FINANCIAL MARKET CONCLAVE – ROAD TO TURN AROUND

Foreword

The implications of change in guard at the centre are going to be significant for the country, and are being watched with keen interest by all as is evident from the market reactions. The stakeholders include the FIIs, foreign companies interested in setting up shop in India and especially the market participants.

With a decisive mandate, the new Government at the Centre has started taking some policy decisions that are urgently needed to revive economic growth. There is further scope for development of Indian financial market. Better products and services to provide higher returns at lower risks needs to be devised, to attract a higher proportion of the huge household savings of the nation. In times of high cost of financing from banks, the sector can play a stellar role to drive the economy by drawing the much needed funds for capital formulation and infrastructure creation from household savings. The recent Companies Act has brought many changes in the Corporate Governance regime. With the world investment lens back on India and a definite policy direction coming from the new Government at the Centre, a lot more activity is in store for a possible turnaround in Financial Markets and BFSI.

Against this backdrop, CII Eastern Region is organizing **"Financial Markets' Conclave"** on 28 June 2014 at Kolkata. The conference will deliberate on the macroeconomic scenario and recent policy changes and how they can impact the financial sector – something all corporate and retail investors closely follow.

It is with pleasure that we present this report on the Theme of Financial Markets' Conclave - "Road to Turn Around". This report captures the recent trend in Capital Market and Mutual Fund with the regulatory changes undertaken by SEBI, trends in MSME funding while elaborating on options like IPO, Private Equity, and Venture Funding, etc. It also probes into the Companies Act 2013, the rulings and its implication for Capital Market.

Feel free to send your feedback at erchairman@cii.in.

Mr. Viresh Oberoi

Chairman

CII Eastern Region

MESSAGE FROM MD RESURGENT INDIA LTD.

Financial Markets move in sync with the movement in the economy. Conversely movements in the stock market can have a profound impact on the economy and the people at large. A meltdown of the stock market has the potential to lead to a widespread economic disruption. The most famous example one can quote is the stock market crash of 1929 which was one of the principal reasons for the great depression of 1930. Conversely an upward swing in the stock market would have a positive impact on people and the economy.

The first impact would be incremental wealth in the hands of the people which lead to an increase in consumer spending. Another impact would be that in an upward stock market situation companies could raise finance on the stock market as it provides a relative low cost way of borrowing. One more impact would be that a stock market going up would attract funds from other instruments like government bonds, gold etc. which would further fuel the rally.

After weathering the storm the economy is poised to look up as the sentiments for revival of the economy are positive. Once the policies of the government are known the market would rally depending upon the perception. When this happens stocks of most of the companies would rise leading to the attendant benefits to the companies.

Even though SMEs play a major role in contributing to the economy whether by share in GDP, creating employment, exports they have major problems in raising funds whether from banks or through IPO or PE or any other source. The reasons are many and both sides would have to change their perception and approach to the issue.

The Companies Act 2013 has attracted more criticism than praise on various provisions of the Act. Some of the criticism seems well founded and different industry and other associations are approaching the government for making the Act Company friendly. Even if major provisions are amended as demanded the stock market would react positively. If the same is not done there could be major issues in running business.

Jyoti Prakash Gadia

Managing Director

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CURRENT MARKET PERSPECTIVE

Capital Markets

Capital markets is one of the driving forces moving the economy of a country. There has been highs and lows in the market during the last 5 years. The markets are yet to find a steady move ahead after being so volatile. It is rather more important that there is stability and liquidity in the market. There are many regulatory changes that are making things clearer in each and every context. The economy is also in the stage of recovering from here on with the various economic data also being positive.[1]

