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PRIVATE PLACEMENT: A SILENT REVOLUTION IN THE INDIAN DEBT MARKET

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Introduction

The debt market is much more popular than the equity market in many parts of the world. In India the reverse has been true. This has been due to the dominance of the government securities in the debt market and that too, a market where government was borrowing at pre-announced coupon rates from basically a captive group of investors, such as banks. This passive internal debt management policy, coupled with automatic monetisation of fiscal deficit prevented a deep and vibrant government securities. The debt market in India comprises broadly two segments, viz., Government Securities Market and Corporate Debt Market. The latter is further classified as Market for PSU Bonds and Private Sector Bonds.

The market for government securities is the oldest and has most outstanding securities, trading volume and number of participants. Over the years, there have been new products introduced by the RBI like zero coupon bonds, floating rate bonds, inflation indexed bonds, etc. The trading platforms for government securities are the "Negotiated Dealing System" and the Wholesale Debt Market (WDM) segment of National Stock Exchange (NSE) and Bombay Stock Exchange (BSE). The **PSU bonds** were generally treated as surrogates of sovereign paper, sometimes due to explicit guarantee of government, and often due to the assurance of government ownership. The perception and reality are two different aspects. The listed PSU bonds are traded on the Wholesale Debt Market of NSE. The **corporate bond market**, in the sense of private corporate sector raising debt through public issuance in capital market is only an insignificant part of the Indian Debt Market. A large part of the issuance in the non-Govt debt market is currently on private placement basis.

Objectives of the Study

The objectives of the study are 1) to review the debt market related developments for the past years in India and 2) to analyse the role of private placement in Indian debt market.

Marketing of Securities

The various methods[1] commonly adopted for marketing of securities are given below.

1. Public Issue by prospectus, which includes:
   a) Direct selling,
   b) Sale through investment intermediaries, and
   c) Underwritten placement.

2. Offer for sale,
3. **Private placement method,**
4. Tender method,
5. Over-the counter placement,
6. Right issue, and
7. Bonus issue.

Now a days the private placement technique is gaining popularity. It becomes common method adopted by all companies. An estimate indicates about 89% of resources mobilized domestically by corporate sector through private placement in the recent past[2].

What is Private Placement?

The private placement involves issue of securities-debt of equity, to a limited number of subscribers, such as banks, financial institutions, mutual funds institutions and high net worth individuals. It is arranged through merchant bankers/ investments bankers who act as an agent of the issuer and bring together the issuer and the investor(s). Since the securities are allotted to a few sophisticated and experienced investors, the public at large don't have much stake in it. The securities offered in a private placement are exempt from the public disclosure regulations and registration requirement of the regulatory body. What distinguishes private placement from public issue is, while the later invites application from as many subscribers as possible, the subscription in the private placement is restricted to a limited few. According to the terms of the Companies Act, 1956, offer of securities to more than 50 persons is deemed to be public issue. In other words, private placement arranges to issue securities to less then 50 persons[3].

Analysis of the Study

The analysis of present study is arranged as following.

a) Resource Mobilization in India
b) Resource Mobilization from Public Issues
c) Debt Issues in India
d) Issuer-Wise Distribution of Private Placement of Debt
e) Sectoral Distribution of Resources Mobilized by Private Placement, and
F) Growth of Private Placement.

a) Resource Mobilization in India

Capital formation is an important ingredient for economic development of any country. Every entrepreneur requires capital resources to convert ideas into product and services. The required resources are mobilized by the issuers of securities- (Government and Corporate) through primary market. The primary market provides link between the savings and the investments across the entities. The issuers of securities raise resources to meet their requirements by issuing / creating fresh securities in exchange of funds either through public issue and/ or private placement. The issuers may issue the securities in domestic market and/ or international market.

Table –I shows resource mobilization by Government and Corporate sector during the period from 1999-2000 to 2002-2003. The total amount mobilized both through corporate securities and government securities have been increased from Rs1,85,786 million in 1999-00 to Rs 2,52,0179 million in 2002-03. The corporate sectors have mobilized funds through public issues and private placement. It is significant to note here that the share of private placement in corporate securities have been more (61%) during the study period.

b) Resources Mobilization from Public Issues

The public issues market for corporate securities remained subdued since 1995-96 due to discouraging global economic trends, depressed conditions in the secondary market, high real interest rates and stringent entry norms. This trend was further reinforced by low confidence of investors arising from unduly high premium charged on issues made earlier years and disappearance of some of these issuers.

Resource mobilization from the public issues from 1999-00 to 2002-03 is given in **Table-II**. The resource mobilization from the primary market by way of IPOs and new issues by listed companies declined to 26 issues during 2002-03 from 151 issues in 2000-01. It is observed that listed companies mobilized Rs. 30316 mn through 20 issues during 2002-03 accounting for 74.48% of the resources while there were 42 issues for Rs. 5098 mn during 1999-00 with their share being 45.16%. It is important to note that over the period there was decrease in the issues made by listed companies but the amount mobilized was increased.

