

COST OF RAISING CAPITAL

A Study of Public Issues made during 1992-93

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Executive Summary

Objective of the study was to assess as to what proportion of project cost, total issue amount and net public offer gets used up as cost of raising capital from the public and to examine the influence of size on the issue expenses. Out of the total 528 public issues made during 1992-93, the study covered 514 issues for which information on issue expenses was available. Results of the study should be viewed in the light of the fact that issue expenditure as reported by companies in prospectus, in general, happens to be an underestimate.

1. Extent of Net Public Offer absorbed by Issue Expenses

The 514 issues sought to raise Rs. 4,677.74 crores from the general investing public. The estimated expenses on these issues was Rs. 473 crores. If the eight OTC category issues are kept outside the analysis, one finds that about 75 per cent of 506 net public offers did not exceed Rs. 5 crores figure. *In the range of Rs. 1 to 2 crores ninety issues as a whole, spent 12.89 per cent of net public offer as issue expenditure. These 90 issues constituted 18 per cent of total number of public issues under study.* In terms of share claimed by the issue expenditure, net public offers upto Rs. 5 cr. proved to be more costly as compared to other higher categories. This should be viewed in the light of the fact that net public offers of this category are in majority in terms of number. Highest proportion -- 33.02 per cent of net public offer worth Rs. 48.45 lakhs was spent by United Leasing Ltd. Among comparatively bigger issues expenditure by Nagarjuna Fertilizers & Chemicals Ltd amounted to 18.93 per cent of net public offer worth Rs. 84.54 crores.

2. High Issue Costs for Small Projects

At the aggregate level, issue expenses accounted for about 3 per cent of the total project cost of Rs. 15,854 crores. However, as in the case of net public offer, considerable differences exist across different project sizes. About two-thirds of the projects were those whose total project cost was not more than Rs. 10.00 crores. In the case of projects costing upto Rs. 5 crores, issue expenditure formed 6.51 per cent of the project cost. Corresponding figure for the Rs. 5 to 10 crores range was 5.00 per cent, which declines steadily as one moves to higher ranges. In the highest category of more than Rs. 100 crores the share of issue cost was 2.98 per cent. The data, therefore, appears to suggest that smaller projects tend to spend a higher proportion as issue expenditure compared to the larger ones.

3. Need for Unambiguous Guidelines

Present guidelines which were basically framed in 1985 and partially amended thereafter provide for two types of costs: (a) mandatory costs including underwriting commission, brokerage, managers' fees, statutory press announcement expenses and listing fees; (b) other costs comprise printing and distribution expenses, advertisement expenses, etc.

It has been noticed that wide differences exist among companies in respect of amount offered per allottee and per non-allottee to the Registrars. The case of NIIT is worth noting. With Rs. 4.25 (per allottee), Rs. 3.25 (per non-allottee) in addition to other expenses, NIIT is among the companies which paid maximum per allottee and per non-allottee. In sharp contrast, Aravali Leasing Ltd offered Rs. 2.00 less in each case. There is thus a scope for detailed enquiry as to why differences in processing expenses by registrars differ so widely.

As per the guidelines, in addition to mandatory costs certain percentage of issue amount is provided as overall ceiling. In case of premium issues this ceiling becomes less effective as the maximum permissible amount can go up in proportion to the premium charged. It has, however, to be underlined that there exists no clear set of instructions but various opinions on what should be taken as public issue for determining overall ceiling on the amount of expenditure on public issue, (as guidelines provide for mandatory costs *plus* a certain percentage of issue amount).

According to one opinion, public issue for this purpose is the issue amount excluding all categories getting firm allotment. Another suggests that all categories of firm allotment and preferential allotment to promoters should be excluded from issue amount. Yet another view prevailing is that total issue amount net of promoters' contribution is public issue for this purpose. This question assumes importance because in a number of cases, out of the total issue amount, firm and preferential allotments claim a sizeable part reducing the net public offer to a small part of total issue amount. For instance, in case of Reliance Polypropylene Ltd. Net public offer was only 43.46 per cent of what was termed as issue through prospectus. In case of Shivaji Works Ltd net public offer formed a mere 11.44 per cent of the total issue. It is suggested that SEBI may provide clear guidelines in this connection.

4. Need for Better Reporting

It has also emerged that no standard or uniform format exists for reporting issue expenditure in prospectus. Some companies did not provide even an overall estimate of issue expenditure and there was also partial reporting.

In cases where issue expenditure is not shown in the detailed break-up of project cost, investors do not get any idea about it from abridged prospectus-cum-application form because issue expenditure given as a part of 'Statutory and General Information' in the

prospectus does not form part of the abridged prospectus. Needless to say many investors do not get to see a prospectus. *It is suggested that total issue expenditure as percentage to total issue amount and net public offer be reported prominently in the prospectus and abridged prospectus-cum-application form to give the prospective investors a better idea about the extent to which funds raised are being used in raising exercises only and to provide a precise picture of the actual availability of funds to the company for more productive purposes.* For further monitoring purposes it would be helpful in the annual report covering the period during which the issue was made report the final issue expenditure as a distinct item.

5. Policy Implications

The findings of the study raise a few basic issues. The problem of issue expenditure involves much more than what may be tackled by the present guidelines. Issue of better disclosure practices, appropriateness of cost of raising capital, fate of the projects for which funds are raised at a very high cost, real intentions of promoters who do not hesitate to raise funds from public at any cost are related to this.

Small and medium entrepreneurs could have genuine problems in marketing their issues particularly when they are little known to the investing public unlike the established industrial houses and multinational corporations. It is obvious that the viability of the smaller projects and their competitiveness is an issue of great policy concern.

An attempt at comparing OTC issues and other issues with net public offer upto Rs. 5.00 crores shows that cost of raising capital through the OTC route is lower than all the categories of issues that opted for the regular stock exchange way. OTCEI appears to be a better alternative for the ordinary investor also due to two main attractions. One, this would lead to savings in cost of raising capital available to the company in which they intend to have a stake. Two, since OTC issues necessarily have to have a Sponsor who would make market in the scrips for three years, these issues are less likely to be brought by those unscrupulous promoters whose main aim is to raise funds from public without caring for costs and future viability of the projects. Since the Sponsor would have to make market for three years, he is likely to assess projects, promoters, costs, etc. very carefully. Sponsors' direct stake happens to be a different and significant dimension of OTC issues which is absent in regular stock exchange issues. Given the fact that majority of the issues are upto Rs. 5.00 crores, the point needing immediate attention is whether OTCEI can take such a responsibility in the near future.

Introduction*

Issues relating to the cost of raising capital are important mainly for two reasons, one is that the funds available for enhancement of productive investment such as that in land and buildings, plant and machinery, working capital, miscellaneous fixed assets or long term resources get reduced to the extent of this cost. In other words, investment in more meaningful avenues gets reduced to the extent of cost of raising funds. The second reason relates to protection of investors' interest. From investors' angle it becomes important to know about what proportion of total project cost and net public offer amount is going to be used in raising exercises only. And if this amount turns out to be significant, then the manner of reporting of this cost also becomes important enough to form the part of debate and discussion aiming for better corporate information disclosure practices. Further, a better understanding of relative magnitudes of cost of raising capital may help capital market monitoring authorities to formulate suitable policy responses to ensure that the cost of raising fresh resources from the community, which is an index of their use, is kept under constant watch and measures are taken from time to time to keep it under reasonable control'.¹

Recent past and more particularly the year 1992-93 has been phenomenal in terms of funds raised by the corporate sector from the public. 528 issues made through prospectus during 1992-93 to raise Rs. 6,060.83 crores² is a figure which almost equals the combined corresponding figures for the preceding three years 1989-90, 1990-91 and 1991-92. During these three years total capital issues made through prospectus were 524. The corresponding amount offered was Rs. 6,208.97 crores, which is slightly higher than the amount offered during 1992-93³.

These developments indicate the increasing role of issue of securities in financing of the corporate sector⁴. With increasing number of security issues and amount thereof,

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1. Government of India, Ministry of Finance, Report of the High Powered Committee on Stock Exchange Reforms, (hereinafter referred to as G.S Patel Committee Report), 1985, P.45.
2. This includes an issue amount of Rs. 400.00 crores offered by the Industrial Development Bank of India (IDBI) and the Small Industries Development Bank of India (SIDBI).
3. Prime Data Base, Prime Annual Report, Part-I, 1993.
4. Over a long period of time, the share of the amount raised by new issues in the total resources mobilised by private corporate sector through new issues and assistance disbursed by All India Financial Institutions (the IDBI, IFCI, ICICI, LIC, GIC, UTI and IRBI) has gone up significantly. The share works out to 22.89 per cent, 28.66 per cent and 40.08 per cent respectively in the Fifth Plan (1974-75 to 1978-79), Sixth Plan (1980-81 to 1984-85) and Seventh Plan (1985-86 to 1989-90). See: Alok Puranik, "Role of Corporate Securities in Household Saving and Private Corporate Sector Financing During Eighties - Some Empirical Observations" Chartered Secretary, Vol. XXII, November, 1992, New Delhi, pp. 991-995. Also see: U.R. Prasad, "A Note on the Trends in Corporate Borrowings of Large Private

greater freedom for companies to raise funds from the public, and the reform of capital market being one of the main facets of economic liberalisation, the matter of cost incurred by companies to raise funds from public assumes more significance.