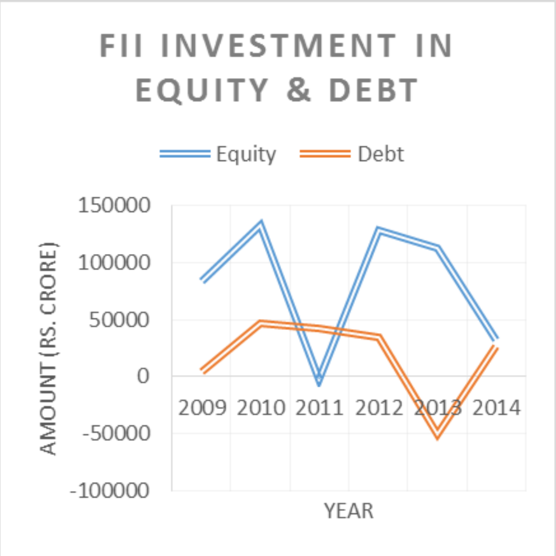

Chart 1

Source: SEBI

It is very important that a boost has to be given for investment in the capital markets. Retail participation in the income generating investment avenues has been a cause of concern for all. Capital markets attract a very miniscule share of household savings. It has been seen that about 68 percent of savings were invested in deposits and provident funds earning only a marginal return whereas more than 30 percent was in the form of currency or life insurance funds potentially earning no returns at all. There is much need that the retail investors should be encouraged to invest in the capital markets rather than relying on the foreign investors.

The retail investors are still hesitant in investing in the markets. Savings and investment behaviour, to a large extent are guided by the attitude towards risk and Indians in general are risk averse when it comes to savings and investment of the savings. Apart from that, the fact is that India is the largest consumer of gold, year after year, for the simple belief that gold is safe. Many of the Indian retail investors invest at highs instead of lows and ultimately lose money or don't get the returns. Educating investors about the risks associated with markets is never-ending. The retail investors needs advise on how and when to invest in the markets

[1] *Deloitte report*

and once they get good returns, it will boost their confidence in the markets. SEBI is also implementing financial literacy programs through the National Institute of Securities Market. Besides the initiative from the regulator, we also see Exchanges, brokerages, banks, etc. also making effort to ensure the masses are well informed through seminars and workshops across India.

Another important factor impacting the investment in the financial markets is the awareness about the need of financial planning and knowledge of the corresponding financial products. In India, awareness of both is significantly low. A survey by Visa ranked 28 countries on the basis of financial education among the population. India was ranked 23rd among the 28 countries taken up for survey. Countries like Lebanon, Taiwan, Egypt, and Saudi Arabia were ranked higher indicating better levels of financial knowledge among masses. Brazil, often compared with India among the developing countries was ranked first.[2]

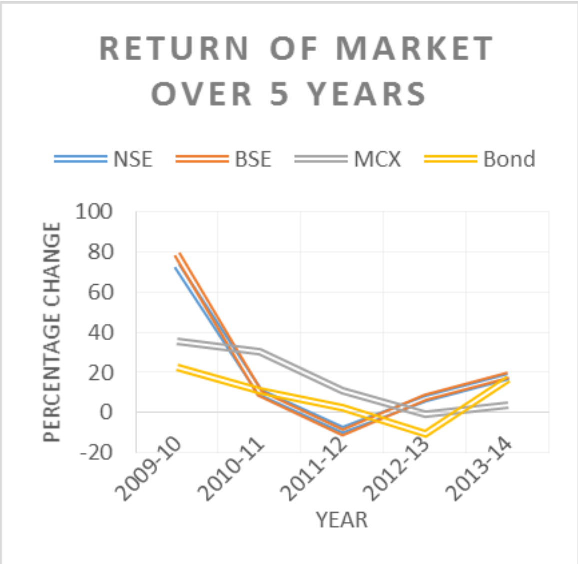

Chart 2

Source: NSE, BSE, MCX, NDTV

The return of the market is shown in the chart 2. In this we see that the equity market has given a return of around 17-18% and the commodity market gave a return of just 3.7%.The Bond market gave a return of around 16.5% in terms of the yield change. The FII & DII investment in the market is really not good seeing the amount of investment made. In the last 6 years, the net investment by the DIIs have been negative. The real investment has always been from the FIIs in every year apart from one year. This implies that we are heavily relying on the FIIs for the investment in the market. Classifying the market into Equity & Debt, the FIIs investments have mainly been in the equity market as compared to the debt market.

IPO/FPO

The IPO market has developed very fast since the liberalisation of the Indian economy. It is one of the most preferred ways of raising capital for the companies. The IPO market has been decreasing since 2009 as the capital raised has a decreasing trend. The number of IPOs has increased a lot in the last year but the capital raised was very low.

