private, [Boehmer and Ljungqvist \(2004\)](#) use a hazard analysis of factors that decide the time at which a firm goes for IPO. They observe a set of 330 privately held German firms between 1984 and 1995 from the day of IPO announcement to the IPO day, a period ranging from two years to more. They utilise the fact that IPO announcements in Germany happen at an early stage in the process and the

event much later. They find that more companies will go public when outside valuations are high or have increased and when uncertainty about their future profitability is high. They also document that firms whose controlling shareholders enjoy large private benefits of control are less likely to go public.

Albornoz and Pope (2004) examine the going public decision in UK, by investigating 525 public firms that listed on the Main Market and 305 firms that listed in the Alternative Investment Market<sup>6</sup> of the London Stock Exchange between 1990-2000. They find that IPO probability depends positively on firm size and stock price levels but is negatively related to leverage and profitability.

While Pagano et al. (1998) documents rebalancing as the primary motive for an IPO, Kim and Weisbach (2008) finds that funds raised in an IPO are more likely to be used for investments in R&D and capital expenditure, or to augment cash holdings. Contrary to Pagano et al. (1998), they find that debt reductions and acquisitions are more likely to be financed from internally generated funds as against capital raised through an IPO.

Chemmanur et al. (2010) use a probit model to investigate the relationship between product market characteristics and the going public decision. They find that a private firm's total factor productivity, size, sales growth, market share, capital intensity, competitiveness of its industry and riskiness of cash flows impact its decision to list, once the access to bank debt and venture capital are controlled. They also report that firms with less information asymmetry and which host projects that are less costly for investors to evaluate are more likely to go public. Performance characteristics as revealed by sales, capital expenditures etc. steadily increase in the years before and after the IPO. They find that the total factor productivity and sales growth exhibit an inverted U-shaped pattern with the IPO happening at the time of peak performance by the firm.

Breinlinger et al. (2002) evaluate the macroeconomic factors that influence the going public decision using a data set of annual observations of IPO volumes for six continental European countries over a period of 18 years

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<sup>6</sup>AIM is the London Stock Exchange's international unregulated market for smaller growing companies, Source: Website of the London Stock Exchange, <http://www.londonstockexchange.com/companies-and-advisors/aim/aim/aim.htm>, accessed on March 11, 2015

(1980 to 1997). The study uses stock index returns, changes in savings deposits, gross domestic product (GDP) growth and interest rates to proxy for the macroeconomic environment. While stock index returns were found to contribute positively to the probability of listing, the other three variables did not seem to exert perceivable influence on demand for raising equity.

Some studies have explored how long firms survive in the capital market once listed. Since the decision to delist can provide insights into why firms go public, studies on the delisting decision are worth analyzing. While the concept of tapping the equity markets when valuations are high has always been considered as a motive for listing (Pagano et al. (1998)), it is notable that not all firms that make it past the IPO-stage continue to remain in the public domain. The reasons for the firms' exit from the capital markets stem from their past performance. Some important studies on delisting are discussed below.

Fama and French (2004) study the survival rates of IPOs of two cohorts of 1970-79 and 1980-2001 and find that the number of entities that remained afloat for 10 years post-IPO declined drastically from 61% for the 1973 cohort to 37% for the 1991 cohort. In their sample, two-fifths of the firms that rushed to take advantage of a favourable market valuation, delisted within 10 years due to deteriorating operating performance. Jain and Kini (2006) echo a similar sentiment examining the industry clustering effects of the IPO. High investment, high R&D firms which enjoy considerable investor support go for IPOs together at the same point in time. But subsequently, many tend to record poor operating performance owing to too many firms chasing the same investment opportunities. Peristiani and Hong (2004) document that if firms had negative pre-IPO performance, they were thrice as likely to exit from the public domain, in their analysis of a sample of US IPO Companies from 1980 to 2000.

Exploring the reasons behind IPOs taking place in 'cold' markets, when generally the valuations are dull and there is no capital offtake, Prenti and Madura (2013) document that IPO-firms are those whose earnings are at a peak and are expected to subsequently decline. These firms are likely to have indulged in earnings management prior to the IPO. They find that investment opportunities, the backing of a venture capitalist, long-term op-



erating performance and an increase in earnings in the year prior to IPO lead to significantly higher long-term stock price performance once the firm is listed. Pre-IPO operating performance emerges as a critical criteria relevant not only for the listing decision, but also as a measure of the ability of the firm to remain listed.

Managerial surveys examine the motivations of listing decision by documenting perceived needs of the firm at various points in time. [Ravasi and Marchisio \(2003\)](#) combine results of a survey of 57 Italian IPOs with evidence from a set of 7 preliminary case studies to understand the non-financial motives behind the listing decision. They conclude that going public supports the firm in its capital needs but also increases its visibility, prestige and perceived trustworthiness. A listed firm begins to enjoy stronger ties with its customers, forges better strategic alliances and renews and improves its corporate image. Listing thus provides a host of other substantial benefits aiding entrepreneurial activity and supporting long-term growth by enhancing the firm's social capital.

[Brau and Fawcett \(2006\)](#) conducted a survey of 336 CFOs of US firms to find out the managerial perception. These firms were in three stages—some having completed their IPO, some which were eligible but chose to remain private and some which had initiated the IPO process only to recall it later. They found that the overwhelming motive of going public was the creation of shares to be used as currency for future acquisitions, closely followed by the need to establish a market value for the firm. Enhancement of company reputation, broadening the base of ownership, diversification of principal stakeholding, minimizing of cost of capital, allowing venture capitalists an exit option, obtaining analyst coverage, reduced private equity funding and an increased cost of debt were found to be additional factors motivating the listing decision.

