

# Role of qib in indian capital markets



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## ROLE OF QIB (QUALIFIED INSTITUTIONAL BUYER) IN THE INDIAN CAPITAL MARKET FOR THE LAST 6 YEARS A] Who are the Qualified Institutional

Buyers? Qualified Institutional Buyers (QIBs), as defined under sub-clause (v) of clause 2. 2. 2B of the SEBI (DIP) Guidelines, can be one of the following: 1. A Public Financial Institution as defined in Section 4-A of the Companies Act. 2.

A Bank 3. FII (Foreign Institutional Investors) that are registered with SEBI 4. Development Financial Institutional, both multilateral and bilateral 5. VCF (Venture Capital Funds) registered with SEBI 6.

SIDC (State Industrial Development Corporations) 7. Insurance Companies registered with the IRDA (Insurance Regulatory and Development Authority) 8. Provident and Pension Funds with minimum corpus of 25 crores. Such QIBs shall not be promoters or related to promoters of the issuer, either directly or indirectly. Besides, QIBs cannot have either veto rights or the right to appoint any nominee director to the board because that would also be considered to be related to the promoter.

The QIBs (especially the Mutual Funds and FIIs) play a very important role in the stock price movements. QIBs play an important role by bringing in the necessary funds needed by the equity stock market. The FIIs, though volatile and essentially market driven, facilitate significantly to the foreign funds inflow. QIBs are generally believed to bring in more efficiency and liquidity in the system. B] Changes brought in by SEBI that impacted QIB role in the recent years Earlier, in the book building route for public issue, 50% was reserved for QIBs, 15% for HNI and 35% for Retail investors.

Even without this reservation for QIBs, the merchant bankers had the discretion allot shares to QIBs in any manner they liked. SEBI brought about the following major changes in the Primary Market in the last 6 years which impacted the role of QIBs in a big way: (a) QIBs now have to bid with margin money of 10% of the application value of the issue. Earlier they did not have to give any margin money. This was an attempt to discourage manipulation of issue oversubscription by forming a cartel of QIBs.

(b) The merchant banks' discretionary quota to the QIB is done away with.

The allotment of the shares to the QIB will be on a proportionate basis.

(c) Mutual funds get at least 5% of the overall 50% reservation for QIBs. (d) All listed companies must have a minimum public holding of 25% of its shares on a continuous basis. All these changes are for the benefit of the small investor and improve liquidity of the stocks.

C] QIBs and price discovery - How effective were the QIB in discovering a realistic price in recent years? QIBs are those who have the financial muscle and necessary expertise to make informed investment decisions. QIBs are expected to play an important role in the price discovery in the book-building mechanism. Theoretically, the QIBs can sober down the prices of the issue to realistic levels but practically, that seldom happens as seen by the recent bursting of the IPO bubble. The companies were quoting a hefty premium over similar stocks in the secondary market but the QIBs had little choice.

If they wanted to participate in the offer, they had to do so in the exorbitant price band range dictated by the company and because of excess liquidity in the market and stiff competition, they generally bid at the upper end of the

price band, thereby debunking the theory of book-building resulting in real price discovery. So, in reality, the QIBs did nothing to sober the prices of the fresh issues during the IPO bubble. D] QIB vs the Retail Investors in the last 6 years An article in Economic Times (4th Jan, 2007) [8], using the data for the last couple of months during that period, mentions that in IPOs, where QIBs are entitled for upto 50% of the issue size, gets subscribed upto 28 times while the retail portion gets subscribed for only upto 6 times on an average. Companies like to share forward-looking sensitive information with the QIBs which is typically not available to retail investors (they mostly rely on the company grading) which gives these QIBs a clear advantage over the retail investors. Also, the retail investors generally look at the subscription levels of the QIB portion of the offer to get an idea about the image of the company in the market. The SEBI guidelines amendment in September 2005 allowed at least 5% of the QIB's reserved portion to go to Mutual Funds which gave an opportunity for the retail investor to get a bigger share of the pie through the Mutual Funds.

THE STATE OF THE QIP (QUALIFIED INSTITUTIONAL PLACEMENT) SINCE IT'S INCEPTION IN 2006 QIPs are a quick and cost effective method of raising funds by way of private placement of securities or convertible bonds with QIBs. Before the introduction of Chapter XIII -A in the SEBI DIP Guidelines, an Indian listed company intending to raise further capital from the public markets in India had the option of doing so by offering securities through a follow-on public offering or preferential allotments. In May, 2006, SEBI came out with it's guidelines for raising funds through the QIP route. Since then, a lot many companies have gone this route. The intention of SEBI behind

allowing QIP Scheme, is to promote the domestic private placement which is generally considered to have two prime advantages over FCCBs (Foreign Currency Convertible Bonds) and GDRs (Global Depository Receipts), i.

e. keeping liquidity in the same market and faster way to get approvals.

Through QIP guidelines, SEBI has opened a window for Indian companies to raise funds domestically instead of exporting the private placement market out of India. QIP has certainly emerged as a preferred instrument for entities to raise funds as it involves lesser disclosures and does not require a pre-issue filing with SEBI. Sebi guidelines say only QIBs can participate in QIPs. A] QIP providing a level playing field.