[2] *DNAIndia.com*

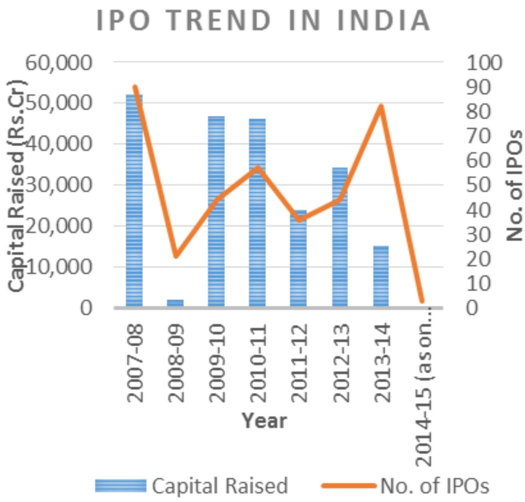

Chart 3

Source: Prime Data Base

The trend for the IPO in the Indian market is shown in the chart 3.

In the recent past, there has been very few IPOs, which have been successful. Let us take a look on some of the IPOs. Wonderland Holiday had planned to raise Rs.1.7-1.8bn with a fresh issue of 14.5 mn shares which would take the value of the company to Rs.6.5-7.1 bn. The offer price was of Rs.125 per share with the IPO ending at a premium of 26.08% taking the price to Rs.157.60. It had been oversubscribed by 38.06 times which shows how successful the IPO was for the company. Just Dial came up with IPO for 17.5 mn shares with a price band of Rs.470-Rs.543, taking the expected valuation of the company to Rs. 32.8 bn – Rs.37.90 bn. Engineers India Ltd. had come out with an FPO worth Rs.505.40 crores at an issue price of Rs.145 – Rs.150 per share. The Issue had a size of 33693660 equity shares of Rs.5 face value each. The investors are still hesitant in investing and there are very few IPOs which are successful.

Regulatory Changes

SEBI has come up with new guidelines regarding the foreign investors who are willing to make portfolio investment in India. It has also made some regulation regarding the terms and procedure of settlement regarding the cases connected with the administrative and civil proceedings. It has laid out the procedure for the search and seizure regulations in the SEBI Act.

There have been many amendments made in the SEBI regulations. These include amendments in the Investor Protection and Education Fund and the Collective Investment Schemes which is in the interest of the investors. It has also made amendments in the Issue of Capital and disclosure requirements during the process of an IPO raising. It is related to the format of Pre-Issue advertisement for public issue.[3]

SEBI, the stock regulator for the Indian market has allowed various entities such as NBFCs, housing finance companies and the companies listed for at least 3 years to issue shelf prospectus for public issuance of non-convertible debt securities. All

[3] *SEBI*

these entities have to also meet some other criteria as per the guideline issued by SEBI regarding this. SEBI has also scrapped grading of IPOs which was mandatory earlier on.[4]

The new regulatory changes have given a lot of opportunity to private companies in raising capital from the overseas market. In September, 2013, it was announced that an Indian company can directly list itself in an overseas exchange before listing itself in an Indian exchange. This will boost the capital inflow in the country in the form of foreign investment.[5]

Investors pumped in a net Rs 1.5 trillion in various mutual fund schemes in May, the highest amount in more than three years.

Source: Business Today

Mutual Fund Perspective

Mutual funds offer opportunities for retail investors to access various asset classes like equities, bonds, Treasury bill and real estate. Recent trends show that Retail Investors have been withdrawing from mutual funds markets. Since their creation, mutual funds have been a popular investment vehicle for investors. Their simplicity along with other attributes provides great benefit to investors with limited knowledge, time or money.

India has a very small share in the global mutual funds market when compared to the population and the savings rate that the country has. The Individual investors are risk averse and so prefer investing in safer options such as gold, bank deposits. As the market is maturing along with the awareness provided to the individual investors regarding the functioning of the market, the market has reached new highs. The Indian investors do not invest for long term in the markets and prefer investing for short term which at the end makes them lose the money invested. It is the regulator, the exchanges and the advisory people who have to educate these investors on the investment decisions.