Since delisting occurs as a result of failure to achieve the motives behind listing [Bharath and Dittmar \(2010\)](#), surveys examining the delisting process have also been reviewed. [Block \(2004\)](#) examine 110 US firms out of a total of 236 firms that went private between January 2001 and July 2003. They found that compliance cost of listing was the primary reason to go private. Other reasons uncovered include constraints on top management time and

resources, lack of analyst coverage, lack of adequate liquidity of shares, lack of flexibility in restructuring operations and the threat of delisting by the Stock exchange due to extremely low share values for extended periods of time.

[Mehran and Peristiani \(2010\)](#) analyze US firms that delisted between 1990 and 2007 to find that non-attainment of the perceived benefits of listing was the major cause of going private. Firms with declining growth in analyst coverage, falling institutional ownership, and low stock turnover were found to go private sooner. Lack of financial visibility and investor interest and availability of free cash flow without necessary growth opportunities forced companies to retreat from public markets.

The major determinants of listing as indicated by prior research is presented in a summary below. We also present the hypotheses that emerge out of the literature review, in comparing eligible firms that go public versus eligible firms that choose to remain private.

**(A) Lowering the cost of capital**

The trade-off theory of debt predicts that firms can continue to accumulate debt in their balance sheets until the costs of bankruptcy exceed benefits of interest tax shields. The overall cost of capital initially decreases with debt, but leverage beyond a limit increases the cost of capital. [Modigliani and Miller \(1963\)](#) and [Scott \(1976\)](#) predict that firms go for equity infusion in order to minimize their cost of capital. [Diamond and Verrecchia \(1991\)](#) notes that when a firm issues new shares, and there is an increased possibility of liquidity, the cost of capital comes down. [Diamond \(1991\)](#), in analyzing the incidence of bank loans versus commercial paper, documents that firms with higher credit rating enjoys lower cost of capital. A firm going public gains financial visibility ([Mehran and Peristiani \(2010\)](#)) and hence would enjoy lower cost of capital.

**(B) Financing for growth**

Firms that go public raise capital to finance high growth and future investments. Due to high levels of current leverage, they may not wish to increase debt ([Pagano et al. \(1998\)](#), [Huyghebaert and Van Hulle \(2006\)](#)).

Therefore firms that go public tend to have high leverage levels and report higher sales growth.

(C) **Reduction in leverage**

Pagano et al. (1998) finds that the reason firms go public to rebalance their capital structure after a period of high growth. This means that firms that go public will have higher levels of leverage than an eligible private peer.

(D) **Diversification of Risk**

Huyghebaert and Van Hulle (2006) examine the factors that affect the proportion of primary and secondary shares in a sample of Belgian IPOs. The entrepreneur have invested the initial capital for the firm. When a risky project comes along, financing becomes a problem. This is because the project may not yield sufficient cash flows in the near future to make interest payments, thus ruling out the possibility of debt. Venture capitalists would demand a premium and increased control for investing in a risky project. Therefore the best option available to the firm is the issue of equity. Further, going public enables the owners to diversify their holdings (Pagano (1993), Zingales (1995), Chemmanur and Fulghieri (1999), Gomes (2000)). We therefore expect promoter ownership to decline with the going public decision.

(E) **Liquidity and visibility**

Firms go public to possess shares that can become currency for acquisitions (Brau and Fawcett (2006)). Diamond and Verrecchia (1991) note that the disclosure norms that accompany listing promote future liquidity of firm's shares, and this reduces the cost of capital for the firm. The reduction in cost of capital is more for larger firms. Therefore, we expect firms that go public to be larger than their counterparts, a feature that helps them gain greater liquidity and trading volume once the shares start trading.

(F) **Profitability**

Pagano et al. (1998) highlights that firms list when uncertainty about their future profitability is high. Premti and Madura (2013) also finds

that firms go public when their current profitability is high, and their performance is at a peak. Therefore, we expect going public firms to be more profitable. Since such firms are likely to have been around for a longer time, their age is also likely to be higher than their counterparts that remain private.

#### (G) Market valuation

Consistent with the ‘windows of opportunity’ argument (Myers and Majluf (1984), Dharan and Ikenberry (1995)), firms are more likely to go for an IPO when they perceive themselves to be overvalued. Ritter (1991) also documents that the number of firms in a particular industry accessing the equity market increases when the industry is overvalued. Therefore, we conjecture that firms that go public are likely to possess greater market-to-book-ratios than other eligible firms that choose to remain private.

### 2.0.1 Business Groups

The Indian business environment is characterized by the presence of large conglomerates of which many are wealthy-family owned entities; marking their presence in diverse avenues, like manufacturing, telecommunications, construction, engineering, textiles, utilities and retail (Ghemawat and Khanna (1998), Ward (2000), Marisetty et al. (2008)). Khanna and Palepu (2000) define a business group (BG) as ‘a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated action.’ These establishments are called ‘*Business Houses*’ in India, emphasizing the close family and relational ties that bind the group (Carney et al. (2011)). We examine the Indian BG architecture from the perspective of the going public decision. A BG, as mentioned before, is formed of legally independent firms that are held together under a common umbrella. Many BG firms have a group-center that oversees, co-ordinates the actions and puts to common use the pool of resources and human talent available across its affiliates<sup>7</sup>. The ties that hold the firm

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<sup>7</sup>For eg., See how Tata developed its low-cost water purifier, Swachh by collaborating three different affiliates, Tata Consultancy Services (Information Technology services), Tata

together and the facility of taking joint actions enable the groups to exchange financial resources, and pool managerial expertise within the group; and appear as one large entity to the outside world. It is therefore likely that the decision to take a BG firm public is done at the apex level, with the choice being made from a number of eligible affiliates.