In this paper an attempt has been made to analyse the expenditure incurred by companies during 1992-93 for raising capital from the public. In the light of the findings of the empirical exercise and other developments in the capital market, the present guidelines on issue expenditure have also been examined.

The study is based on the data reported by companies in issue prospectus. **Section One** analyses issue expenditure based on all issues made through prospectus during 1992-93. **Section Two** examines the guidelines on issue expenditure and offers a few suggestions besides raising some issues for debate. **Section Three** sums up the main observations of the study and offers a few suggestions. Data, sources and methodology are given in the **Appendix**.

Section One

SIGNIFICANCE OF ISSUE EXPENDITURE

1. An overview of the issues made during 1992-93

A total of 528 companies made issues through prospectus during 1992-93 to raise Rs. 4,885.29 crores from general Indian investing public and Rs. 323.35 crores from NRI investing public to fund projects worth Rs. 16,583.31 crores. Total proposed amount of issues which included contribution from all special categories such as private promoters, foreign collaborators, financial institutions, mutual funds, banks, existing security holders of promoter companies, etc. in addition to the general Indian and NRI investing public was Rs. 9,045.93 crores (Table-1). Equity capital proved to be the most preferred instrument for raising capital as far as number of issues are concerned. Out of 528, the number of equity issues was 479 (373 at par and 106 at premium). In other words, more

Table-1
An Overview of Issues made through Prospectus during 1992-93

(Amount in Rs. Crores)								
S. No. of	Nature of Instrument	No. of Issues	Total through	Issue Cost Pros- pectus	Project Offer to	Net Offer to Indian Public	Net Offer NRI Public	Net Public Offer (6)+(7)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
1	Equity at par	373	1,981.12	1,309.39	3,663.46	1,130.42	103.48	1,233.90
2	Equity at premium	106	1,721.63	1,318.03	5,590.93	1,126.17	70.99	1,197.16
	Total Equity (1+2)	479	3,702.75	2,627.42	9,254.39	2,256.59	174.47	2,431.06
3	Fully Convert. Debs.	21	580.11	268.34	900.70	228.43	13.61	242.04
4	Partly Convert. Debs.	2	225.12	91.96	352.84	77.36	10.00	87.36
5	Bonds	2	400.00	400.00	400.00	400.00	0.00	400.00
6	Composite Issues	24	4,137.95	2,673.11	5,675.38	1,922.91	125.27	2,048.18
	Total	528	9,045.93	6,060.83	16,583.31	4,885.29	323.35	5,208.64

Notes:

- (1) Total Issue amount includes firm and preferential quota reserved for special categories such as promoters, foreign collaborators, employees, mutual funds, banks, security-holders of promotor companies, as the case may be, and general Indian and NRI investing public;
- (2) Issue through prospectus includes amount reserved for preferential allotment to special categories such as promoters, employees, mutual funds, banks, FIs, security holders of promotor companies, etc. as the case may be, besides the amount offered to general Indian and NRI investing public;
- (3) Net Offer to Indian public is the amount offered to general Indian investing public not covered under any of the special categories;
- (4) Net Offer to NRI public: amount offered to general NRI investing public not covered under the categories getting firm allotment;
- (5) Net Public Offer is the total offer made to general Indian and NRI investing public; and
- (6) Composite Issue means the issue in which a company has raised capital through more than one instrument.

than 90 per cent of all issues made through prospectus were equity issues. However, in terms of quantum of money, composite issues (issue of more than one instrument -- some of which also involved equity issues) accounted for 39.32 per cent of total net public offer (NPO) of Rs. 5,208.64 crores to both Indian and NRI investing public.

Table-2 provides an overview of 506 issues after excluding 8 OTC cases and the 14 cases in which companies have not reported issue expenditure from the total 528 issues. Out of these 506, 463 equity issues accounted for 91.50 per cent of total number of issues. This sub-set of 506 companies proposed to raise Rs. 4,345.67 crores from general Indian investing public and Rs. 320.06 crores from NRI investing public to fund projects worth Rs. 15,826.01 crores.

Table-2

An overview of the Issues made through Prospectus during 1992-93
(excluding OTC* Issues and those not reporting full issue expenditure)

(Amount in Rs. Crores)

S. No. of	Nature of Instrument	No Issue Issues	Total through	Issue Cost Pros- pectus	Project Offer to	Net Offer to Indian Public	Net Offer NRI Public	Net Public (6)+(7)
(1)		(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Equity at par	369	1,959.62	1,295.99	3,627.61	1,120.71	100.73	1,221.43
2	Equity at premium	94	1,635.86	1,247.84	5,432.04	1,061.87	70.45	1,132.33
	All Equity Issues (1+2)	463	3,595.48	2,543.83	9,059.65	2,182.58	171.18	2,353.76
3	Fully Convert. Debs.	18	484.05	223.42	798.44	183.81	13.61	197.43
4	Partly Convert. Debs.	2	225.12	91.96	352.84	77.36	10.00	87.36
5	Composite Issues	23	4,104.39	2,651.01	5,615.08	1,901.92	125.27	2,027.19
	Total	506	8,409.04	5,510.22	15,826.01	4345.67	320.06	4,665.74

Note: See: Table-1 for Notes.

* Over the Counter Exchange of India.

2. Extent of Net Public Offer (NPO) absorbed by Issue Expenditure

Some exercises based on net public offer have been attempted keeping the 8 OTC issues outside the analysis. It becomes evident that 75 per cent of 506 net public offers did not exceed Rs. 5 crore figure (see Table-3 and Graph-1). Further, 255 of these were upto Rs. 3 crores. This speaks clearly the dominance of smaller offers in terms of numbers. Since about 75 per cent of net public offers were upto Rs. 5 crores, this category of net public offer has been analysed in a detailed manner.

Issues with net public offers upto Rs. 1 crore were the highest spenders with 17.57 per cent of NPO absorbed as issue expenditure. In the next category of NPO *i.e.*, Rs. 1 to 2 crores, 90 issues as a whole spent 12.89 per cent of NPO as issue expenditure. These issues constituted about 18 per cent of issues under study. The table also shows that issue expenditure as proportion to net public offer is higher in small size offers as compared to bigger ones. In other words, small sized net public offers are proving to be more costly.

However, one finds certain larger issues also to be allocating a significant proportion of NPO towards the issue expenditure. For instance, Nagarjuna Fertilizers and Chemicals Ltd. whose net public offer was Rs. 84.54 crores proposed to spend 18.93 per cent of this amount on the issue itself (Table-4).

Table - 3
Showing Higher Expenditure in Small Issues

Net Public Offer Range (Rs. Crore)	Number of Issues	Issue Expenditure as per cent of Net Public Offer
(1)	(2)	(3)
Upto 1	3	17.57
1 to 2	90	12.89
2 to 3	162	11.70
3 to 4	84	11.27
4 to 5	38	10.92
5 to 10	73	10.77
10 to 15	21	10.27
Above 15	35	9.42
Total	506	10.10

Notes: See Note 5 of Table 1.

Graph - 1

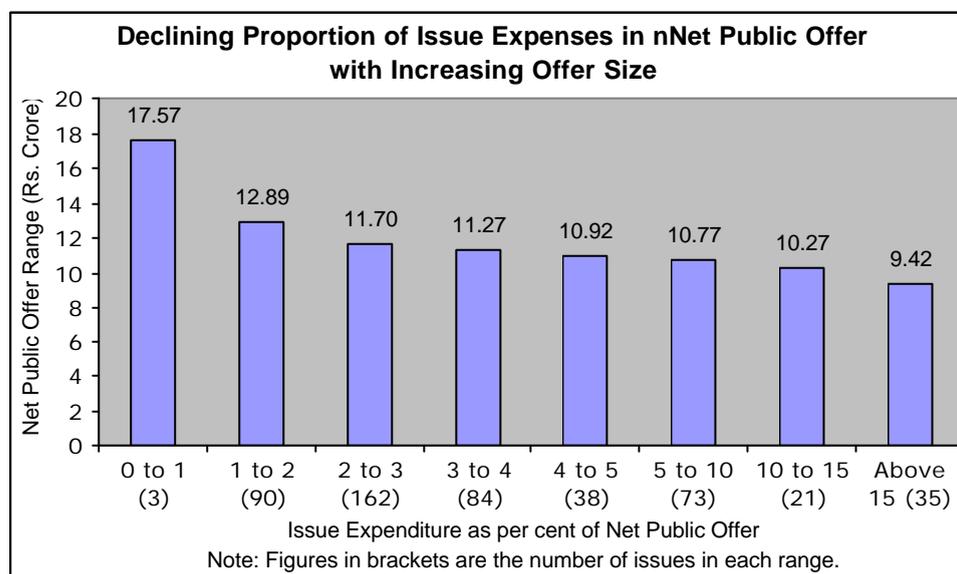


Table-4
Top Ten Spenders based on Net Public Offer

(Amount in Rs. Lakhs)