The private mutual fund players after entering the Indian market have done a good job in the development of the mutual fund Industry but still there is a long way to go. The Indian Mutual fund Industry is still very behind compared to the global mutual fund industry. There are basically two reasons – one is that there is no enough

[4] *India Info Line*

[5] *EY*

investments from the retail individuals and the other is that the funds have not really outperformed the benchmarks on many occasions.

SME FUNDING

SME(Small and Medium Enterprises),according to the SEBI guidelines are those companies which have a paid up capital of Rs.1 crore to Rs.25 crore. It should also have distributable profits in 2 out of the 3 preceding financial years for IPO. This sector contributes to around 8% of the Indian GDP. In many cases, SMEs provide support services to the big corporates and form a very important part of the economy. Almost two-third of the workforce of any country is employed by the SME sector. The stability of the SME sector forms an important part for the revival of the economy.

There are many new start-ups coming up in India and we get to see a lot of professionals turning into budding entrepreneurs. The main hindrance that arises is the availability of funds for these small start-ups. Majority of the SMEs operates on the funds of its promoters, thus limiting its growth. The opening up the Capital markets for the SMEs has given a boost to these entrepreneurs. It has given an opportunity to them to raise as much capital needed in the form of debt and equity with a lower finance cost.[6]

SME funding to get Rs 5,000-cr boost

Source: Business Standard

The Government has taken various initiatives from time to time to address the problems faced by the MSME sector. It has set up numerous, organizations, boards, corporations and training centres to provide technological, entrepreneurial, managerial and financial assistance to these units. Likewise, several committees and study groups set up by the Government, the Reserve Bank of India and Small Industries Development Bank of India (SIDBI) have studied the problems faced by MSMEs and suggested various measures to address these issues. This have significantly contributed and set up a favourable environment for setting up and nurturing small industrial units.

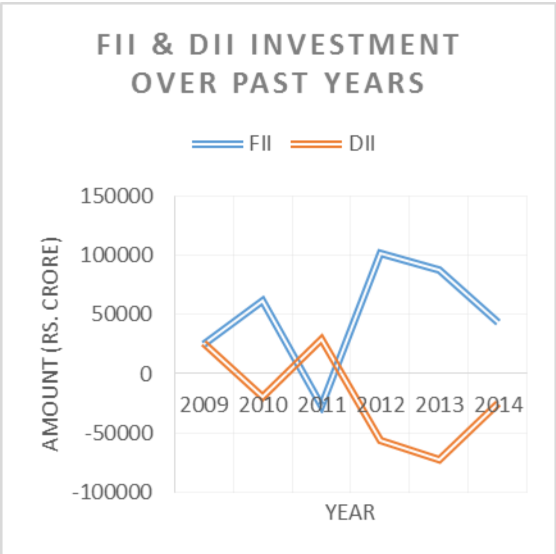

Chart 4

Source: Money Control

Recently, the Credit Guarantee System for SMEs has been introduced by commercial and other financial institutions. For instance, under the Credit Guarantee Fund Trust for MSEs (CGTMSE) life insurance cover for the chief promoters of enterprises is guaranteed. Further, various industry

[6] *BC Shetty Report*

associations have signed MoUs with commercial banks and other financial institutions to offer collateral security to upcoming entrepreneurs for their credit requirements. The CGTMSE will function under the monitoring of the SIDBI. Unless the credit guarantee system is strengthened and streamlined smaller units would continue to suffer neglect in accessing the much needed credit for both inception and expansion.