[Granovetter \(1995\)](#) highlights BG-ownership provides a guarantee for contract enforcement within group firms reducing information asymmetry. In one of the earliest papers on Indian Business Groups (IBGs), [Ghemawat and Khanna \(1998\)](#) supplement this argument. They document that the reason why IBGs flourished is attributable to the twin issues of policy distortions and lack of well-developed institutional frameworks and labor markets in India. In a scenario where capital and other resources were severely constrained, staying together as one entity and diversifying into unconnected businesses ensured access to credit; and aided survival and growth of the group. They observe that when unrelated businesses are grouped, access to 'outside capital' can improve as it reduces the variability of cash flows, the probability of financial distress and the costs of bankruptcy. Internally, these groups would allocate capital better owing to their ability to extract sensitive non-disclosed information about an affiliate. This allotment of funds would occur at the lowest possible transactional costs. They also indicate that a reputation for excellent capital administration within the group supports generation of outside capital.

[Khanna and Palepu \(2000\)](#) find that group affiliation offers Indian firms the ability to 'internally replicate the functions' performed by standalone intermediary institutions in more advanced capital markets like the US. It is easier for such firms under single ownership to utilize their expertise and reputation to form an internal venture capital fund to finance new projects. [Ghatak and Kali \(2001\)](#) argue that financial interlinkages between group entities helps to solve the problem of credit rationing due to information asymmetry. When a member firm is likely to default on an external loan, the better-off group members chip in to save the sinking member. They also highlight that BG firms will tend to portray similar characteristics be-  

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Chemicals (Chemicals and Fertilizers) and Titan (Watches and Jewellery) in [Ramachandran et al. \(2013\)](#)

cause a low-risk group member will not like to add a high-risk borrower to its group. [Fisman and Khanna \(2004\)](#) postulate that in the absence of well-developed capital markets, the many unrelated businesses within a BG ensure a smoother internal cash flow as compared to a focused business. This gives the BG the confidence to undertake ambitious investments which otherwise it would rationally let go of. [Ayyagari et al. \(2009\)](#) document that new projects are likely to be housed within an existing BG firm in the same industry. They also present that these firms are more likely to be larger and more profitable than other listed affiliates. We seek to supplement this argument by conjecturing that these are also likely to be the firms that ultimately go public from within the group-fold. Thus given these characteristics of strong group ties, an internal capital market to incubate ideas in, support to the group members in times of distress, and projection of a stable image to the external world, we conjecture that

***When compared with standalone firms, the BG affiliated firms that go public are larger, older and more profitable.***

Product Relatedness is defined as the extent to which a group's different lines of business are linked ([Peng et al. \(2005\)](#)). [Chatterjee and Wernerfelt \(1991\)](#) document that consistent with the free cash flow hypothesis ([Jensen \(1986\)](#)) firms with higher leverage need to approach capital markets for funding where they will be subject to greater scrutiny. Since capital markets are wary of unrelated diversification, external funds are less likely to be available for unrelated projects. [Kedia et al. \(2006\)](#) find that the evolution and transformation of Indian Business Groups can be characterized into two eras; the pre-reform era (pre-1991) and the reform era (post-1991). The pre-reform era corresponds to the period when BGs grew manifold pursuing unrelated diversification and the post-reform era witnessed focusing of businesses and led to related diversification. [Kali and Sarkar \(2011\)](#) find that the closer an affiliate's activity is to the core (highly related), ownership-control wedge (wedge between control and cash-flow rights of insiders) is higher. Therefore, we conjecture that,

***The greater the degree of relatedness of an affiliate to the core firm, the more likely it is to be chosen for listing.***

Regarding how a BG may utilise the funds accruing to it through the

multiple affiliates under its wing, prior literature provides two opposing view points. One is the expropriation of minority shareholders by the firm's concentrated ownership. [Bertrand et al. \(2002\)](#) document evidence supporting the tunneling of resources from firms where the owners have low cash flow rights to firms where they have higher cash flow rights. [Bertrand and Mullainathan \(2003\)](#) highlights how an ultimate owner uses indirect ownership to maintain control over a large group of companies. [Almeida and Wolfenzon \(2006\)](#) justifies the existence of pyramids as mechanisms that enable owners to use retained earnings of existing firms to set up new ones, and to share the firm's non-diverted pay-off with the original shareholders.

The opposing viewpoint emerges out of [Friedman et al. \(2003\)](#), where the authors highlight how a firm with possible growth opportunities and in financial distress is propped up by group firms. [Gopalan et al. \(2007\)](#) document that intragroup loans are used to transfer cash across group firms especially to support financially weaker firms. This helps to avoid default by a group firm and consequent negative spillovers to the rest of the group. In another documentation of group support, [Gopalan et al. \(2014\)](#) indicates that cash-rich group firms pay heavy dividends to owners, which gets invested in other affiliated firms. They postulate that group firms may distribute large dividends if affiliated firms have attractive investment opportunities that need financing. Given these two competing viewpoints we postulate that

***The greater the investment in a group-firm the less is its likelihood of being listed.***

[Gopalan et al. \(2007\)](#) contend that weaker firms in a BG are supported by the stronger affiliates through intragroup loans to avoid the possibility of default. They note that this action could be arising from a concern about projecting a negative image about the group due to default by a member firm. We conjecture that the capital markets value the "reputation" of the business group as proxied by the absence of any bankrupt firm in the group and so,

***If the firm's reputation (proxied by absence of bankrupt group-affiliate) is intact, the more is the likelihood of listing.***

### 3 Data and Methodology

Our paper bears close resemblance to [Pagano et al. \(1998\)](#), in that they evaluate the period when the Italian CONSOB (equivalent to the US SEC) was formulating the listing criteria and regulatory framework<sup>8</sup>. The two major national stock exchanges viz., the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE) follow the SEBI guidelines in determining the firms eligible for listing<sup>9</sup>. The firms eligible for listing in each financial year are chosen based on SEBI (Issue of Capital and Disclosure Regulations), 2009, which replaced the SEBI (Disclosure and Investor Protection Guidelines), 2000. (See Appendix 1 for detailed criteria). These include having distributable profits (excluding extraordinary items), a networth of INR 1 crore and Net Tangible Assets of INR 3 crores for a period of minimum three years prior to the listing date, among others. Any exchange-specific requirement demanded of a firm is over and above the SEBI guidelines and generally pertains to issue size, post-issue paid up capital requirements etc.