Regarding public issues, the number of issues in 1999-00, 2000-01, 2001-02 and 2002-03 was 14,10,13 and 8 respectively. The amount mobilized through public issues has increased from Rs. 3538 mn in 1999-00 to Rs. 26004 mn in 2002-03 with fluctuations. It is a surprise that the right issue of 28 in 1999-00 against Rs. 1560 mn decreased to 12 against Rs.4312 mn during the study period.

c) Debt Issues in India

Government and corporate sector accessed market through debt issues. **Table-III** explains resources raised from debt market from 1999-00 to 2002-03. They collectively raised a total of Rs. 2350956 million from primary market during 2002-03. This is against the amount of Rs. 172735 million in 1999-00. The share of Govt out numbered the share of corporate sector during the study period.

d) Issuer-Wise Distribution of Private Placement of Debt

Table-IV reveals issuer-wise distribution of private placement of debt during 1999-00 to 2002-03. It is understood from the Table that all India financial institutions/Banks, public sector, State level undertakings and private sector are more active in mobilizing funds through private placement. The shares of state level undertakings were insignificant during study period. The amount raised through private placement by different issuers has increased from Rs.54702 mn to Rs. 484235 mn during the study period.

e) Sectoral Distribution of Resources Mobilized by Private Placement

Table-V shares sectoral distributions of resource mobilized by private placement during 1999-00 to 2002-03. It is clear from the Table that financial service sector continues to dominate the private placement market and its share was raised to 50% in 2002-03. The share of power sector ranged from14% to 16% during study period.

f) Growth of Private Placement

It is evident from above that private placement now provides a substantial part of corporate finance in India. What is missing is a comprehensive framework governing issue of securities in this segment. The obvious reason, as already stated, for the tremendous growth of private placement market could be an attempt by the issues to avoid regulatory compliance, which is mandatory for public issues.

Table-VI shows the share of private placement in debt issues from 1995-96 to 2002-03. The total resources raised in the primary market increased from Rs. 218570 mn in 1995-96 to Rs. 541556 mn in 2001-02 with fluctuations. The highest amount of Rs. 623740 mn was mobilized in 1999-00. In respect of debt issues, the amount mobilized by way of private placement has been increased from Rs. 100350 mn in 1995-96 to Rs. 484236mn, in 2001-02, which is around four and half times greater. According to the above Table, the percentage of private placement in debt issues has been more than 72% in all the years during the study period. The highest and lowest share percentage of private placement in debt issue was recorded in 1997-98 (94.14%) and 1996-97 (72.50%) respectively. The over all analysis of the above Table reveals the fact that private placement of debt has emerged in the recent past as the major route for raising resources. The growth of private placement of debt is given in **Chart-I** which is self-explanatory.

Why Private Placement is Popular?

The private placement is popular due to the following reasons.

1) This method is a very cheap way of marketing the securities as it saves the issuing costs.
2) The rationale for investing in the private placement market lies in the convenience and flexibility to the issuers as well as investors.

3) This method is preferred by small and midsize firms, particularly new entrants who do not have track record of performance. They are skeptical about generating adequate public response for their public issues.
4) Even big- size firms prefer this route when the general market environment is not conducive for floating public issues.
5) Many companies prefer private placement if they wish to raise funds quickly to take advantage of interest rate changes in volatile market conditions.
6) Indian corporate sector prefers this route and avoids public issues due to the fact that regulatory compliance is not mandatory.
7) When there is no adequate supply of good public issues to match the amount of funds available for investments, investors look for securities at attractive rates in the private placement market.
8) This method provides investors with securities with more or less fixed/ predictable cash inflows, which help investor to match the expected stream of returns with the expected cash inflows.
9) For many investors, matching asset/ liability is an important goal, which can be fulfilled only in private placements, and not in public issues. The sophisticated investors, who possess the capability and expertise for assessing the risks associated with the issues, can earn higher returns by investing in more risky investment avenues.

Conclusion

The present study is basically explorative in nature and no empirical study has been carried out. A vibrant debt market enables investors to shuffle their portfolios depending upon the expected changes. Debt market, in particular, provides financial resources for the development of infrastructure. Hence a well functioning debt market becomes significant for all the market participants. This study creates scope for further research on Debt market in general and private placement in particular.

Reference

1. Shashi K.Gupta & Sharma. R.K. (2001). **"Financial Management Theory & Practice"**, Kalyani Publications, New Delhi, p.25-31.
2. (2003). **"Indian Securities Market- A Review** ", (Vol.VI), National Stock Exchange of India Limited, p.42.
3. (2003). **"Indian Securities Market- A Review",** (Vol.VI), National Stock Exchange of India Limited, p.55.