S.No	Name of the Company	Net Public Offer	Issue Exp- enditure	Issue Exp. as % of Net Public Offer
(1)		(2)	(3)	(4)
A: Issues not involving NRI Participation				
1	United Leasing Ltd.	48.45	16.00	33.02
2	Shivaji Works Ltd.	192.94	60.00	31.10
3	Metalman Pipe Mfg. Co. Ltd.	339.87	95.51	28.10
4	Citicorp Securities & Investments Ltd.	300.00	80.00	26.67
5	Usha Ispat Ltd.	1,018.40	260.00	25.53
6	Chokhani Global Express Ltd.	133.00	33.20	24.96
7	Trimurtee Fertilisers Ltd.	183.20	45.00	24.56
8	Shubham Industries Ltd.	195.51	45.40	23.22
9	Weizmann Industries Ltd.	897.00	200.00	22.30
10	Innovation Medi Equip Ltd.	225.00	50.00	22.22
B: Issues involving NRI Participation				
1	Mcdowell & Co. Ltd.	2,776.38	760.00	27.37
2	Surya Agroils Ltd.	1,786.50	420.00	23.51
3	Punsumi India Ltd.	495.99	106.00	21.37
4	Nagarjuna Fertilizers & Chemicals Ltd.	8,453.76	1,600.00	18.93
5	Malar Hospitals Ltd.	280.25	50.00	17.84
6	Aquamarine Food Products Ltd.	426.76	72.00	16.87
7	Benchmark Homes & Resorts Ltd.	178.50	30.00	16.81
8	Western Paques (India) Ltd.	2,574.00	400.00	15.54
9	Sangam (India) Ltd.	354.45	54.00	15.23
10	Kanishk Steel Industries Ltd.	205.20	30.00	14.62

Notes: 1) For purposes of this list OTC issues have been excluded.
2) See Note (5) of Table-1.

Mcdowell and Co. Ltd. is another important example with net public offer of Rs. 27.76 crores. 27.37 per cent of this amount was to go towards issue expenditure. United Leasing Ltd which spent 33.02 per cent of NPO as issue expenditure is a prominent spender among the smaller issues. In case of Shivaji Works Ltd. the corresponding share of issue expenditure was 31.10 per cent.

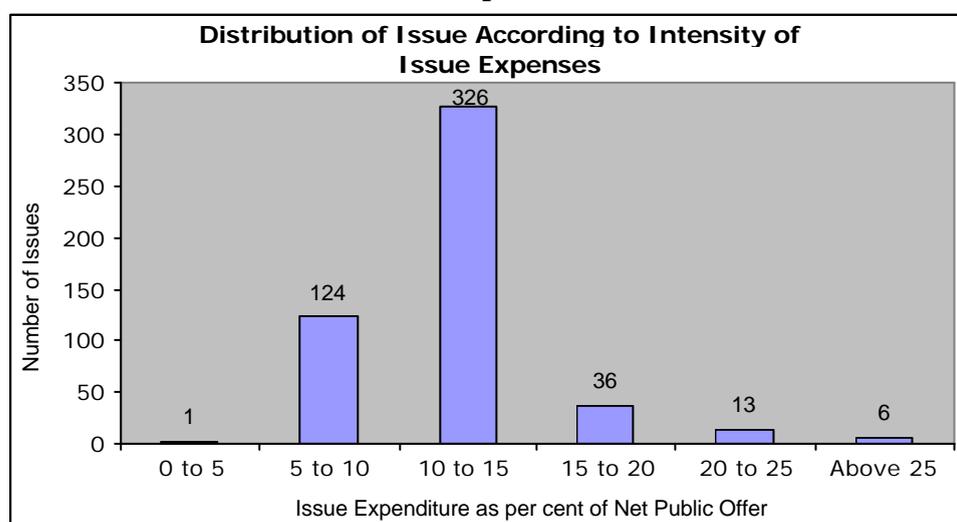
It becomes evident from Table-5 (also see Graph -2) that out of the total 506 companies only one company had spent less than 5 per cent of NPO as issue expenditure. Majority of these companies (64.43 per cent) spent between 10 to 15 per cent of NPO as issue expenditure. 55 companies spent more than 15 per cent of NPO as issue expenditure. Six out of the 506 companies had the dubious distinction of spending more than 25 per cent of NPO as issue expenditure. Over all, about 10 per cent of the net public offer was estimated to have gone towards the issue itself.

Table – 5
Issue Expenditure as Percentage of Net Public Offer

Issue Expenditure as per cent of Net Public Offer	Equity Issues	Debentures and Composite Issues	All Issues
(1)	(2)	(3)	(4)
Up to 5	0	1	1 (0.20)
5 -10	112	12	124 (24.51)
10-15	302	24	326 (64.43)
15-20	32	4	36 (7.11)
20-25	13	0	13 (2.57)
Above 25	4	2	6 (1.18)
Total	463	43	506 (100.00)

Notes: 1) See Table 1 for notes. 2) Figures in brackets in column (4) indicate percentage to total.

Graph - 2



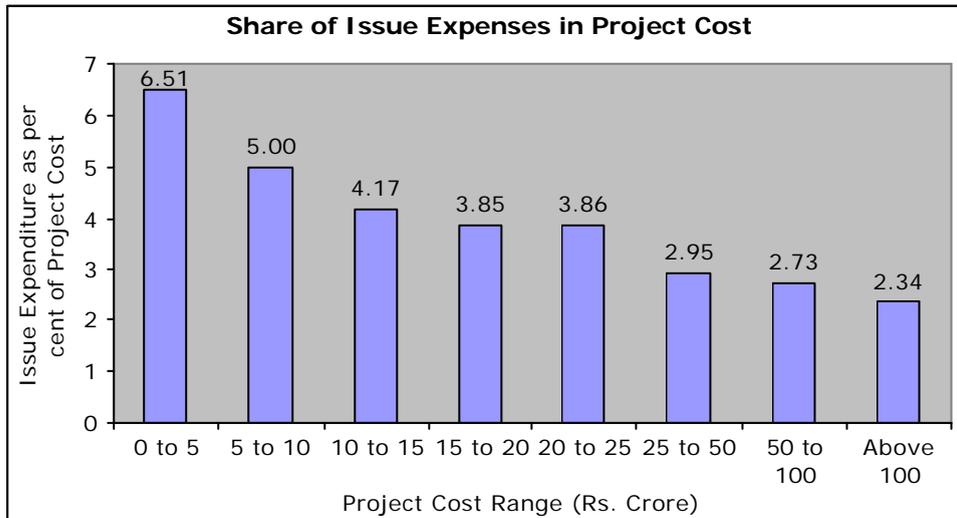
2. Share of Issue Expenditure in Project Cost

Table-6 (Graph-3) gives the issue expenditure in various ranges of project cost of 514 companies (including 8 companies which raised funds through the OTC route). It can be seen that about two-thirds of the projects were those whose total project cost was not more than Rs. 10.00 crores. In the case of projects costing upto Rs. 5 crores, issue expenditure formed 6.51 per cent of the project cost. Corresponding figure for the Rs. 5 to 10 crores range was 5.00 per cent. In the case of projects ranging between Rs. 50 to 100 crores and those with above Rs. 100 crores project cost, issue expenditure accounted for 2.73 per cent and 2.34 per cent respectively of the project cost. The data, therefore, appears to suggest that the smaller projects tend to spend a higher proportion as issue expenditure compared to the larger ones.

Table - 6
Relative Share of Issue Expenditure in Various Ranges of Project Cost

Project Cost Range (Rs. Cr)	Number of Projects	Project Cost	Issue Expenditure	Issue Expenditure as per cent of Net Public Offer ((4)/(3))x100
(1)	(2)	(3)	(4)	(5)
Upto 5	165	670.74	43.69	6.51
5 to 10	171	1,242.67	62.15	5.00
10 to 15	57	688.19	28.71	4.17
15 to 20	36	619.29	23.87	3.85
20 to 25	20	440.02	16.98	3.86
25 to 50	30	1,121.99	33.06	2.95
50 to 100	18	1,230.69	33.56	2.73
Above 100	17	9,840.64	230.69	2.34
Total	514	15,854.23	472.71	2.98

Graph – 3



Further, Table-7 shows that projects spending more than 5 per cent of project cost as issue expenditure are relatively smaller. Average size of projects whose estimated issue expenditure constituted 7 to 9 per cent of the project cost was Rs. 7.39 crores. The corresponding figure for the above 9 per cent category was Rs. 4.73 crores. Table-8 gives the list of top 10 spenders in each of the two categories of 514 issues. It shows that among the issues not involving NRI public participation, M.S. Shoes East Ltd. topped the list with 17.78 per cent of project cost as issue expenditure. In the category of companies involving NRI participation, Ellora steels Ltd. topped the list. The company allocated 10 per cent of project cost towards issue expenditure. In this category, the only company having a project of more than Rs. 5 crores was Surya Agroils Ltd which spent 7.92 per cent of project cost as issue expenditure.