The financial data on firms that went for IPOs for the period from 2000 onwards, are obtained from the Centre for Monitoring Indian Economy's PROWESS database. The Prowess database has been used previously in many studies, viz., [Siegel and Choudhury \(2012\)](#), [Gopalan et al. \(2007\)](#). We use the Business Group (BG) classification provided by Prowess. CMIE tracks Indian business houses, changes in their structure and utilizes information about the family ties to arrive at this classification.

In [Marisetty and Subrahmanyam \(2010\)](#), the authors remark that there is ambiguity regarding the 'exact number of IPOs among the total public issues'. We therefore, obtain data initially from the websites of the two national stock exchanges, National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) to arrive at the listed firms for the Financial Year 2000-2014. Data on IPOs begins with February 8 1995 for NSE and from February 2 2002 for BSE. In order to avoid missing out on firms that were listed on

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<sup>8</sup>In India, the decade after the opening up of the capital markets in 1991 saw a series of high-value scams that led to the progressive improvement of the regulatory framework ([Shah and Thomas \(2001\)](#))

<sup>9</sup>The NSE was operationalised in November 1994, while the BSE is the oldest exchange in Asia, having begun in 1875. NSE began fully computerised screen based trading since inception and BSE followed shortly afterward.



the BSE prior to February 2 2002, we include data from a third source Thomson One, for the period from April 1 1999- February 2 2002. The NSE website provides 1104 firms, BSE website 490 firms and Thomson One provides 159 firms. The NSE-BSE website data are compared first to weed out duplication, 317 firms are common to both exchanges. The earliest listing date amongst the two exchanges is taken as the listing date[i.e. if a firm is listed on NSE in the sample period, but was listed on the BSE prior to April 1 1999, it is dropped from the sample]. This merged list was then compared with Thomson One. In case there were two entries pertaining to the same company, one of which came from Thomson One, and another from the exchanges, the date provided by the exchanges was taken, even if it was not the oldest date. This removal of duplicates yielded a sample of 1356 firms. The list was refined with removal of firms under Government or foreign ownership as the ownership structure of these entities was distinct from the aim of the study. Non-financial firms and those not under Government or Foreign Ownership that listed during the sample period were found to be 850. We then utilized a host of resources, viz., trading data available on websites of BSE and NSE, final offer documents available on the SEBI website, Annual Reports of the companies, Capital history and first trading date available in Prowess, PRIME Database, websites of leading business newspapers like the Hindu Business Line, Economic Times and Financial Express, and a website on IPOs viz., <http://www.chittorgarh.com><sup>10</sup> to ascertain if the listings were indeed Initial Public Offerings. Entries pertaining to demerger or scheme of arrangement, where listing of the new entity happened without raising capital, were removed from sample. IPOs which were subsequently withdrawn or cancelled were removed. Cases where the stock listed only on Regional Stock Exchanges were not included<sup>11</sup>. Firms for which financial statement data was not available for the year prior to listing were removed. Firms that are Small and Medium Enterprise(SME) entities were removed, as SEBI permits firms

<sup>10</sup>This website has been previously used in Brooks et al. (2014)

<sup>11</sup>The regional stock exchanges are on the verge of closure due to lack of turnover. Listing on the Regional Stock Exchanges was limited post-1997 <http://www.thehindubusinessline.com/markets/as-17-exchanges-face-closure-investors-in-over-3000-companies-could-be-left-in-the-lurch/article6493928.ece>, accessed on May 1, 2015.

to list on the SME Platform without an IPO. The final sample consisted of 461 firms with listing dates between April 1 1999 and March 31 2014. Of these 117 firms possessed Business Group affiliation.

To determine the influence of different factors like Size, leverage, growth in Sales, business group affiliation, profitability, RD expenses, market valuation, capex, and to control for industry and year effects, a panel Probit regression analysis is used. The dependent variable is  $LIST_{i,t}$ , a dummy variable that takes a value 1 if the company  $i$  goes for an IPO in the year  $t$  or chooses to remain private.

The variables included in the study are presented in Table 1.

TABLE 1	
VARIABLE	DEFINITION
BG	Dummy Variable =1 if firm is group-affiliated, 0 otherwise
LIST	Dummy Variable =1 if firm is listed in the Financial Year of analysis, 0 otherwise
SIZE	Natural log of total assets
AGE	Natural log of number of years since incorporation
INTANG	Ratio of Intangible assets to total assets
SG	Sales Growth , defined as $(Sales_t - Sales_{t-1})/Sales_{t-1}$
SGAVG	Average of sales growth of three years
PBDITA	Profits before depreciation, interest, tax and amortisation;
INTT	Total interest expense
CAPEX	Change in Gross Fixed Assets as a percentage of Total Assets
DEF	Financing deficit ,defined as $[(Change\ in\ total\ assets - change\ in\ retained\ profits)/\ beginning\ of\ year\ total\ assets]$ , following Huang and Ritter, 2009
RDratio	Ratio of R&D to Total Assets
INTTCOVR	Ratio of PBIT to INTT
ROA	Ratio of PBDITA to Total Assets
LEV	Leverage , defined as $Total\ Assets - Net\ Worth$ as a percentage of Total Assets
INVEST	Ratio of Financial Assets to Total Assets ( within the BG)
2DIGIND	Two digit National Industries Classification Code for industry
LR1	Listing Ratio 1 = No. of IPOs in a particular industry/No. of eligible firms in that industry as of t-1 , following Chittoor et al., 2014
LR2	Listing Ratio 2 = No. of IPOs in a particular industry/No. of listed firms in that industry as of t-1, following Chittoor et al., 2014
BSEP	Average PB of previous 4 quarters on the BSE for the industry as of t-1
MKTRET	Average Returns on the BSE Sensex as of t-1
HITECH	Dummy Variable =1 if firm belongs to a hitech industry, as defined by Govt. of India
RQ	Relatedness Quotient (for BG, NIC code of eligible affiliate firm matched with core firm)
REPUT	Dummy variable retains a value 1 until the year in which BG affiliate registers under BIFR, whereupon it becomes zero