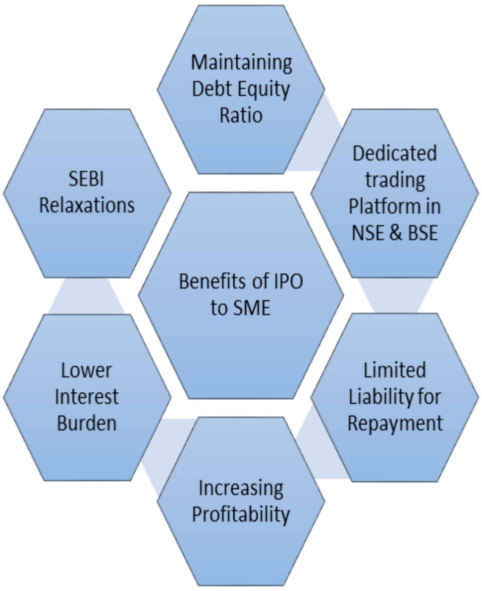

Chart 5

Source: bcshettyco.com

In the coming years, the SME sector will be the driving engine to growth for the economy. The availability and access to timely credit to the SMEs has always hindered the growth of this sector. There have been various initiatives taken to boost the sources of capital for the SMEs which provides easy access to finance. On the other part, the SMEs should use the capital more efficiently and take advantage of the business opportunities. They should improve operational efficiency and productivity and meet all the legal compliances. This would also help the sector to contribute to the economic growth of the country.

Financing through IPO

The firms which are ready to dilute some part of their holding to raise capital can go for IPO. There are many legal compliances which are to be fulfilled before going for an IPO. Some of these are -

- Prepare annual reports and get it audited
- A company website is needed
- It should be a public limited company
- Appoint a full time company secretary

In March 2012, both BSE and NSE launched their SME exchange platforms to enable MSMEs to raise funds and get listed as public entities. BCB Finance Ltd. was the first Indian SME to get listed on the BSE SME Exchange. The launch of SME exchanges will play an important role in growth of MSMEs and the need of the hour is to improve the awareness among MSMEs about equity capital, stock markets and funding options, other than banks. The capital markets can play a crucial role in helping MSMEs improve their visibility and raise capital for their growth and expansion, offering an effective way to improve financial inclusion.

Recently, SEBI has also announced that the SMEs will be allowed to raise capital through the offer to sale platform rather than the IPO as it would reduce the cost drastically. A SME would not be required to make an IPO to list itself on any SME exchange.

Chart 6

Source: bcshettyco.com

The two main exchanges designed for the SME sector have 60 firms listed in the BSE SME and 5 firms listed in the NSE Emerge. Recently, SPS Finquest Ltd., a NBFC registered SME came up with an IPO issuing 33.44 lakhs of equity shares @ Rs.75 per share amounting to Rs.25.08 crores.

SEBI ICDR regulations deal with the initial and further public offering by a new and listed issuers. There are various amendments and provisions made in the regulations with regards to the SME sector. A company whose post issue paid up capital is not more than Rs.10 crores can list itself on the Exchange. Those companies whose post issue paid up capital is more than Rs.10 crores but less than Rs.25 crores have to follow some provisions to list itself. The offer document for the IPO has to be given to a merchant banker who in turn files it with SEBI. The underwriter has to ensure that 100% of the issue has been underwritten before the process starts. The minimum application size for an IPO is fixed at Rs.100000 per application. The minimum number of members in an IPO should be at least 50. A listed issuer whose total paid up capital is less than Rs.25 crores has the option to migrate to SME exchange and an issuer with more than Rs.25 crores as paid up capital will be shifted to main board of exchange. The merchant banker has the mandatory responsibility of market making for at least 3 years.[7]

Private Equity Funding

Private equity is another source of raising capital for SMEs. The Private equity funds have been in India for more than two decades. They usually try to add value to the company at the early stage and exit at a later stage usually between 3-5 years and

[7] *Money control*

finally making profits from the investment. They not only seek return on the investment but also provide expertise and experience to the new firm. This helps the firm to perform well and achieve efficiency in all forms of business operations.

A key focus area in the plan is to promote equity investment in MSMEs by constituting a Working Group devoted to the concept. Owing to the high valuations at which the investments were made in 2007 and 2008, a number of portfolio investments of PE funds are currently not 'in the money' and with the relative fall in Indian rupee, exits have been becoming even less attractive.