These new guidelines have been hailed as a significant step for the Indian Capital Market. Through QIP, the equity private placement markets are expected to come onshore. Also, the Indian Mutual Funds - who are becoming comparable to FIIs, will get an opportunity to participate in these issuances. These guidelines are likely to create a more level playing field and removed a substantial aberration from the marketplace [1]. B] QIP and it's impact on Retail Investor The view that the QIP has made the primary market out of bounds for the retail investors by allowing only the QIBs to participate in it has been doing the rounds for quite some time now. The Retail investor share in an IPO process is typically 35% and QIP route dictates that potentially no portion of the follow-up issue reaches the retail investor directly because it bypasses them altogether.

Indirectly though, the retails investor can participate in QIP through Mutual funds. C] QIP vs Preferential Issue As compared to a preferential issue, a QIP

does not involve a lock-in and hence it offers an opportunity for liquidity, if an investor wants to exit. D] QIPs in the US vs in India – Key differences [2] US Securities & Exchange Commission's (SEC) Rule 144A (came into effect in 1990) is for the QIP in the US while the SEBI's QIP Scheme is for the Indian Capital Market. The intention of both regulations is to encourage private placements in the domestic markets of the US and India, respectively. There are some key differences between the SEC's QIP and the SEBI QIP Scheme such as the SEBI pricing guidelines and the US rule that a private placement under Rule 144A must be a resale and not a direct issue by the issuer. Under Rule 144A, transactions must actually involve an initial sale from the issuer to the underwriter and then a resale from the underwriters to the QIBs.

A QIB is defined under Rule 144A as having investment discretion of at least \$100 million and includes institutions such as insurance agencies, investment companies, banks, etc. In addition, the target audience of both regulations is different -while the impetus behind Rule 144A was to encourage non-US issuers to undertake US private placements, the impetus behind the SEBI QIP Scheme was to encourage domestic Indian issuers to undertake domestic Indian private placements. E] Key features of QIP Pursuant to the QIP Scheme, the Securities may be issued by the issuer at a price that shall be no lower than the higher of the average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange (i) during the preceding six months; or (ii) the preceding two weeks. The issuing company may issue the Securities only on the basis of a placement document and a merchant banker needs to be appointed for such purpose.

There are certain obligations which are to be undertaken by the merchant banker. The minimum number of QIP allottees shall not be less than two when the aggregate issue size is less than or equal to Rs 250 crore; and not less than five, where the issue size is greater than Rs 250 crore. However, no single allottee shall be allotted more than 50 per cent of the aggregate issue size. The aggregate of proposed placement under the QIP Scheme and all previous placements made in the same financial year by the company shall not exceed five times the net worth of the issuer as per the audited balance sheet of the previous financial year.

The Securities allotted pursuant to the QIP Scheme shall not be sold by the allottees for a period of one year from the date of allotment, except on a recognized stock exchange. This provision allows the allottees an exit mechanism on the stock exchange without having to wait for a minimum period of one year, which would have been the lock-in period had they subscribed to such shares pursuant to a preferential allotment. Companies should be listed at least for a year to be eligible for making qualified institutional placement, according to the SEBI's new guidelines. QIP shall be managed by a SEBI registered merchant banker who shall exercise due diligence and furnish a due diligence certificate to Stock Exchanges stating that the issue complies with all the relevant requirements. The merchant banker shall file a copy of the placement document and post issue details with SEBI within thirty days of the allotment, for record purpose. Offering of securities through QIP is a Private Placement.

As per Section 67(3) of the Companies Act, 1956 we cannot make offer to more than 49 Investors under the private placement. It means that we

cannot issue an offer document inviting for subscription under the QIP placement to more than 49 Investors. Each placement of the specified securities issued through QIP shall be on private placement basis, in compliance with the requirements of first proviso to clause (a) of sub-section (3) of Section 67 of the Companies Act, 1956. A minimum of 10% of the securities in each placement shall be allotted to Mutual Funds.

For each placement, there shall be at least two allottees for an issue of size up to Rs. 50 crores and at least five allottees for an issue size in excess of Rs. 250 crores. Further, no single allottee shall be allotted in excess of 50 per cent of the issue size. Investors shall not be allowed to withdraw their bids / applications after closure of the issue.

The aggregate funds that can be raised through QIPs in one financial year shall not exceed five times of the net worth of the issuer at the end of its previous financial year. Issuer shall prepare a placement document containing all the relevant and material disclosures. There will be no pre-issue filing of the placement document with SEBI. The placement document will be placed on the websites of the Stock Exchanges and the issuer, with appropriate disclaimer to the effect that the placement is meant only for QIBs on private placement basis and is not an offer to the public. The floor price of the specified securities shall be determined on a basis similar to that for GDR / FCCB issues and shall be subject to adjustment in case of corporate actions such as stock splits, rights issue, bonus issue etc.

F] Some examples of QIP Spentex Industries Ltd was the first QIP after the SEBI Guidelines came in May. Edelweiss managed the QIP and it was to the



tune of 46.6 crores for which 75 lakh equity shares were issued to the QIBs. Sundaram Mutual Fund was the main Indian QIB subscribing to this share among some other FIIs, mainly from Mauritius. Mahindra Gesco Developers Ltd.

(MGDL) one of India's leading real estate and infrastructure developers closed its \$105 million Qualified Institutional Placement (QIP), one of India's largest QIP under the new Securities Exchange Board of India's (SEBI) regulations [4]. Rs 23,400 cr were mopped up thru QIP route (41 QIPs were done in this year) in 2007 while this was 3,935.45 crore in 2006 (Only 16 QIPs were done in this year) [7]. GMR Infrastructure and Suzlon Energy, India Inc were some of the big names going for the QIP route for raising capital.

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