Panel Probit Regression Analysis

**Analysis 1: Comparison between firms that go public and firms that are eligible but choose to stay private**

$$p(LIST_{i,t}) = fn(\beta_1 SIZE_{i,t-1} + \beta_2 AGE_{i,t-1} + \beta_3 INTANG_{i,t-1} + \beta_4 SGAVG_{i,t} + \beta_5 LEV_{i,t-1} + \beta_6 INTTCOVR_{i,t-1} + \beta_7 CAPEX_{i,t-1} + \beta_8 DEF_{i,t-1} + \beta_9 RDratio_{i,t-1} + \beta_{10} ROA_{i,t-1})$$

**Analysis 1(A): Comparison between BG and standalone firms to assess the impact of BG affiliation**

H1(a): When compared with standalone firms, the BG affiliated firms that go public are larger, older and more profitable.

$$p(LIST_{i,t}) = fn(\beta_1 SIZE_{i,t-1} + \beta_2 AGE_{i,t-1} + \beta_3 INTANG_{i,t-1} + \beta_4 SGAVG_{i,t} + \beta_5 LEV_{i,t-1} + \beta_6 INTTCOVR_{i,t-1} + \beta_7 CAPEX_{i,t-1} + \beta_8 DEF_{i,t-1} + \beta_9 RDratio_{i,t-1} + \beta_{10} ROA_{i,t-1} + \beta_{11} BG + \beta_{12} PBDITA_{i,t-1} + \beta_{13} BG * SIZE_{i,t-1} + \beta_{14} BG * AGE_{i,t-1} + \beta_{15} BG * ROA_{i,t-1})$$

**Analysis 1(B): Within BG, parameters to choose the going-public-affiliate**

- (a) H1(a): the greater the degree of relatedness of an affiliate to the core firm, the more likely it is to be chosen for listing.

The core firm is defined as the one with the largest total assets, following [Kali and Sarkar \(2011\)](#).

Related Quotient (RQ) is defined as similarity in the NIC codes of the eligible firm with the core firm, such that RQ = 5, 4, 3, if match with first 5, 4 or 3 digits of 5-digit NIC of the core firm; RQ = 2, if NIC codes belong to same section, RQ = 0, for no match)

- (b) H1(b): the greater the control rights from a group-firm the less is its likelihood of being listed.

Control rights can be proxied by the ratio of investments to total assets (INVEST). The greater the proportion of financial assets in a firm the more control the BG would wish to exert on it.

- (c) H1(c): If the firm's reputation (proxied by absence of bankrupt group-affiliate) is intact, the more is the likelihood of listing.

A Bankrupt firm in India is one that has been referred to the government-owned Board for Industrial and Financial Reconstruction(BIFR)<sup>12</sup> for diagnosis and recovery from financial distress.Reputation is proxied by a dummy variable(REPUT)that retains a value 1 until any one of a group’s affiliates, files for BIFR protection.[Data upto 2009 received with thanks from authors of (?) and for the period 2009-2014 constructed from website of BIFR <http://bifr.nic.in/casesregd.htm>, accessed on 11.11.2015]

Within BG,

$$p(LIST_{i,t}) = fn(\beta_1 SIZE_{i,t-1} + \beta_2 AGE_{i,t-1} + \beta_3 INTANG_{i,t-1} + \beta_4 SGAVG_{i,t-1} + \beta_5 LEV_{i,t-1} + \beta_6 INTTCOVR_{i,t-1} + \beta_7 CAPEX_{i,t-1} + \beta_8 DEF_{i,t-1} + \beta_9 RDratio_{i,t-1} + \beta_{10} ROA_{i,t-1} + \beta_{11} RQ_{i,t-1} + \beta_{12} REPUT_{i,t-1} + \beta_{13} INVEST_{i,t-1})$$

## 4 Preliminary Results

The IPO Sample description is provided in Table 2. The industry-wise distribution of the sample is provided in Table 3.

<b>IPO Sample Description</b>			
Financial Year	Standalone	BG	Total
2000	14	16	30
2001	53	7	60
2002	1	2	3
2003	2	0	2
2004	9	1	10
2005	10	8	18
2006	43	22	65
2007	45	19	64
2008	56	19	75
2009	18	1	19
2010	22	10	32
2011	32	9	41
2012	23	2	25
2013	14	1	15
2014	2	0	2
<b>Total</b>	<b>344</b>	<b>117</b>	<b>461</b>

<b>Industry-wise Distribution of IPO Sample</b>	
Industry	Firms
Accommodation and food service activities	4
Administrative and support service activities	4
Arts, entertainment and recreation	9
Construction	41
Education	8
Electricity, gas, steam and aircondition supply	7
Human health and social work activities	3
Information and communication	118
Manufacturing	208
Mining and Quarrying	1
Professional, scientific and technical activities	4
Real estate activities	14
Transport and storage	8
Wholesale and retail trade; repair of motor vehicles and motorcycles	32
<b>Total</b>	<b>461</b>