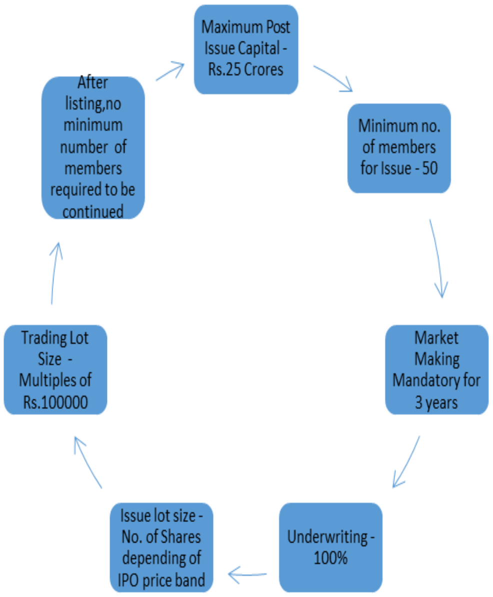

Chart 7

Source: bcshettyco.com

In the market scenario a year earlier, it has been a tough time for the SME sector to get capital from the market. The investors are not ready to invest as they are uncertain about the performance of the business. A little push may turnaround things for the businesses. The PE investors are financing SMEs in the field of technology and renewable energy which have the potential to give return along with certain amount of risk. They are also trying to analyse some particular sectors and limiting the investment only to those sectors. This analysis will help them in knowing the sector in a better way along with the strengths and weaknesses. This will also let them invest in the right areas which will enable them to earn more return per unit of risk taken.

The big players such as SBI Capital and SIDBI have floated SME funds which will boost the confidence in the SME sector. The initiative taken by a handful of equity players won't help in reviving the economy. The total private equity investment in India continues to fall year on year. This is only making the Indian economy to miss on new opportunities. There is still some funding from the international PE investors in India which is helping the SMEs but it is not good for an economy as a whole.

Angel/Venture Funding

Angel/Venture funding is often the way the start-ups and other small businesses are being funded. This type of funding has increasingly become popular but has to be enhanced considerably. SMEs at the starting stage require money to study, analyse and develop the product. At this stage, these firms usually spend time on promoting themselves and are not able to earn any profit. After this stage, when a firm starts growing, they look for venture/angel funding to explore new markets and domain. The new ventures in the field of Bio-tech, food processing, IT and some other sectors usually take help from angel/venture funding for the initial and subsequent funding of capital.

SEBI has come up with strict norms for the angel investors. These angel investors are being allowed to register themselves as Alternative Investment Funds. In order to ensure that the investment is genuine, SEBI has restricted investment by such funds in between Rs.50 lakhs to Rs.5 crore and it is to be held for a minimum of 3 years. The angel funds can invest money in companies only incorporated in India. Angel funds should have a corpus of at least Rs.10 crore. The continuing interest by sponsor in the angel fund should not be less than 2.5% of the corpus or Rs.50 lakhs, whichever is lesser. SEBI also stipulated that there should be no family relation with the investee company and there cannot be more than 49 investors for a particular fund.

COMPANIES ACT, 2013

The Companies Act, 2013 has made several changes in the regulatory requirements of the companies. It has introduced several new concepts and has streamlined many of the requirements by introducing new definitions. The Act aims to raise the governance level of the Indian companies at par with the global companies.

The Board of Directors are the core for the good governance of companies. Being the representatives to the shareholders of the company, they provide various expertise in strategy approval, maintaining integrity, enhancing efficiency and smooth performance of the business operations. The Board needs to be aware of the new challenges in the business market and frame the best policies and processes with the support of the management. The Act has several new roles and responsibilities for the boards and the directors.

There are many new provisions which apply to the board of all companies. There are additional disclosures which are to be filed in the annual return of the companies. It requires preparation of annual return containing the details of the principal business activities, particulars of holding, subsidiary and associate companies, details of promoters, directors, key management personnel, meetings of board and other members along with attendance details, remuneration of directors and key management personnel and penalties imposed on directors. All this should be as on the closing date of the financial year. An extract of this is to form a part of the board's report. This board report would have additional disclosures including meeting of board, director's responsibility statement, company's policies on director appointment and remuneration, state of company affairs, dividends to be paid and many more things. The director's responsibility would have additional disclosure regarding the internal financial controls and regulatory compliance. It should also be stated that these controls are adequate and are operating effectively.