Table-7

Showing the Relationship between Relative Share of Issue Expenditure and Size of Project
(Amount in Rs. Crores)

Issue Expenditure as % of Project Cost	No of Projects	Average Project Cost
(1)	(2)	(3)
Upto to 1	7	566.70
1 to 3	106	39.38
3 to 5	157	34.58
5 to 7	140	11.42
7 to 9	73	7.39
Above 9	31	4.73
Total	514	30.84

3. Extent of Total Issue Absorbed by Issue Expenditure

Table-9 gives issue expenditure as percentage of total issue, in various ranges of total issue amount. It becomes evident that 56.42 per cent of the total 514 issues were in the size range of upto Rs. 5 crores. More than 80 per cent of the issues did not exceed Rs. 10.00 crore figure. The table also shows that, in general, lower sized issues use up a higher proportion of issue amount as issue expenditure. Except for Rs. 25.00 to 50.00 crores range, one finds a steady decline in the share of issue expenditure in the total issue amount. It was noted earlier that in terms of numbers, projects worth upto Rs. 10 crores accounted for two-thirds of the total projects. It was also observed that in more than half of the cases total issue amount was not more than Rs. 5 crores. Therefore, smaller issues/projects were dominating the capital market in terms of numbers. This fact should be viewed in the light of the finding that, in general, these are the cases

Table - 8**List Showing Top Ten Spenders based on Project Cost**

(Amount in Rs. Lakhs)

Name of the Company	Project Cost	Issue Expenditure	Issue Expenditure as % of Project Cost (3)/(4) x 100
(1)	(2)	(3)	(4)
A: Issues not Involving NRI Public Participation			
1 M.S. Shoes East Ltd.	225.00	40.00	17.78
2 Innovation Medi Equip Ltd.	300.00	50.00	16.67
3 Maxwell Apparel Industries Ltd.	413.00	55.00	13.32
4 Sanmac Motor Finance Ltd.	194.36	25.00	12.86
5 Jenson & Nicholson Financial Serv. Ltd.	368.13	45.00	12.22
6 Orde Industries Ltd.	518.81	60.98	11.75
7 Carbon Composites (India) Ltd.	259.66	30.00	11.54
8 Raghunath Cotton & Oil Products Ltd.	764.00	87.20	11.41
9 Elegant Pharmaceuticals Ltd.	440.00	50.00	11.36
10 Veena Textiles Ltd	262.00	28.00	10.69
B: Issues Involving NRI Public Participation			
1 Ellora Steels Ltd.	450.00	45.00	10.00
2 Super Tannery (India) Ltd.	1,270.00	120.00	9.45
3 Sayaji Hotels Ltd.	192.00	18.00	9.38
4 Modern Malleables Ltd.	1,350.00	120.00	8.89
5 Patodia Textile Industries Ltd.	450.00	40.00	8.89
6 Sangam (India) Ltd.	623.00	54.00	8.67
7 Unicorn Pharmaceuticals (India) Ltd.	853.20	69.00	8.09
8 Raj Irrigation Pipes & Fittings Ltd.	340.00	27.00	7.94
9 Surya Agroils Ltd.	5,300.00	420.00	7.92
10 Ratnamani Metals & Tubes Ltd.	657.16	51.50	7.84

Note: This list is based on an analysis of 514 projects including the eight OTC issues.

Table - 9**Issue Expenditure in Various Ranges of Total Issue**

(Amount Rs. Crores)

Total Issue Range (Rs. Cr.)	No of Issues	Total Issue	Issue Expenditure	Issue Expenditure as % of Total Issue
(1)	(2)	(3)	(4)	(5)
Upto 5	290	958.65	79.94	8.34
5 to 10	128	891.32	62.35	7.00
10 to 15	28	342.45	22.17	6.48
15 to 20	22	370.35	23.64	6.38
20 to 25	9	206.26	10.61	5.14
25 to 50	17	593.90	33.16	5.58
50 to 100	10	752.15	37.97	5.05
Above 100	10	4,309.04	202.87	4.71
Total	514	8,424.11	472.71	5.61

Note: See note (1) of Table-1.

where issue expenditure is high whether seen in relation to the total project cost or the total issue amount.

4. Implications of High Costs of Issue

It emerges from the foregoing that in a good number of cases a substantial portion of net public offer, total project cost and total issue amount is getting spent in raising exercises only.⁵ Cost of raising capital is a matter of interest and significance for those who have a stake in the company or likely to have a stake in the company. Expenditure of sizeable amount on raising exercises only implies that the funds available for enhancement of productive investment in resources such as land and buildings, plant and machinery, working capital, miscellaneous fixed assets and building of long term resources get reduced to the extent of this expenditure. This is likely to affect small projects adversely. One point also becomes clear that if it is possible to raise funds from public by spending a high proportion of issue amount on raising exercises, unscrupulous promoters are unlikely to hesitate to raise funds from public. This makes it imperative that problems relating to cost of raising capital need specific attention of policy makers.

5. A Comparison of Issue Costs: OTC and Regular Stock Exchange Issues

The OTCEI has been claiming for sometime that cost of raising capital through the OTC route is much less than the costs involved in the regular stock exchange option⁶.

5. It is not out of place here to discuss in brief about the scenario of cost of raising capital abroad. In USA, there are three primary means by which companies offer securities to the general public; traditional (or firm commitment) underwriting, a best efforts offering and a shelf registration. In the traditional underwriting way, an investment banker, or group of investment bankers buy the new securities from issuing company and then resell them to investors (at retail). For this service, investment bankers receive the difference or underwriting. In best efforts offering way instead of underwriting a security issue, investment bankers may enter into an agreement with the company to sell only as many securities as they can at an established price. In other words, they do not underwrite the issue. The third way i.e. shelf registration allows a company to register a quantity of securities' put them on the shelf' and sell them in successive issues for upto two years. Usually, large and established companies follow this method. Cost of raising capital through large common stock issue, using a traditional underwriting might run 3 to 4 per cent of the gross proceeds. A study done by Securities and Exchange Commission indicated that with shelf registration cost would run about 2 to 3 per cent. For smaller issues, this cost as a percentage of gross proceeds of the issue is higher as compared to that of bigger issues. See: James C. Van Horne, Financial Management and Policy, Prentice Hall of India, New Delhi, 1991, pp. 562-563 and James C. Van Horne and John M. Wachowicz Jr., Fundamentals of Financial Management, Prentice Hall of India, New Delhi, 1993, pp. 577-580.

6. One of the objectives of Over the Counter Exchange of India (OTCEI) is to create a stock exchange which will help companies raise finance from capital market in a cost-effective manner. There are two ways to make offer through the OTC. First is to offer capital directly to public with fulfilling requirements for listing at OTC. Getting a Sponsor is one of the requirements. The Sponsor would make market for its scrip for a period of 3 years. Another way is to approach a member of OTC, who would act as Sponsor and buy out the total capital

During 1992-93 eight companies chose the OTC route to raise capital (Table 10). Out of the combined total issue of Rs. 15.07 crores total NPO was Rs. 12 crores. Five of the OTC issues had offered equity at premium, two were FCD issues and the remaining one was equity at par.