<sup>12</sup>The Board for Industrial and Financial Reconstruction is an agency of the Government of India with expertise to identify and manage private and public sector companies in poor financial and commercial condition

**Table 4: Summary Statistics**

Variables	ALL	BG	Standalone	P-value	Eligible	IPO	P-value	Standalone Eligible	Standalone IPO	P-value	BG Eligible	BG IPO	P-value
	Mean	Mean	Mean	BG Vs Standalone	Mean	Mean	Eligible & Unlisted Vs IPO	Mean	Mean	Standalone Eligible Vs IPO	Mean	Mean	BG Eligible Vs IPO
SIZE	2.5750	2.4529	2.8057	0.0000	2.5714	2.9425	0.0000	2.4491	2.8016	0.0000	2.7934	3.3809	0.0000
AGE	2.7456	2.8469	2.5539	0.0000	2.7492	2.3782	0.0000	2.8523	2.5549	0.0000	2.3621	2.4258	0.3803
SGAVG	0.3843	0.3515	0.4461	0.0000	0.3814	0.6962	0.0000	0.3485	0.4435	0.0000	0.6484	0.8344	0.3238
LEV	0.5615	0.5699	0.5456	0.0000	0.5618	0.5321	0.0122	0.5704	0.5455	0.0000	0.5236	0.5571	0.1910
INTTCOVR	17.1774	13.5323	24.7555	0.0000	17.0603	27.9342	0.0017	13.3810	24.6831	0.0000	26.1142	33.2570	0.4803
DEF	0.7648	0.5244	1.2074	0.0000	0.7622	1.0463	0.1633	0.5206	1.2054	0.0000	0.8858	1.4963	0.0892
RDRatio	0.0133	0.0139	0.0125	0.0968	0.0131	0.0248	0.0018	0.0138	0.0124	0.0791	0.0196	0.0453	0.1006
ROA	0.1092	0.1133	0.1014	0.0000	0.1086	0.1694	0.0000	0.1126	0.1011	0.0000	0.1783	0.1431	0.0024
CAPEX	0.0532	0.0524	0.0546	0.0461	0.0529	0.0759	0.0000	0.0521	0.0545	0.0361	0.0763	0.0748	0.9069
INTANG	0.0511	0.0437	0.0593	0.0000	0.0511	0.0478	0.7578	0.0436	0.0594	0.0000	0.0498	0.0424	0.6678
BSE_PB	2.5768	2.5068	2.7091	0.0000	2.5690	3.3756	0.0000	2.4973	2.7040	0.0000	3.3602	3.4208	0.8045
MKTRET	0.0790	0.0831	0.0713	0.0001	0.0788	0.0974	0.1899	0.0833	0.0705	0.0000	0.0652	0.1919	0.0000
LR1	0.0081	0.0081	0.0079	0.0696	0.0079	0.0211	0.0000	0.0080	0.0078	0.2151	0.0219	0.0186	0.2662
LR2	0.0337	0.0346	0.0319	0.0000	0.0334	0.0621	0.0000	0.0343	0.0318	0.0000	0.0670	0.0463	0.0295

SIZE is defined as the natural logarithm of total assets. AGE is the difference between year of eligibility for listing, and the year of incorporation. SGAVG is the average of sales growth for the past 3 years. LEV is defined as ratio of (Total Assets- Net worth) to Total Assets. INTTCOVR is the ratio of PBIT to total interest expenses. DEF is the financing deficit, defined as the ratio of difference between change in total assets and change in retained profits, to beginning of the year total assets as in Huang and Ritter, 2009. RDRatio is the ratio of R&D expenses to Total Assets. ROA is the ratio of PBDITA to Total Assets. CAPEX is the ratio of change in Gross Fixed Assets to beginning of the year total assets. INTANG is the ratio of intangible assets to total assets. BSEPB is Average PB of previous 4 quarters on the BSE for the industry. MKTRET is average returns on the BSE Sensex. LR1 is the Listing Ratio1 defined as the ratio of number of IPOs to the number of eligible firms in a particular industry. LR2 is the Listing Ratio2 defined as the ratio of number of IPOs in a particular industry to the number of listed firms in that industry. All variables are taken at t-1 values. All variables are winsorized at 1% and 99% levels to minimize the impact of outliers.

The summary statistics is provided in Table 4. "ALL" refers to the entire sample of eligible firms. Comparisons are presented between BG-affiliated and standalone firms; all eligible firms and those that had an IPO; Standalone eligible firms and standalone IPOs as well as BG eligible firms and BG IPOs. Amongst eligible firms that went for an IPO, BG firms were smaller and older, more profitable and had a lesser proportion of intangible assets as compared to standalone firms. In comparing eligible firms with those that had an IPO, IPO firms appear to be larger and younger, with a greater level of sales growth and lower level of leverage. These are more profitable and have greater need for capital expenditure. Amongst standalone firms the comparison between eligible and IPO firms reveals that IPO firms were larger, younger, had greater sales growth and lower levels of leverage. They had greater proportion of intangible assets, but slightly lower level of profitability. BG firms that went for an IPO appear to be considerably larger than BG-affiliated eligible firms.

The results of a simple pooled Probit regression model are provided in Table 5 and the impact of BG affiliation is examined in Table 6. While Size and Profitability are positively related to the probability of going public, age is negatively related. It could be that younger firms are riskier and hence they approach the capital markets to meet their funding needs. LR1, the ratio of number of IPO firms to the number of eligible firms in a particular industry is positively correlated to probability of IPO.

BG affiliation is negatively related to the probability of going public in Table 6. This could be because affiliate firms enjoy the benefits of internal capital markets.