Every company having a net worth of Rs.500 crore or more, or a turnover of Rs.1000 crore or more, or a net profit of Rs.5 crore or more during a financial year has to constitute CSR (Corporate Social Responsibility) committee having at least one independent director. The CSR committee has to formulate CSR policies and get it approved by the board. All these companies have to spend at least 2% of the last 3 years average net profits on CSR activities. The composition of the board of directors is to have a minimum of 3 directors for a public company and 2 directors for a private company and in total of 15 directors. There should be at least 1 woman director in the board. One-third of the board of listed companies should be independent. An independent director has to declare that he does not have any relation in any way with regards to subsidiary and associate company and also should not be the promoter of the company. The Independent director is entitled to receive fees, reimbursement of expenses, profit related commission but not any stock options. An independent director has a tenure of 5 consecutive years and can be reappointed for a second term by passing a special board resolution. A listed company to have one director appointed by the small shareholders having a shareholding of Rs.20000. Differing compliance requirements with respect to the appointment of independent directors, remuneration thereto, imposed by multiple regulators will lead to hardship as well increased cost of compliance for companies.

The Board has to constitute the audit committee for the company which has to be disclosed in the board report. The board has to also constitute the nomination and remuneration committee for the company. A company having more than 1000 security holders have to form a stakeholder's relationship committee which is to be appointed by the board. The board has to annex the secretarial audit report with the board's report. The Act also lists down the list of fiduciary duties for the directors. It also lays down the minimum number of board meetings to be held annually to be as four.

The period between two consecutive meetings should not be more than 120 days and the meetings can be held through video-conferencing or other audio visual mode. It also defines the whole-time key managerial personnel of the company which is to be appointed by means of board resolution. He should not hold office in more than 1 company and the vacancy should be filled within 6 months.

The Companies Act, 2013 has introduced a new section which only deals in how a public company or a private company may issue securities. It can be through the prospectus, through private placement and through right or bonus issue of shares. There are many disclosures that have been changed. The Act includes a section in which the members of the company in consultation with the board members may offer a part of their shareholding to the public. In private placement, the offer of securities or invitation to subscribe securities shall be made to no more than 50 members in a financial year. All the money payable towards the subscription has to be paid by any way other than cash.

The Act proposes to re-instate the existing concept of shares with differential voting rights. Pursuant to this section the company may face hardship with regards to computation of proportionate voting rights. It also restricts the application of securities premium for a certain class of companies if they fail to comply with the accounting standards. It continues to state that securities premium amount can be utilized for purpose of writing off preliminary expenses. However, in view of the requirements of accounting standard 26, the requirement of this sub-section appears to be superfluous. The companies are no longer permitted to issue shares at a discount exception being sweat equity. The requirement for further issue of share capital is now also applicable to private companies.

The Act has introduced certain significant amendments in the accounts and audit domain. There are several additional requirements introduced such as preparation of consolidated financial statements, additional reporting requirements for the directors in their report such as the development and implementation of the risk management policy, disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates, etc. The unlisted companies have to prepare a consolidated financial statement which would substantially increase the cost of compliance. There is also a requirement to add a statement containing the salient features of the financial statement of the subsidiary, associate and joint ventures.

The provisions envisaged by the 2013 Act in respect of re-opening and voluntary revision of the financial statements and board report is yet to be acknowledged by SEBI in the equity listing agreement and thus, pending similar amendment in the equity listing agreement, listed companies may face unnecessary hardships.

The provisions in the new act related to the area of mergers and acquisitions, are aimed at simplifying and rationalizing the procedures and also ensuring higher accountability for the company and majority shareholders and increasing flexibility for corporates.

The changes proposed would require companies to consider the scale and extent of compliance
These changes are quite constructive and could go a long way in streamlining the manner in which mergers and other corporate scheme of arrangements are structured and implemented in India.

According to the new companies Act, 2013, only those public companies which meet the prescribed net worth and turnover criteria will be able to accept deposits from persons other than its members. The provisions regarding the protection of the deposit holders have been enhanced. This will basically increase the cost for the companies due to requirements related to credit rating, maintenance of additional liquid funds, deposit insurance, etc.

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Our strength lies in our outstanding team, sector expertise, superior execution capabilities and a strong professional network. We have served clients across key industry sectors including Infrastructure & Energy, Consumer Products & Services, Real Estate, Metals & Industrial Products, Healthcare & Pharmaceuticals, Telecom, Media and Technology.

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