Combined issue expenditure of the eight OTC issues was Rs. 1.35 crores which accounted for 11.25 per cent of the total NPO. It is interesting to note that out of total issue expenditure of Rs. 1.35 crores, a single company Maxwell Apparel Industries Ltd. alone accounted for Rs. 55 lakhs. This company also topped the list of spenders in the OTC category as the issue expenditure covered 13.32 per cent of the NPO. If one leaves out this extreme case, the combined issue cost works out to be 9.07 per cent of total NPO. Although results based on a small number of OTC issues cannot strictly be compared with those for a very large set of companies which chose the regular stock exchange way for issuing capital, a comparison based on similar sized offers may still give an idea of the relative performance of the two modes in minimising the issue cost. It may be noted that the highest NPO made by any OTC issue during 1992-93 was Rs. 3.51

which the company intends to offer to the public. The Sponsor would later sell the shares at an appropriate time through an 'offer for sale' to the public. One of the advantages cited for investors in this practice is that since for issuing capital through OTC a company needs a Sponsor, this indirectly means additional protection for the investor as a Sponsor would not be interested to take a monetary risk if the project appears to be unviable one. As regards the cost of raising capital, if the company chooses to go directly to public, then it is to incur the expenditure as is done in case of regular stock exchange issues. If it chooses to sell out capital first to a Sponsor, who in-turn would off load it to the public, then also it is not necessary that the cost is borne by sponsors. Two main reasons cited for effecting a saving in the cost of raising capital through OTC are as follows: (a) Listing agreement on regular stock exchanges prescribes that a company should provide for at least 57 centres (recent SEBI guidelines has reduced this number to 30) for collecting application money while the OTC prescribes a minimum of 4 collection centres for any public issue. (b) On regular stock exchanges companies pay listing fees to each of the exchanges on which, it proposes to get listed. A company on the OTCEI would, however, pays listing fees only to one exchange. Although companies with an issued equity capital of more than Rs. 30 lakhs and upto Rs. 25 crores may seek listing at OTC, its main focus is on small and medium-sized companies. For further details, see: Brochure of 'OTC Exchange of India'; R. Ravimohan, 'OTC Exchange of India: A Brief Outline', Background Material for Seminars on Financial Services, Institute of Chartered Accountants of India, New Delhi, 1992, pp. V-I 1-4; Prema Aiyer, 'OTC Exchange of India: Operations and Prospects', All India Conference on Capital Market Trends and Investment Consultancy, Institute of Chartered Accountants of India, New Delhi, 1992, pp. IV-B, 1-11; Nipum S. Mehta, OTC Exchange of India, Jaico Publishing House, New Delhi, 1992; Indrani Datta Gupta, 'OTCEI issues - The Instant Version Arrives', The Economic Times, Sept. 16, 1993; and 'Instant Relief' Capital Market, Bombay, October 10, 1993, p. 27.

Table - 10

An Overview of the OTC Issues made during 1992-93

(Amount in Rs. Lakhs)

SNo	Name of the Company	Nature of Issue	Total Issue	Project Cost	Net Public Offer	Issue Expenditure	Issue Expenditure as % of	
							Net Public Offer	Total Project Cost
(1)		(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Maxwell Apparel Inds. Ltd.	Equity#	379.50	413.00	321.68	55.00	17.10	13.32
2	Rustom Spinners Ltd.	-do-	153.00	153.00	67.50	10.75	15.93	7.03
3	Vasundhara Rasayans Ltd.	Equity@	40.00	362.00	38.00	6.00	15.79	1.66
4	Surat Fashions Ltd.	FCD	150.00	500.00	124.29	15.00	12.07	3.00
5	Aurangabad Asbestos Cement Products Ltd.	Equity#	165.00	165.00	129.60	15.00	11.57	9.09
6	Chordia Food Products Ltd.	FCD	136.54	193.00	76.00	8.00	10.53	4.15
7	Co-nick Alloys (India) Ltd.	Equity#	92.80	645.00	92.80	7.00	7.54	1.09
8	Electronica Machine Tools Ltd.	-do-	390.00	*	351.00	18.00	5.13	4.62
Total			1506.84	2431.00	1200.87	134.75		

* This company had no new project. The existing shareholders offered equity shares and there was no fresh issue of capital.

At Premium; @ At Par.

crores by Electronica Machine Tools Ltd. An attempt at comparing OTC issues and other issues with NPO upto Rs. 5.00 crores has been made in Table-11. It shows that cost of raising capital through the OTC route is lower than all the categories of issues that chose the regular stock exchange. Further calculations show that issue expenditure claimed 17.57 per cent of net public offer as a whole in case of those 3 regular stock exchange issues which did not offer more than Rs. 1 crores' issue to general public. Corresponding figure was 11.57 per cent in case of those 4 OTC issues, which did not offer more than Rs. 1 crores' issue to general public.

Table-11**Share of Issue Expenditure in Net Public Offer of Upto Rs. 5 crores**

Category		No. of Issues	Issue Expenditure as % of NPO
(1)	(2)	(3)	
A:Regular Stock Exchange Issues			
1.	Equity at par without NRI public participation	252	11.84
2.	Equity at par with NRI public participation	68	10.65
3.	Equity at premium without NRI public participation	39	11.64
4.	Equity at premium with NRI public participation	9	13.01
5.	Debentures and composite issues	9	12.75
B:OTC issues		7	9.07

Notes:

1. One extreme case of Maxwell Apparel Industries Ltd. accounting for more than 40 per cent of total issue expenditure incurred by eight OTC issues has been excluded.
2. Out of seven OTC issues 4 are equity at premium, 2 are FCD and one is equity at par.
3. None of the OTC issues involved NRI public participation.
4. Out of nine debenture and composite issues four involved NRI public participation.

Section Two

PRESENT GUIDELINES IN THE CONTEXT OF RECENT TRENDS AND DEVELOPMENTS

Present guidelines on issue expenditure⁷ provide for two types of costs of issuing securities -- (1) mandatory costs and (2) other costs. Mandatory costs include underwriting commission, brokerage, fees to managers to the issue, fees to registrars to the issue, statutory press announcements and listing fees. Other costs comprise of printing and distribution expenses, publicity and advertisement expenses and miscellaneous expenses. The guidelines on various components of mandatory costs are described in the following.

1. Registrars' Fees

Examination of present guidelines on issue expenditure indicates that the guidelines do not pay even as much attention to registrars' expenses as they show towards other components of the mandatory costs such as underwriting commission, brokerage, etc. For underwriting commission and brokerage specific guidelines exist. But about registrars expenses, the guidelines mention only that fees to registrars to the issue forms a part of mandatory costs⁸. In effect, for Registrars fee as such, there exist no guidelines. This is surprising because the Registrars' fees forms a significant part of mandatory costs.⁹ Companies also do not provide a consolidated estimated figure of registrars' fees in prospectus. Instead, the usual practice is to give an amount to be paid per allottee and per non-allottee. There are wide differences between the amount offered per allottee and per non-allottee to the Registrars. Table-12 provides the necessary evidence in this regard.

7. See: Notifications of the Ministry of Finance, Department of Economic Affairs, Stock Exchange Division -- (i) Notification No. F-14/1/SE/85 dated 7.5.85; (ii) Notification No. F-14/1/SE/85 dated 12.7.85; and (iii) Notification No. F-14/1/SE/85 dated 6.6.1990. Also SEBI, "Guidelines for Disclosure and Investor Protection, Clarification VIII", dated October 11, 1993 (hereinafter SEBI Clarification VIII) and G.S. Patel Committee, *op. cit.*, pp. 45-59.

8. See: Notification No. F/14/1/SE/85 Government of India, Ministry of Finance, Department of Economic Affairs, Stock Exchange Division, July 12, 1985.

9. Registrars handle the post-issue work such as coordination with the bankers to the issue for accounting of receipt of applications and amounts, arranging for processing and tabulation of data, furnishing of required information regarding receipt of applications and amounts collected centre-wise and state-wise, completion of formalities for allotment of issues, printing and despatch of refund orders, allotment letters, share certificates and maintaining of registers connected therewith, etc. The G.S. Patel Committee Report observed that expenses of the registrars to the issues account for as much as 3 to 4 per cent of the issue amount in case of majority of public issues making it one of the most important components of the issue expenditure. See: G.S. Patel Committee, *op. cit.*, P.56.

The case of NIIT is worth noting. With Rs. 4.25 (per allottee), Rs. 3.25 (per non-allottee) in addition to other expenses, NIIT is among the companies which paid maximum per allottee and per non-allottee. There is a scope for further detailed enquiry into the issue as to why the differences in processing expenses by registrars differ so widely.

Table-12

Illustrative List Showing Wide Divergence in Registrars' Fees

S. No.	Name of the Company	Registrars Fees		Minimum amount committed by the Company (Rs.)	Remarks
		Per allottee (Rs.)	Per non-allottee (Rs.)		
(1)	(2)	(3)	(4)	(5)	
1.	NIIT Ltd.	4.25	3.25	30,000	other expenses also to be paid
2.	Gujarat Dehyd Foods Ltd	3.65	1.66	N.A.	--
3.	Reliance Polypropylene Ltd*	3.00	1.95	N.A.	other expenses also to be paid
4.	Arvind Polycot Ltd.	2.85	1.75	N.A.	--
5.	Videocon International Ltd.	2.50	1.50	N.A.	--
6.	Mastek Ltd.	2.50	1.70	N.A.	other expenses also to be paid
7.	MIRC Electronics Ltd.	2.50	1.25	50,000	--
8.	Jindal Photo Films Ltd.	2.35	1.35	50,000	--
9.	Apple Credit Corporation Ltd.	2.25	1.50	N.A.	--
10.	Aravali Leasing Ltd.	2.25	1.25	N.A.	other expenses also to be paid

Notes: * Additional Rs. 1.50 per stock invest.
N.A. Not Available.