Table 5		
Variable	Coef.	Std. Err.
SIZE	0.3612***	0.0612
AGE	-0.1847***	0.0573
SGAVG	0.0226	0.0195
LEV	-0.2449	0.2024
INTTCOVR	-0.0003	0.0004
DEF	0.0096	0.0096
ROA	1.7715***	0.3723
CAPEX	-0.3523	0.3264
INTANG	-0.4921	0.3571
MKTRET	0.6419***	0.1572
LR1	12.6068***	2.3635
LR2	-0.9146	0.8371
HITECH	-0.1966**	0.0936
Intercept	-3.0096***	0.2832

Table 6		
Variable	Coef.	Std. Err.
SIZE	0.4802***	0.0665
AGE	-0.2246***	0.0601
SGAVG	0.0279	0.0200
LEV	-0.264	0.2097
INTTCOVR	-0.0002	0.0004
DEF	0.0138	0.0097
ROA	1.7337***	0.3919
CAPEX	-0.4496	0.3354
INTANG	-0.4382	0.3557
MKTRET	0.6988***	0.1613
LR1	12.9316***	2.4378
LR2	-1.1346	0.8659
HITECH	-0.2042**	0.0964
BG	-0.5163***	0.0895
Intercept	-3.0757***	0.2959

Table 5 presents the results of a pooled Probit regression to estimate the probability of going public. Table 6 presents the impact of BG affiliation. The dependent variable is 'LIST' which takes a value 1 if the firm goes public in the sample period and 0 otherwise. Coefficients reported with standard errors (\*\*\*)  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$  respectively)

#### Within BG - Probit

The results of the within BG probit analysis are reported in Table 7. BG affiliation contributes negatively to the probability of listing. Size and age of the BG positively impact the choice of affiliate to list. Profitability is found to be negatively related, to the probability of listing of the affiliate. Table 8 presents the results of the reputation and relatedness hypotheses. Relatedness and Reputation are both significant and positively impact the choice of affiliate to list.

Table 7		
Variable	Coef.	Std. Err.
SIZE	0.3670***	0.0786
AGE	-0.3156***	0.0750
SGAVG	0.0263	0.0209
LEV	-0.2789	0.2134
INTTCOVR	-0.0002	0.0005
DEF	0.0136	0.0103
ROA	1.9558***	0.4161
CAPEX	-0.4685	0.3406
INTANG	-0.4969	0.3674
MKTRET	0.6997***	0.1631
LR1	12.9423***	2.4849
LR2	-1.2093	0.8804
HITECH	-0.1879**	0.0972
BG	-3.1081***	0.6645
BG_SIZE	0.5751**	0.1693
BG_AGE	0.2470**	0.1202
BG_PROFIT	-0.0001*	0.0000
Intercept	-2.5137***	0.3373

Table 8		
Variable	Coef.	Std. Err.
SIZE	0.8524764***	0.1751
AGE	0.0243	0.1283
SGAVG	0.0296	0.0325
LEV	-0.1951	0.4452
INTTCOVR	0.0002	0.0010
DEF	0.0133	0.0149
ROA	0.0927	0.9175
CAPEX	-0.3426	0.6075
INTANG	-0.5224	0.7714
MKTRET	1.956854***	0.4827
LR1	16.7899**	5.0549
LR2	-3.2723	2.0697
HITECH	-0.6127**	0.2490
RQ	0.1172**	0.0415
REPUT	0.4722**	0.2049
Intercept	-5.5804***	0.7473

## 5 Brief Conclusion

The results are briefly summarized as below: Size & ROA seem to positively impact going public decision. Younger firms are more likely to go public. Market return positively impacts the likelihood of going public. Listing ratio (No. of IPOs/eligible firms in industry at t-1) positively impacts the IPO decision. BG affiliation is significant and negatively impacts the odds of listing. While Size and age support BG-affiliate's going public, its profitability reduces the likelihood. In within BG analysis, Size, Relatedness to Core firm, and reputation (proxied by absence of bankrupt affiliate) increase the likelihood of the affiliate going public.



## Appendix 1

### Important Milestones pertaining to Listing Regulation in the Indian Capital Market from 1992-2012

The Securities and Exchange Board of India (SEBI) is the regulator for securities market in India. Set up by the Government of India in 1988, it was accorded statutory powers on 12 April 1992, through the SEBI Act 1992. SEBI issued the Disclosure and Investor Protection (DIP) Guidelines in June 1992. These guidelines were subsequently amended from time to time, in order to streamline the public issue process. The guidelines apply to all public issues, offer for sale, and rights issues by listed and unlisted companies. Besides when National Stock Exchange with its electronic trading platform and innovations in use of computing technology and regulatory framework began operations in the capital market segment in November 1994, it forced its competitor, the Bombay Stock Exchange (BSE) (one of the oldest exchanges in Asia) to follow in its path. Both the top exchanges promoting technology gave an added fillip to capital market revival.

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 as they exist now mandate that an issuer is eligible to go for a (first-time) public issue if,

- (a) it has net tangible assets of at least 3 crore rupees<sup>13</sup> in each of the preceding three full years (of twelve months each), of which not more than fifty per cent. are held in monetary assets; Provided that if more than fifty per cent. of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project;
- (b) it has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three out of the immediately preceding five years: Provided that extraordinary items shall not be considered for calculating distributable profits;

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<sup>13</sup>1 crore = 10 Million INR, 1 USD = 51.1565 INR as on 31.03.2012 ,Source: <http://www.rbi.org.in/scripts/ReferenceRateArchive.aspx>, accessed on 15.03.2015

- (c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);
- (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;
- (e) if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

If the firm does not satisfy the above criteria, then it can go for a book-built IPO with at least 50% of the issue size being allotted to Qualified Institutional Buyers (QIBs) failing which the full subscription monies shall be refunded or the 'project' has at least 15% participation by Financial Institutions/Scheduled commercial banks of which at least 10% comes from appraiser. In addition to this, at least 10% of the issue size shall be allotted to QIBs, failing which the full subscription monies shall be refunded **and** that the minimum post-issue face value capital of the Company shall be Rs. 10 crore or that there shall be a compulsory market-making for at least 2 years.