Table-I
Resource Mobilization by Government and Corporate Sector

(Rs.mn)

Issues	1999-00		2000-01		2001-02		2002-03	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%
1. Corporate Securities (a+b)	**72450**	**38.99**	**78118**	**37.81**	**744032**	**32.78**	**700389**	**27.79**
a. Domestic Issues	68963	37.16	73921	35.77	720612	31.75	666125	26.43
(i). Public Issues	7704	4.14	6421	3.10	71117	3.13	48667	1.93
Non-Govt. Public Companies	5153	2.77	4949	2.39	56922	2.50	18777	.745
PSU Bonds	---	---	---	---	---	---	---	---
Govt.Companies	---	---	---	---	3500	0.154	---	---
Banks & FIs	2551	1.37	1472	0.712	10695	0.471	29890	1.186
(ii).Private Placement	61259	32.97	67500	32.67	649495	28.62	617458	24.50
b. Euro Issues	3487	1.87	4197	2.03	23420	1.03	34264	1.36
2. Government Securities	**113336**	**61.01**	**128483**	**62.19**	**1525080**	**67.21**	**1819790**	**72.21**
Central Government	99630	53.36	115183	55.75	1338010	58.96	1511260	59.96
State Government	13706	7.37	13300	6.44	187070	8.25	308530	12.24
Total (1+2)	**185786**	**100.00**	**206601**	**100.00**	**2269112**	**100.00**	**2520179**	**100.00**

Source: Database of RBI, SEBI & Prime Data Base.

Table-II
Resource Mobilization from Public Issues

(Amount in Rs.mn)

Issues	1999-00				2000-01				2001-02				2002-03			
	No.	%	Rs.	%	No.	%	Rs.	%	No.	%	Rs.	%	No.	%	Rs.	%
1. IPOs	51	54.84	2719	34.78	114	75.50	2722	44.57	7	20	12018	15.93	6	23.08	10387	25.52
2. Issues by Listed Companies (a+b)	42	45.16	5098	62.22	37	24.50	3385	55.43	28	80	63413	84.07	20	76.92	30316	74.48
a. Public Issues	14		3538		10		2656		13		53000		8		26004	
b. Rights Issues	28		1560		27		729		15		10413		12		4312	
Total (1 + 2)	93	100	7817	100	151	100	6107	100	35	100	75431	100	26	100	40703	100

Source: SEBI.

Table-III
Resource Raised from Debt Markets

(Amount in Rs.mn.)

Issues	1999-00		2000-01		2001-02		2002-03	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%
1. Corporate	**59399**	**34.39**	**56578**	**30.57**	**515610**	**25.27**	**531166**	**22.59**
a. Public Issues	4698		4144		53410		46930	
b. Private Placement	54701		52434		462200		484236	
2. Government	**113336**	**65.61**	**128483**	**69.43**	**1525080**	**74.73**	**1819790**	**77.41**
Total (1+2)	**172735**	**100.00**	**185061**	**100.00**	**2040690**	**100.00**	**2350956**	**100.00**

Source: Prime Database (for corporate debt) & RBI (for Government debt).

Table-IV
Issuer-wise Distribution of Private Placement of Debt.

(Amount in Rs.mn)

Issuer	1999-00		2000-01		2001-02		2002-03	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%
1. All India Finacial Institutions / Banks	14539	26.58	21673	41.33	186026	40.25	173687	35.87
2. State Finacial Institutions	2606	4.76	2286	4.36	17087	3.70	38665	7.98
3. Public Sector Undertakings	8436	15.42	7839	14.95	83750	18.12	125491	25.92
4. State Level Undertakings	16526	30.21	11466	21.87	63338	13.70	43894	9.06
5. Private Sector	12595	23.02	9169	17.49	111998	24.23	102498	21.17
Total	**54702**	**100.00**	**52433**	**100.00**	**462199**	**100.00**	**484235**	**100.00**

Source: Prime Database.

Table-V
Sectoral Distribution of Resources Mobilized by Private Placement

(In percent)

Sector	1999-00	2000-01	2001-02	2002-03
Financial	39	51	50	50
Power	15	14	16	16
Water Resources	8	6	4	3
Telecommunications	6	2	--	1
Others	32	27	30	30
Total	**100**	**100**	**100**	**100**

Source: Prime Database.

Table –VI
Share of Private Placement in Debt Issues

(Amount in Rs.in Mn)

Year	Public Equity Issue	Debt Issues		Total	Share of Private Placement in Debt Issues (%)	Total Resource Mobilization in the Primary Market	Share of Debt. in Total Resource Mobilization (%)
		Public Issue	Private Placement				
	1	**2**	**3**	**4=2+3**	**5=3/4*100**	**6**	**7=4/6*100**
1995-96	88,820	29,400	100,350	129,750	77.34	218,570	59.36
1996-97	46,710	69,770	183,910	253,680	72.50	300,390	84.45
1997-98	11,320	19,290	309,830	329,120	94.14	340,450	96.67
1998-99	5,040	74,070	387,480	461,550	83.95	466,580	98.92
1999-00	29,750	46,980	547,010	593,990	92.09	623,740	95.23
2000-01	24,790	41,390	524,335	565,725	92.68	590,520	95.80
2001-02	10,820	53,410	462,200	515,610	89.64	526,430	97.94
2002-03	10,390	46,930	484,236	531,166	91.16	541,556	98.08

Source: Indian Securities Market: A Review National Stock Exchange, Bombay 2002

Chart –I
Growth of Private Placement of Debt