CHAPTER NO. VI

SUMMARY AND CONCLUSIONS

CHAPTER NO. 6

SUMMARY AND CONCLUSIONS

The study was divided in to six chapters The first chapter discusses the survey of literature which reveal that there is a dearth of published materials in this field As mentioned in 1st chapter the study was made to know determinants of share premium The chapter no 1 describes rationale of the study, objective of the study, sources of the data and research methodology adopted during the course of the study The legal aspects and history of legal frame work are also discussed in the same chapter

The 2nd chapter reviews the repealled C C I guidelines dated 13th July 1990 and 13th April 1992 As a consequences of presence of the office of the C C I. prior to 29th May 1992, the issuer companies could mobilised less amount of capital, owing to conservative approach of the office of the C C.I Such an approach accoustomed the investors to receive abnormally high return with in short period.

As a consequences of abolition of the office of the C.C I.,the issuer companies charged high premium from the investors The issuing companies looted the then, investors by giving empty promises and by showing rosy pictures in the prospectus.It is also observed that the C C I guidelines did not considered intrinsic characteristics of each company/industry or market conditions of each company at the time of issue In all the issues under study, it is noticed that new shareholders benefited at the expense of the then existing shareholders

It is also concluded that the valuation norms ignore the considerble variations that exist in the price-earning ratio across the industries and corporate sectors A conclusion can also be drwan that the capitalisation rate adopted by the then repealled guidelines was at variance with market valuation The C.C I formula do need modifications as discussed in Chapter No 2 The C.C.I method never gave due weightage to non-financial factors like grwoth of the company, industry, experience of promoter group, industry average profitability, market share of the issuing company, Foreign collborations, export potentials etc. while pricing the issue.

It is also concluded that the formula differ in relation to treatment to equity issues and F C D issues resulting in higher premium arrived at in case of F.C.D issues

Another weakness of the C C.I formula was that the conversion terms of IInd Part of debentures was predecided, in fact if conversion is to take place after 18 months, the price should be decided based on financial performance,at the time of conversion The chapter also discusses guidelines of the Security Exchange Board of India for equity shares, debenture and preference shares etc based on Annexures No. 3, 4, 5, 6, 7 and 8.

In all, it is concluded that the SEBI guidelines also suffers from imperfections and inadequacies The same chapter also reviews Pherwani Committee report, approach of the Reserve Bank of India and financial institutions The relevant points of Malegaon Committee report are also discussed in the same chapter

The 3rd chapter is devoted to analysis and interpretations of financial data of each companies The first portion of the third chapter, i e ,'introduction' gives details of criteria for selection of the companies, sources of data, C.C I. based calculation method etc It also discusses relationship among different variables and relationship of different variables with the share premium. It also describes the variables of the statement no.A, B, C and D based on which calculations are performed It also analyse the reasons for the difference among the fair value of each company.

The write-up at the begining of the analysis of each company describes company background, issue highlights and over all observations of each company based on analysis and calculations The observations are made about underpricing and overpricing at different capitalisation rate, offer price of each issue as a percentage of pre-issue average market price, excess or less amount per equity share or per F.C D., post-issue returns available to the shareholders, maximum and minimum chargeable premium etc. Lastly, at the end of each write-up, the results of the test of the hypothesis were presented Then, calculations as per the C C.I guidelines are performed hypothesis were presented Then, calculations as per the C C I. guidelines are performed

In additions to the above calculations, only for F C D issues, calculations of P E P S and F D.E P S based on U S A reporting system (with indian touch) are made. In the last part of analysis, to observe the impact of changes in different elements of fair value on premium fixation, in absolute term, various calculations based on different combinations of these parameters are also performed in the statement no A to D or A and B, as the case may be, of each company.