Though the SEBI(DIP)guidelines came into existence in 1992, it underwent multiple changes over the two decades. The process of book-building was introduced in India in November 1995 following the recommendation of an expert committee appointed by SEBI under Y. H. Malegam, subject to certain terms and conditions<sup>14</sup> like,

- (a) The option should be available only to issues exceeding Rs. 100 crores;
- (b) The Draft prospectus should exclude the information on price
- (c) A Book-running lead manager has to be appointed and
- (d) 25% of securities has to be offered to the public.

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<sup>14</sup><http://www.thehindu.com/biz/2004/03/22/stories/2004032201151800.htm>, accessed on 13.03.2015

- (e) Unlisted companies which have been in commercial operation for more than 2 years and whose post issue paid-up capital is greater than 3 crore but less than 5 crore shall list only on those exchanges where screen-based trading is available<sup>15</sup>.
- (f) Greater disclosure on means and source of financing the project, on bridge loans to be closed from issue proceeds and company turnover calculation was sought
- (g) Revaluation reserves to be deducted from fixed assets and reserves prior to calculating networth and,
- (h) 3 years dividend payment track record mandatory for IPOs, and a manufacturing company not satisfying the above criteria provided the project has been appraised by a public financial institution or Scheduled Commercial Bank contributing at least 5% of project cost.

Based on recommendations by the Chandratre Committee on Delisting of securities(March 1997), SEBI mandated that the basic minimum norms for listing should be uniform for all recognised stock exchanges and that stock exchanges will be permitted to prescribe additional norms( which were to appear in bye-laws of the exchanges)over and above the minimum norms.The Stock exchanges were allowed the freedom to determine the amount, manner and periodicity of listing fees. The Primary Market Advisory Committee recommendations were also adopted in March 1997 which specified that dividend payment track record was modified to mean dividend declaration in each of the three years.

In 1998-99 SEBI amended the eligibility norm (for companies going public)of having a dividend payment track record for 3 out of immediately preceding 5 years to 'ability to pay dividend' in terms of Section 205 of the Companies Act, 1956. This meant that the company making IPO must have distributable profits for at least three out of immediately preceding five years. The company was to have a minimum pre-issue networth (i.e. paid up capital and free reserves minus intangible assets and revaluation reserves) of not less than Rs. 1 crore in three out of the preceding five years, with a

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<sup>15</sup>Source : SEBI Annual Report 1995-96

minimum networth to be met during the immediately preceding two years. The ceiling of issue size was reduced from Rs.100 crores to Rs.25 crores. The requirement of the lock-in period of promoters' contribution in full was reduced to only 20% of the total capital of the company<sup>16</sup>.

In 2000, SEBI issued 'Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000' which compiled all circulars till date and organized these in chapter forms. These came to be referred to as the SEBI(DIP) Guidelines,2000. In July ,2001, the restriction of a minimum public issue size of Rs 25 crore in case of an IPO through the book building route was removed<sup>17</sup>.

In the year 2002, one of the chief recommendations made by the Y.H.Malegam Committee, pertained to calculation of Networth of eligible companies as that pertaining to the immediate previous year and that extraordinary items should not be included for calculating profits. The committee also recommended that the companies should not be allowed to come out with a public/rights issue unless 75% of the stated means of finance are tied up.<sup>18</sup>.

Some subsequent capital market developments include the creation of a Central Listing Authority to regulate all classes of securities (August 2003; rescinded in January 2007); making the Green Shoe option available to all public issues(August 2003);introducing the concept of Fast Track Issues with relaxation in requirement of average market capitalization of public shareholding (November 2007)and the supplementary process of applying in public issues, viz, the 'Applications Supported by Blocked Amount' (ASBA) in July 2008<sup>19</sup>.

The SEBI (Issue of Capital and Disclosure Requirements)Regulations, 2009 (also referred to as "the ICDR Regulations")were first notified on August 26,2009. These guidelines emerged through conversion of the SEBI (Disclosure and Investor Protection) Guidelines, 2000, which was then re-

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<sup>16</sup>Source: SEBI Annual Report 1998-99

<sup>17</sup>Source:<http://www.sebi.gov.in/circulars/2001/CIR01MB2001.html>, accessed on 13.03.2015

<sup>18</sup>Source/s: [www.sebi.gov.in/commreport/maligamdip.pdf](http://www.sebi.gov.in/commreport/maligamdip.pdf),[http://www.sebi.gov.in/cms//sebi\\_data/Regulations.html](http://www.sebi.gov.in/cms//sebi_data/Regulations.html) and <http://www.sebi.gov.in/sebiweb/home/list/1/3/0/0/Regulations>, all accessed on 11.03.2015

<sup>19</sup>Source: Indian Securities Market Review, Various issues,<http://www.nse-india.com/research/dynaContent/ismr.htm>, accessed on 13.03.2015

scinded. The requirement that an issuer who had subsidiary/ subsidiaries for a period lesser than five years, shall have net profits on a consolidated basis in atleast one year for which consolidated accounts were prepared was brought in on 23 September 2011. This was modified on October 12, 2012, to read that the issuer has a minimum average pre-tax operating profit of rupees fifteen crore, calculated on a restated and consolidated basis, during the three most profitable years out of the immediately preceding five years.

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