2. Fees to Managers to the Issue

Guidelines on fees to Managers to the Issue framed in 1985 and amended in 1990 were effective during the whole year 1992-93, the period covered by our study. However, with the introduction of new SEBI guidelines applicable in respect of the offer documents submitted to SEBI for vetting on or after December 1, 1993, "the lead managers are free to negotiate the management fee with the issuer company".¹⁰ Guidelines that were effective for the period under study provided that aggregate amount payable as fees to manages to the issue shall not exceed the following limits:

- a) For issues upto Rs. 25 crores* - 0.5 %

10. See: SEBI, Clarification No. VIII.

b) For the additional amount over and above Rs. 25 crores* - 0.2 %

* Revised from Rs. 5 crores to Rs. 25 crores vide Notification F.NO. 14/1/SE/85, Government of India, Ministry of Finance, Department of Economic Affairs, Stock Exchange Division, June 6, 1990.

Further, managers to the issue shall not be paid any fees in respect of the following:

- a) Amounts agreed to be taken up by the financial institutions and the amounts devolving on the financial institutions as investors/underwriters;
- b) Promoters' quota of capital, including the amount taken up by the employees, directors, their friends and business associates; and
- c) On amounts subscribed on rights basis.

3 Underwriting Commission¹¹

Present guidelines treat expenditure on underwriting commission and brokerage in a somewhat detailed manner.

	<u>Underwriting Commission</u>	
	On amounts devolving on the underwriters	On amounts subscribed by the public
(A) Equity shares	2.5%	2.5 %
(B) Preference shares/convertible and non-convertible debentures		
(a) For amounts upto Rs. 5 lakhs	2.5%	1.5%
(b) For amounts in excess of Rs. 5 lakhs	2.0%	1.0%

- (i) The rates of underwriting commission mentioned above are maximum ceiling rates, within which any company will be free to negotiate the same with the underwriters.
- (ii) Underwriting commission will not be payable on amounts taken up by the promoters' group, employees, directors, their friends and business associates.

Underwriting was mandatory for net offer to the public during the period of study.¹² However, new SEBI Guidelines have introduced some changes applicable in

11. The underwriting commission, as is commonly understood, is the amount payable to a person who undertakes the risk of devolvement of a fixed amount of the issued capital offered to the public and underwritten by him, if the said capital is not fully subscribed by the public. If the issue is oversubscribed or fully subscribed, the full underwriting commission is paid to the underwriter on the amount underwritten. Underwriting commission constitutes about 30 per cent of total cost of issue to the public. See: G.S. Patel Committee, op.cit., pp. 46-47. Also See: M. Thiripalraju, 'Changing Structure of Underwriting Business in India', Chartered Financial Analyst, Hyderabad, March-April, 1992, pp. 3-10.

12. See: SEBI, "Consolidated Guidelines for Disclosure and Investor Protection", April 1993, p. 13.

respect of the offer documents submitted to SEBI for vetting on or after December 1, 1993.¹³

4. Brokerage

- i) Brokerage rate applicable to all types of public issues of industrial securities is fixed at 1.5 % whether the issue is underwritten or not;
- ii) The mailing cost and other out-of-pocket expenses for canvassing of public issues, etc. will be borne by the stock brokers and no payment on that account will be made by the companies. A clause to this effect must be included in the agreement to be entered into between the broker and the company;
- iii) Listed companies are allowed to pay brokerage on private placement of capital at the maximum rate of 0.5%;
- iv) Brokerage will not be allowed in respect of promoters' quota, including the amounts taken up by the directors, their friends and the employees; and in respect of the rights issues taken up or renounced by the existing shareholders; and
- v) Brokerage will not be paid when the applications are made by the institutions/banks against their underwriting commitments or on the amounts devolving on them as underwriters consequent to under-subscription of the issues.

13. As per the new provisions, where the issuer company makes arrangements for firm allotment of securities to the extent of 75 per cent (including promoter's contribution) of the proposed issue amount the requirement as to mandatory underwriting to the extent of public offer shall not apply subject to the issuer company fulfilling the conditions (i) the persons to whom firm allotment is proposed to be made have given legally enforceable written commitment to take up the shares on allotment and the issuer company makes disclosures to that effect in the prospectus; and (ii) if the balance 25 per cent is not subscribed in full the issue will be deemed to have failed and the issuer company will be bound to return all the moneys including those, if any, received from the persons to whom firm allotment is proposed to be made. However, otherwise for the purpose of mandatory underwriting the amount to be underwritten in any public issue will be aggregate of the amounts offered under reserved categories and the net offer to public. It is expected that these provisions may bring down the cost of issue considerably, if a company can make arrangement for firm allotment of 75 per cent of issue, it can save expenditure on underwriting commission. But this would be worth examining later on as to how many issues can manage to get firm subscription to the extent of 75 per cent of issue. Another recent step by SEBI applicable in respect of the offer documents submitted to SEBI for vetting on or after December 1, 1993 is also expected to bring down the costs of postage etc. As per new provision the minimum amount of subscription has been put at Rs. 5,000 per application. It is expected by authorities that this will reduce the number of applicants. See: SEBI, Clarification No. VIII and "Proposed Reforms in the Primary Market", Consultative Paper No. VII, 1993.

5. Advertisement and Publicity Expenditure

Expenditure on advertisement and publicity does not form part of mandatory costs. No separate details of advertisement and publicity expenses are offered in the prospectus. It is, therefore, not possible to calculate their share in total issue expenditure. However, in a number of cases, it may be made out that amount spent on this head appears to be not insignificant. Take the cases of Nagarjuna Fertilisers and Chemicals Ltd, Indian Petrochemicals Ltd, Reliance Polypropylene Ltd and Reliance Polyethylene Ltd. Advertisement campaigns of these companies in visual and print media appeared for a considerably long period of time. It may be noted that in the era of free pricing, companies that fix their premium over what market can normally accept may have to, in order to hard sell the issue, spend considerably large amounts on advertisement and publicity.

It is not out of place to mention that most of the companies issuing securities hold press conferences in five star hotels and give various types of gifts to press persons in order to get a positive coverage. These gifts may include gift coupons worth Rs. 250 to Rs. 1,000, silver coins (priced Rs. 100 to Rs. 500), bed sheets, shirts, suit lengths, etc. Giving such expensive gifts to media persons has almost become customary. In cases where issue expenditure tends to form a very important portion of the amount planned to be raised, the expenditure on advertisement and publicity acquires added importance. It would be better, if the amount planned to be spent on advertisement and publicity is given separately as a component of the total issue expenditure.

6. Overall Ceiling on Issue Costs

The overall ceiling on the expenditure on public issues of capital is as follows:

Particulars/size of the issue	Limit of the Cost
(a) Equity and Convertible Debentures:	
- Up to Rs. 5 crores	Mandatory costs + 5%
- Amount in excess of Rs. 5 crores	Mandatory costs + 2%
(b) Non-Convertible debentures:	
- Up to Rs. 5 crores	Mandatory costs + 2%
- Amount in excess of Rs. 5 crores	Mandatory costs + 1%

It has, however, to be underlined that there exists no clear set of instructions on what should be taken as public issue for determining overall ceiling on the amount of expenditure on public issue, as guidelines provide for mandatory costs plus a certain percentage of issue amount. What should be treated as public issue amount for this purpose? This question assumes importance because in a number of cases, out of the total issue amount, firm and preferential allotments claim a sizeable part reducing the NPO to a small part of total issue amount. For instance, in case of Reliance Polypropylene Ltd. NPO was only 43.46 per cent of what was termed as issue through prospectus (Tables-13 & 14).

Corresponding figures in case of Reliance Polyethylene Ltd and Citicorp Securities and Investments Ltd. were 45.00 and 37.50 per cent respectively. Similarly, in the case of Sterlite Industries (India) Ltd NPO was only 19.96 per cent of what was termed as total issue. In case of Usha Ispat Ltd. and Shivaji Works Ltd. it was 13.38 per cent and 11.44 per cent respectively. Since in many cases, the difference between total issue amount, amount offered through prospectus and NPO happen to be quite substantial, the question of determination of public issue for assessing the cost of raising capital deserves greater attention than what it gets at present from policy planners and the authorities. Our discussions with the merchant bankers and chartered accountants also confirmed the absence of un-ambiguous set of guidelines. More importantly, the prevailing feeling among the merchant bankers is that the guidelines are too irrelevant to be taken seriously.

A few prevailing interpretations of the composition of public issue are presented below.

What forms Public Issue for determining Ceiling of Issue Expenditure ?

Investor Category	Opinion I	Opinion II	Opinion III
Reserved for firm allotment to:			
1. Promoters	-	-	-
2. Foreign Collaborators	-	-	Yes *
3. Financial Institutions	-	-	Yes
4. Banks/Mutual Funds	-	-	Yes
Reserved for preferential allotment to:			
1. Promoters	Yes	-	-
2. Employees	Yes	Yes	Yes
3. Existing Shareholders	Yes	Yes	Yes
4. Shareholders of Promoter Companies	Yes	Yes	Yes
5. FIs, Banks and Mutual Funds	Yes	Yes	Yes
General investing public	Yes	Yes	Yes

Note: This presentation is based on discussions with a number of merchant bankers, chartered accountants and stock exchange authorities.

* If these are not among the promoters.