Based on the statements no A to D, we can conclude that there exist direct and positive relationship between Net Worth and Fair Value, between Profit After Tax and Earning Per Share, between Profit After Tax and Fair Value Per Share, between Profit After Tax and Earning Per Share and Profit After Tax and Profit Earning Capacity Value Conversly, there exist inverse relationship between Number of Equity Shares and Fair Value Per Share, between Number of Equity Shares and Net Asset Value Per Share, between Number of Equity Shares and Earning Per Share and between Number of Equity Shares and Profit Earning Capacity Value There is also inverse relationship between Fair Value Per Share and Capitalisation rate and Profit Earning capacity Value and Capitalisation rate

The Table No.5 shows maximum and minimum underpricing and overpricing at different capitalisation rates with percentage of underpriced and. overpriced issues Accordingly, maximum underpricing was noticed in the case of B S.E S Limited at all the four capitalisation rate,while minimum underpricing was observed in the case of Shri Krishna Petro Yarn Limited, Lloyed Steel Industries Limited, Punjab Con-cast Steel Limited and Khatau Junker Limited at 15 00%, 12.00%, 10 00% and 8.00% capitalisation rate respectively.

Similarly,maximum overpricing was observed in the case of Onida Savak Limited and minimum overpricing was noticed in the case of Nivas Spinning Mills Limited,ATV Projects (I) Limited, Khatau Junker Limited and Onida Savak Limited at 15 00%,12 00%,10.00% and 8 00% capitalisation rate respectively

The Table No 2 shows company-wise maximum and minimum chargeable price per equity share.

Accordingly, among all these companies,I.C.I C I. Limited can price it's issue at maximum price of Rs.652.20, while Onida Savak Limited can price it's issue at minimum price of Rs.11.26.

The Table No.4 shows company-wise comparision of actual offer price per equity share with the paid-up value per share, with the pre-issue average market price per share, with the net asset value per share, with the P.E.C.V.per share and with the fair value per share.The table shows that the average market price per share was higher than the offer price per share for all the companies under study.

The said table also revealed that the net asset value per share of 13 companies out of the 25 companies under study were less than their offer price per share The table also shows that the fair value per share of 6 companies out of 25 companies were higher than the average market price per share.

The Table No.1 shows company-wise percentage of underpricing and overpricing at different capitalisation rates where in it is seen that at 8.00% capitalisation rate, 96.00% of the companies under study have underpriced their issues.The Table No.3 presents company-wise comparision of actual premium charged with the different premium chargeable. Accordingly, as per U.S.A. reporting system only four companies can charge premium, while nine companies have to issue their share at discount only. Based on statement No. A to D, of the all the companies under study, The Dhampur sugar mills limited can charge maximum premium of Rs.529.20 per share.

As per the C.C.I guidelines, the applicable capitalisation rate was 15.00% in case of 7 companies out of 25 companies under study.The same was 12.00% in case of 6 companies and it was 8.00% in case of 11 companies.

As regards underpricing, there were 16 companies whose issues were underpriced at 15 00% capitalisation rate. Similarly, there were 19 companies whose issues were underpriced at 12.00% capitalisation rate. There were 22 companies whose issues were underpriced at 10 00% capitalisation rate and at 8.00% capitalisation rate, issues of 24 companies were underpriced

As regards overpricing of the issue,there were 10 issues which were overpriced at 15 00% capitalisation rate There were 7 issues which were overpriced at 12.00% capitalisation rate Similarly, there were 3 issues which were overpriced at 10.00% capitalisation rate

As regards the C C I 's direction about the fair value that should be in the range of 80 00% to 100 00% of the pre-issue average market price, only 44 00% of the selected companies have observed the guidelines

As regards mobilisation of excess or less amount per equity share or per fully convertible debenture,61 53% of companies incurred notional loss as the issues were underpriced at 15 00% capitalisation rate, while 38.47% of companies mobilised excess amount per equity share or per fully convertible debenture,as the issues were overpriced at 15 00% capitalisation rate.

Similarly,73 07%,88 00% and 96 00% of the companies under study incurred notional loss as their issues were underpriced at 12 00%, 10.00% and 8.00% capitalisation rate.

