Our Views

Immediate capital infusion – possible with some tweaking in the guidelines

During the current unprecedented pandemic situation, several businesses are facing challenges. For businesses where the business models are intact in the long term but have difficulty in tiding over the current circumstances, an immediate infusion of significant equity capital is required. The lack of funding at such a crucial stage may lead to a major disruption in functioning of the operations of such companies. Their revenue streams have been impacted adversely due to the crisis, but the other side of the P&L continues – the costs still exist. If this situation and the mismatch persists and lingers on for long, it will eventually lead to significant job cuts and could rapidly spiral the economy downwards.

Our capital markets are vibrant and mature and can provide the required capital. We have been able to attract a fair share of global capital pool as well. During the lockdown period itself almost 1.40 lacs of equity was raised/ going to be raised through large primary and secondary issuances. This is in addition to the strategic transactions.

During a volatile market situation like the one we are currently witnessing; equity contribution becomes challenging particularly in a listed company because of the regulatory framework. Given that businesses are only temporarily impacted because of the present situation, there could be local and global institutional investors, strategic investor or the current promoter itself who would be willing to put in the strategic capital. Due to the urgency of the capital required, the methodology which works best for issuer and investors is a preferential issue.

SEBI guidelines for a preferential issue has a pricing limitation for any such investment. The pricing guideline mandates issue price to be the average of last 2 weeks or last 26 weeks, whichever is higher. In the volatile market conditions, these prices are not in line with the current market levels. This large latency in pricing period especially given the deteriorating share price trend leads to a wide gap in pricing between the price at the beginning of the 26 weeks and the current price when funds are required to be raised. An analysis of 500 listed companies indicates that there is a gap of app 50% between the current price and the SEBI formula price.

Given these pricing regulations, it is practically difficult if not impossible for companies to raise funds through preferential allotment route. While there is a minor exemption provided in the guideline for allotment to Qualified Institutional Buyers (QIBs), it does not help strategic investors or the existing promoter.

The strategic investors (both domestic and foreign) and promoters of these companies who could bring in significant capital have to follow higher of the 26 weeks and 2 weeks formula. This is a deterrent for them to bring in the fresh capital for the businesses as the pricing does not align with the current business and market situation.

Given the times, the government should pull out all the stops to safeguard the continuity of businesses and enable funding from sources which do not dip into public resources. A small relaxation in the pricing formula for the promoters or strategic investors who would be willing to invest strategic capital can be a very tactical solution in the near term. It will surely help businesses tide over the current crisis with adequate funding support without burdening the government. Of course, the government could make it a time-bound relaxation which could be reversed after the crisis is behind us.

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