Table - 13

Illustrative List Showing Extent of Net Public Offer in Issue Through Prospectus

(Amount in Rs. lakhs)

S.No	Name of the Company through Prospectus	Issue Offer	Net Public as % of Issue through Prospectus ((3)/(2)) x 100	Net Public Offer
(1)	(2)	(3)	(4)	
1	Zenith Computers Ltd.	1,758.44	1,212.60	68.96
2	Narmada Agro Industries Ltd.	240.00	158.00	65.83
3	Weizmann Industries Ltd.	1,380.00	897.00	65.00
4	Mcdowell & Co. Ltd.	4,652.18	2,776.38	59.68
5	Madhumilan Syntex Ltd.	680.00	368.00	54.12
6	Morepen Laboratories Ltd.	725.00	365.00	50.34
7	Lloyds Finance Ltd.	3,116.75	1,430.00	45.88
8	Reliance Polyethylene Ltd	32,500.00	14,625.00	45.00
9	Reliance Polypropylene Ltd.	32,500.00	14,125.00	43.46
10	Citicorp Securities & Investments Ltd.	800.00	300.00	37.50

Table - 14

Illustrative List Showing Extent of Net Public Offer in Total Issue

(Amount in Rs. Lakhs)

S.No	Name of Company	Total Issue	Net Public Offer ((3)/(2)) x 100	Net Public Offer as % of Total Issue
(1)	(2)	(3)	(4)	
1	Mcdowell & Co. Ltd.	10,999.60	2,776.38	25.24
2	Waterbase Ltd.,The	2,295.00	561.00	24.44
3	Phoenix Electric (India) Ltd.	600.00	142.50	23.75
4	Nath Pulp & Paper Mills Ltd	3,111.36	718.04	23.08
5	Arihant Cotsyn Ltd.	1,800.00	387.00	21.50
6	GBC Hi-tech (India) Ltd.	235.00	48.25	20.53
7	Phoenix Lamps India Ltd.	2,359.00	479.75	20.34
8	Sterlite Industries (India) Ltd.	61,423.08	12,262.68	19.96
9	Usha Ispat Ltd.	7,612.00	1,018.40	13.38
10	Shivaji Works Ltd.	1,686.00	192.94	11.44

According to Opinion-I, public issue is the issue amount excluding all categories getting firm allotment. Opinion-II suggests that all categories of firm allotment and preferential allotment to promoters should be excluded from the issue amount for determining public issue. Opinion-III indicates that the issue amount net of promoters' contribution is public issue for this purpose. It, thus, appears that it is a matter of interpretation and opinion and not one of clear cut calculations. Merchant Bankers agree that the guidelines being ambiguous leave scope for ones' own interpretation. It is not out of place to discuss about what the *Companies Act* says about public offer. The Act does not deal specifically with what should be treated as public issue. Section 67 sub-section (1) of the Act states that an offer to the public shall include a reference to offering to :

... any section of the public whether selected as members or debenture-holders of the company is, as the sub-section itself states, to be read subject to the provisions of sub-sections (3) and (4). Sub-section (3) states that no offer shall be treated as made to the public if the offer or invitation can be regarded as "not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation."¹⁴

On this the Ramaiya Guide on the Companies Act comments: "These provisions, which are merely copied from the English section are somewhat difficult to construe in the abstract and each case will have to be decided on its own facts and circumstances"¹⁵. With the new SEBI guidelines applicable on offer documents submitted on or after December 1, 1993 a company may, in general, limit its net public offer to 25 per cent of total issue amount by way of firm allotments and reservations.¹⁶ But these guidelines also do not indicate as to what should be treated as public issue for determining over all cost of raising capital. It is suggested that SEBI may provide clear guidelines on what should be considered as public issue for this purpose.

It is also evident from the foregoing that there is no overall ceiling based on the issue amount as such. Instead, in addition to mandatory costs, a certain percentage of issue amount is provided as overall ceiling. In the era of free pricing of public issues, many companies are issuing their securities at a premium, which happens to be number of times the amount of face value. In such cases the amount of public issue tends to increase to the extent premium is charged. Table-15 provides an indicative list of companies and the corresponding face and issue values of securities. The point, however, is that in case of those issues, where premium charged happens to be a number of times the amount of face value, the

14. A. Ramaiya, A Guide to the Companies Act, Wadhwa and Company, Nagpur, 1991, P. 261.

15. *Ibid.*, P. 261.

16. See: SEBI, Clarification No. VIII and Consultative Paper No. VII.

Table - 15

Illustrative List of Premium Issues

(Amount in Rs. lakhs)

S.No.	Name of the Company	Face Value	Total Issue including Premium	Issue Amount as a Proportion of Face Value (3)/(2)
(1)		(2)	(3)	(4)
1.	Weizmann Industries Ltd	565.80	2,539.20	4.49
2.	Lloyds Finance Ltd	735.00	4,777.50	6.50
3.	Madhumilan Syntex Ltd	505.00	1,010.00	2.00
4.	Aruna Sugars Finance Ltd	250.00	375.00	1.50
5.	S M Finance Ltd	672.26	1,680.65	2.50
6.	Vallabh Steels Ltd	170.00	340.00	2.00
7.	Bhatinda Chemicals Ltd	290.00	435.00	1.50
8.	Videocon International Ltd	6,250.00	20,000.00	3.20

Notes: See Table 1.

guidelines based on a certain percentage of amounts of issue are rendered less effective as the maximum permissible amount can go up in proportion to the premium charged.

It appears that the guidelines basically framed in 1985 cannot address to the developments that have taken place as a result of free pricing of public issues.

Section Three

SUMMING UP

1. Main Empirical Results

What emerge from the study are a few basic issues. On an average more than 10 per cent of the funds raised from general public went towards issue expenses. It is has been observed that in about seventy-five per cent cases out of 514 issues studied net public offer did not exceed Rs. 5.00 crores and that issue expenditure as proportion to net public offer was highest for these issues. Even among these, the position of smaller issues was considerably worse. Net public offers ranging between Rs. 1 to 2 crores numbering 90 spent on an average 12.89 per cent of net public offer as issue expenditure. These results should be seen in the light of the fact that issue expenditure as reported by the companies in prospectus, in general, happens to be an underestimate.

The small and medium entrepreneurs could have genuine problems in marketing their issues particularly when they are little known to the investing public unlike the established industrial houses and multinational corporations. In comparatively smaller projects costing upto Rs. 5.00 crores, issue costs claimed a share of above 5 per cent. Needless to say, the viability of the smaller projects and their competitiveness is an issue of great policy concern. Appropriateness of cost of raising capital, fate of the projects for which funds are raised at a very high cost, intention of promoters who do not hesitate to raise funds from public at any cost are other related issues.

2. Need for Unambiguous Guidelines on Issue Expenditure

It also emerged that there do not exist clear cut guidelines on what should be treated as public issue for determining over all cost of raising capital. In the absence of unambiguous guidelines, it becomes a matter of convenient interpretations. Determination of public issue becomes very important in those cases where differences between total issue, issue through prospectus and net public offer are substantial. SEBI guidelines in this connection would be welcome. Surprisingly, wide differences exist among issues in respect of Registrars' fee. There is scope for detailed enquiry as to why differences in processing expenses by Registrars differ so widely.

Guidelines for issue expenditure provide that auditors of the companies concerned should be required to qualify the reports suitably, if the cost of public issues of the concerned companies exceeds the overall limits. It should be a matter of enquiry, how many company reports have been qualified by the auditors as per the guidelines on issue expenditure. The annual report covering the period during which the issue was made

should report the final issue expenditure as a distinct item. Further, guidelines also provide that adherence to the ceiling on expenditure will be a pre-condition for listing of securities on stock exchanges for new companies and for continued listing in the case of listed companies. It would be interesting to know how many companies have been denied listing or continued listing on the basis of these guidelines.

3. Need for Better Reporting

It has also emerged that no standard or uniform format exists for reporting issue expenditure in prospectus. Some companies did not provide even an overall estimate of issue expenditure and there was also partial reporting. It is also worth-noting that issue guidelines provide nothing on an important mandatory cost such as Registrars' fees.