The offer price as a percentage of book value per share was less than 100.00% of the book value per share in case of 42 30% of the companies. The offer price as a percentage of the book value per share was in the range of 100.00% to 150.00% of the book value per share in case of 38 46% of the companies and it was more than 150 00% of the book value per share in case of 19 23% of the companies under study. It means that 57 70% of the companies have charged excess price than allowable based on the book value per share of the concerned companies.

In case of 84 00% of the companies under study,the investors could have realised return of more than 100 00% on their investment with in a year of the issue.

In case of 88 00% of the companies,the offer price was highly underpriced compared to the pre-issue average market price and it was moderately underpriced in case of 12 00% of the companies under study.

The study also reveal that the companies under study could have mobilised more money, but they satisfied with the targetted amount The fear of the issue failure could be one of the reasons for underpricing of majority of the issue The presence of the office of the C C.I could be another and perhaps chief reason for underpricing of majority of the issues

As regards observations of hypothesis no 1 is concerned, conservative pricing are noticed in cases of 19 companies out of 25 companies. According to hypothesis no 2,the office of the C C I. has followed uniform premium fixation method for all the issuing companies under study, since there was no other guidelines to follow Based on the observations of hypothesis no.4, it is found that the offer price was highly disproportionate to the pre-issue average market price in cases of 19 companies Similarly, it is also found that offer price was highly disproportionate to the book value per share in cases of 12 companies In case of 9 companies both the book value per share and pre-issue average market price per share were disproportionate to the offer price.

Based on the calculations, analysis and interpretations carried out in chapter no.3, following determinants of the share premium are identified.

1. Net profit and it's consistancy,
2. Net worth,
3. Earning per share,
4. Dividend per share,
5. Profit earning capacity,
6. Pre-issue market price,
7. Book value per share.

The 4th chapter discusses pricing and merchant banking at length. It concludes that the merchant bankers and lead managers have to play very crucial role while pricing the issues they are important intermediary between investors and issueing companies. The merchant bankers have to perform their tasks without any undue favour to the issuing companies, as either underpricing or overpricing is attached with socio-economic costs The survey of merchant bankers and expert's opinion indicates that the premium should be fixed on the basis of financial fundamentals only

According to survey results, the E P S was the most important determinant for premium fixation The next determinant in order of importance was Net Asset Value per share. As per the order of importance, Return on net worth, profit projections and Return on total assets were assigned less weightage.

As regards non-financial factors, promoter group and past performance of the issuing company were rated as most significant factors affecting premium fixation Of the total number of merchant bankers, 67.00% responded that they still use C C I methodology while pricing the issues

All of the respondent merchant bankers unanimously stated that even in free pricing era they do consult the repealled C.C.I guidelines for premium fixation Even the S E.B I has prescribed that the premium arrived at as per the repealled C C.I. guidelines should be mentioned in the prospectus of the issue This means that the repealled C C I guidelines still form a bechmark for premium fixation and hold good today also. The same chapter also suggest the way of legitimising gray market It also presents two models for pricing the issues.

The 5th chapter discusses pricing practices followed in foreign countries. At international level, there do not exist concept of premium The chapter reviews pricing mechanism followed in different countries like U.S.A., Japan, Taiwan,South Korea, Singapore, Malaysia, Nigeria and Pakistan.

The chapter also briefly reviews worldwide phenomena of underpricing.

Suggestions

1) The recommendations of Malegaon Committee covered in the study may be executed in true spirit.
2) Pricing of the issue may be allowed close to the issue date.

3) The premium fixation may be certified by SEBI appointed auditors.

4) The issuing companies should provide comprehensive informations over and above following.

   - An estimate of the minimum/maximum range of offer price.
   - Complete and factual informations about company's cashflow positions.
   - A discussion of any pending or ongoing legal actions involving the company.

5) The gray market may be legalised.

6) The financial projections should not be allowed in prospectus as there is hazard of misleading the investors.

7) Before committing itself to underwrite the issue,a merchant banker or lead manager be allowed to conduct a thorough investigation of the company with the help of SEBI appointed accountants, engineers and other specialists.