In the light of the fact that issue expenditure tends to form a sizeable portion of total issue amount in a good number of cases, the manner of reporting this amount need to be looked into so that monitoring of this major expenditure head could become possible. Estimated consolidated amount of expenditure on advertisement and publicity should also be reported separately as a component of other costs of the issue. In cases where issue expenditure is not shown separately as part of project cost, investors do not get any idea about it from abridged prospectus cum application form because issue expenditure given as a part of 'Statutory and General Information' in the prospectus does not form part of abridged prospectus. *It is also suggested that total issue expenditure as percentage to total issue amount and NPO be reported prominently in the prospectus and abridged prospectus cum application form to give the prospective investors a better idea about the extent to which funds raised are being used in raising exercises only and to provide a precise picture of the actual availability of funds to the company for productive purposes.*

4. Possible Role of OTCEI in Helping Smaller Issues

The very fact that there is large variation in the share of issue expenditure in the net public offer is indicative of the wide scope for introducing remedial measures. From the investors' point of view, as also in the interest of genuine small and medium entrepreneurs OTCEI appears to be a better alternative. Specifically, for the ordinary investors there are two main attractions. One, this would lead to savings in cost of raising capital available to the company in which they intend to have a stake. Two, since OTC issues necessarily have to have a Sponsor who would make market in the scrips for three years, OTC issues are less likely to be brought by those unscrupulous promoters whose main aim is to raise funds from public without caring for costs and future viability of the projects. Since he would have to make market for three year, the Sponsor is likely to assess projects, promoters, costs, etc. very carefully. Sponsors' direct stake happens to be a different and significant dimension of OTC issues which is absent in regular stock exchange issues. Given the fact that majority of the issues are upto Rs. 5.00 crores, the point needing immediate attention is whether OTCEI can take such responsibility in the near future.

Appendix

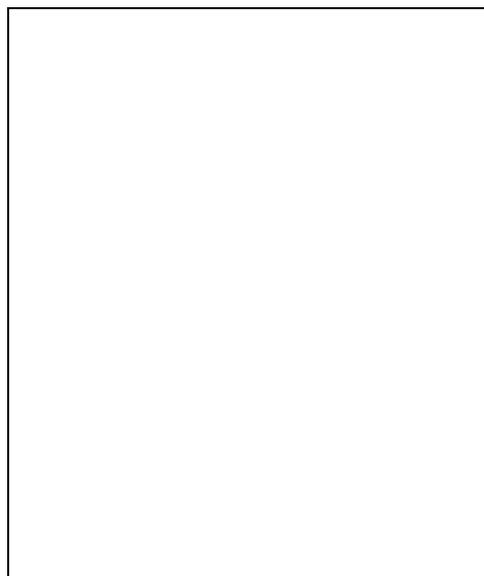
DATA, SOURCES AND METHODOLOGY

This exercise is confined to the capital issues made through prospectus. Prospectuses issued at the time of issue of capital, forming part of the ISID library of company annual reports and prospectuses are the main data source for the analysis. Data compiled by **Prime Data Base** from prospectuses was also relied upon for the empirical exercises. In any case, prospectuses issued are the basic source of data. Out of the 528 companies issuing capital through prospectus 14 were excluded from the study due to inadequate or non-reporting of requisite data by these companies. Out of the remaining 514, eight companies were those which chose Over the Counter Exchange of India (OTCEI) route to raise capital.

The concepts used and the measurement problems noticed are described in the following:

1. **Total Issue (TI)**

This represents the total value of the issue made by a company and includes the value of the securities reserved under firm and preferential categories for private promoters, foreign collaborators, Indian financial institutions, international financial institutions, employees and working directors (other than the category covered in private promoters) and others such as preferential quota of securities reserved for mutual funds, banks, existing security-holders of promoter companies, as the case may be, and finally the value of the securities offered to general Indian and NRI investing public. In cases where companies have clubbed the right issues with issue through prospectus, this amount includes right offer too.



2. **Issue Through Prospectus (ITP)**

This is the amount what is termed by companies as amount offered through prospectus. In general, this amount is inclusive of preferential quota reserved for promoters, mutual funds, banks, FIs, employees and existing security holders of promoter group companies, etc. as the case may be, besides general Indian and NRI investing public.

3. Net Public Offer (NPO)

Net public offer is the amount which a company plans to raise from general Indian and NRI investing public. NPO is defined as the value of securities offered to general Indian and NRI investors not covered under any of the following special categories: private promoters, foreign collaborators, financial institutions and banks, international financial institutions, mutual funds, employees and working directors (not covered under private promoters' quota) and others. Out of the 528 companies, 125 proposed to involve NRI public participation. In case of these companies NPO is inclusive of the amount offered to NRI public, NPO is expected to be a better measure for comparison purposes as issuing securities to special categories of investors involves comparatively less amount of expenditure compared to the issue to general investors. In case of the latter, larger number of investors need to be approached and serviced, which involves expenditure on brokerage, underwriting, commission to bankers, registrars' fee, managers' fee, publicity expenditure, etc. It is, therefore, hoped that exercises involving NPO may indicate the importance of issue expenses better compared to total issue amount and offer a more relevant yardstick for assessing cost of raising capital.

4. Issue Expenditure

Issue expenditure is the amount estimated to be spent to raise funds from the public. This includes underwriting commission, brokerage, fees to issue managers, registrars' fee, statutory press announcement expenses and listing fees, which are mandatory in nature. Other expenses covered under this head are the amounts spent on printing, distribution, advertisement and publicity and miscellaneous related items.¹⁷ At the time of issue companies can only give an estimate of issue expenditure because some of the items of expenditure are dependent on the number of applications received and the number of final allottees.

In general, companies report an estimate of consolidated issue expenditure in prospectus in either of the two following ways:

- (i) This expenditure is shown separately as part of over all project cost as well as in statutory and other general information.
- (ii) This expenditure is shown only in statutory and general information and not separately as part of project cost.

The details relating to issue expenditure as shown in statutory and general information do not form part of information supplied in abridged prospectus-cum-application form. In the case of companies following second way investors would not have any idea about this expenditure from the abridged prospectus-cum-application form. In five cases we noticed that the companies gave no information about issue expenditure (See: List). Majority of them stated that issue expenditure would be within the limits specified by

17. See footnote 7.

the Government. Nine other companies gave only partial information about issue expenditure. A typical explanation in this regard runs as follows.

The expenses of the present issue such as fees to the registrars to the issue, stamp duty, printing, distribution and publication expenses, legal charges, registration fees, bank charges auditor's fee and other miscellaneous expenses are estimated to be Rs. 210 lakhs, in addition to mandatory costs such as underwriting commission, brokerage, fees payable to the managers to the issue, statutory announcement costs and listing fees¹⁸.

**List of Issues which provided Partial or no
Information on Issue Expenditure**

S.No.	Name of the Company	Total Issue Amount (Rs. Crores)
A. No information on Issue Expenditure		
1	Advanced Medical Care Ltd.	11.51
2	Industrial Development Bank of India	200.00
3	Nova Steels (India) Ltd.	0.60
4	Small Industries Development Bank of India	200.00
5	Usha Services & Consultants Ltd.	10.00
	Total	422.11
B. Partial Information on Issue Expenditure		
1	Ajanta Soya Ltd.	8.98
2	Arvind Polycot Ltd.	93.20
3	Jindal Photo Films Ltd.	13.05
4	Motherson Sumi Systems Ltd.	8.25
5	NIIT Ltd.	18.04
6	Pearl Polymers Ltd.	11.32
7	Salvigor Laboratories Ltd.	2.55
8	Shriram Agro-tech Industries Ltd.	10.75
9	Tata Vashisti Detergents Ltd.	33.56
	Total	199.70

Issue expenditure being the main variable under observation, it becomes imperative to discuss about the quality of information supplied in this regard by companies in the prospectus. Our discussions with informed sources in merchant banking circles reveal that issue expenditure as reported in the prospectuses is generally an underestimate. Different means are available to companies to show lower expenditure than the actuals. A few of the reported practices are as follows:

- (i) Banks that act as collecting banks for the issue may foot in the

18. See: Prospectus of Arvind Polycot Ltd., p. 21 (issue opening date: February 1, 1993).

advertisement bills and justify this on the ground that their names appear in the issue advertisements. In return, the banks get the float money of the issue;

- (ii) Bills of press conferences relating to issues, gifts to media persons (which have become customary) and advance publicity for image build-up may be transferred to normal promotional or advertisement expenses; and
- (iii) Company may instruct the printing press wherefrom they get application forms printed to give only partial bills for printing of application forms, the remaining amount may be adjusted against bills for other items such as diaries, calendars, etc.

5. Project Cost

This is the estimated expenditure on the project to finance which companies issue securities. Details about this given in the prospectus usually relate to cost of land and buildings, plant and machinery, miscellaneous fixed assets, payments made to foreign technicians, technical know-how fees, preliminary and pre-operative expenses, issue expenses (if shown separately), working capital and provision for contingencies etc. In a few cases, companies also raise funds exclusively for building-up long-term resources or for working capital requirements. In cases where companies have not provided any specific project cost, total issue amount was treated by us as the project cost. Most of such companies were those that sought to finance their working capital requirements through issue of securities only. In case of two companies namely, Nova Steels (India) Ltd (total issue Rs. 60 lakhs) and Electronica Machine Tools Ltd (total issue Rs. 390 lakhs) shares offered for sale by the existing shareholders of these companies were not meant for any new projects. For the sake of comparability the total issue amount of each of the two companies was treated as project cost.

One main limitation of the data set is that a number of variables are only estimates as the ultimate figures may be at variance with these. For instance, projects suffer from cost overruns, companies could retain a certain percentage of the over subscription in case they had CCI approval.