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Qualified Institutional Placement Vs Preferential Allotment: Choice of Seasoned Offering for Private Equity Placement in India

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Abstract

Qualified Institutional Placement (QIP) and preferential allotment are two ways in which firms privately place equity in India. The paper looks at the private placements made between 2010 to2017 and finds that information asymmetry plays a role in one method of placement being chosen over the other. The variables of Size of the firm, institutional and promoter shareholding are a key determinant of one method being chosen over the other. Issue size in QIP is likely to be higher than that of preferential allotment. Further levered firms are more likely to choose preferential allotment over QIP.

Keywords: Qualified Institutional Placement, Preferential allotment

1. Introduction

Uptill 2006 seasoned equity offerings in India could be done by using one of the three methods, namely follow-on offer, rights and private placement. In 2006 Securities and Exchange Board of India (SEBI), the Indian market regulator split private placement into two categories, namely preferential allotment and qualified institutional placement (QIP). While in preferential allotment the equity could be placed with anyone including the promoters at a price not less than SEBI determined price[1], a QIP could however be made only to a select group of registered institutional investors known as Qualified Institutional buyers (QIB's) at a price not less than SEBI determined price[2]. Further while preferential allotments carried a lock-in for a period of 1-year for the investors (3-year if placement made to

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[1] As per SEBI (ICDR) chapter VII, 2010 regulation the in case of preferential offer equity shares shall be allotted at a price not less than the higher of the following:

The average of the weekly high and low of the closing prices of related equity shares quoted on the recognized stock exchange during the six months preceding the relevant date or

The average of the weekly high and low of the closing prices of related equity shares quoted on recognized stock exchange during the two weeks preceding the relevant date

[2] In case of QIP's as per SEBI (ICDR) chapter VIII 2010 regulations the shares will be issued at a price not less than the average of the weekly high and low of the closing price of the equity share of the same class quoted on the stock exchange during the two weeks preceding the relevant date.

Relevant date in case of preferential offer is the date thirty days prior to the date on which meeting of shareholders is held to consider the proposed preferential issue while for QIP's it is the date of the meeting in which the board of directors of the issuer decide to open the proposed issue.

promoters), QIP's carried no such lock-in. In year 2010 SEBI made QIP's attractive by allowing a maximum discount of 5% on the SEBI determined price.

QIB's as a category of investors include mutual funds, insurance companies, pension funds, etc. Broadly speaking they are a category of investors whom one could classify as the market experts. This interpretation also manifests itself through regulator actions. For example in cases of non-profitable companies raising funds through Initial Public offering (IPO's), SEBI regulations mandate that at least 75% of the allotment should be made to QIB's since they can better evaluate a business. Also in case of capital being raised through the Institutional Trading platform (ITP)[3] by small and medium scale companies, QIB's are required to hold at least 25% of capital in case of technology companies and 50% in case of companies in other sectors/Industries. Is this intention of the regulator also getting manifested in the kind of companies that are getting attracted to do QIP in case of private placement? Thus we seek answer to the question of what kind of companies are going for QIP versus the kind of companies going for preferential allotment. With this background we investigate the characteristics of companies that have gone for QIP vis a vis the companies that have gone for preferential offer in the period 2010 to 2017.

The results show that as compared to preferential allotment, the QIP's are being offered by companies with higher market capitalization, lower debt to equity ratio and higher promoter shareholding. Further more money is being raised in QIP's as a percentage of market capitalization. In essence high market cap companies with low leverage are making QIP's to QIB's and that too at a discount to the SEBI price and added sweetener of no lock-in requirement as compared to preferential allotment. The results show that the QIP placement is helping the stable and less risky companies to raise equity easily and is also favorable to the investors in terms of the price at which the equity is raised. However the smaller and risky companies need to seek out other sources of raising capital with the additional provision of lock-in. The study brings out that in India smaller size companies face difficult environment for raising equity through private placement of equity in comparison to larger players.

The paper is organized as follows. Section II reviews the literature, Section III presents the data and methodology used, Section IV describes the results and Section V concludes.

2. Literature Review

Myers and Majluf (1984) is amongst the earliest work in the area of private placement of equity. They present a model of corporate financing under asymmetric information. In this the firm forgoes positive NPV investment opportunities rather than go for public issue of securities at an undervalued price taking into account the interest of the old stockholders who are at a dis-advantage with such an action. However this under-investment problem disappears if the firm has "private line" to existing stockholders or if the firm can costlessly convey this information to group of investors to whom the equity could be issued.

Literature then extensively looks at the announcement effects of private equity placement as compared to other forms. Wruck (1989) reports a positive average abnormal return for private equity placement as compared to negative average abnormal returns for public offering largely on account of change in ownership concentration after private placement. Hertzel and Smith (1993) also show a positive market reaction to announcement of private sale of equity which they ascribe to favorable inside information about the firm.

Cronqvist and Nilson (2005) in their study of Sweden market find that firms with a high degree of asymmetric information are likely to choose private placement over rights issue, especially if there is uncertainty with respect to the new investment opportunity. Further they find higher positive abnormal returns for firms issuing securities on private placement basis than firms making a rights offer. The firms making private placement showed improved operating performance while it was absent in case of firms making a rights offer.

[3] Platform introduced by SEBI in 2015 for Small and Medium Scale businesses to raise equity through IPO. Only Qualified Institutional Buyers (QIB's) and High Net worth Individuals (HNIs) are allowed as investors.

Wu et al (2005) find positive announcement effects for both private placement as well as public placement of equity for Hong Kong market. Further they find that announcement returns are likely to be positive for smaller issuers where asymmetric information arises more from growth rather than from assets in place.

Wu (2004) find that private placements firms are characterized by higher information asymmetry. They do not find evidence of higher monitoring in private placement firms in comparison to firm making a public issue.

Chen et al (2002) examine the wealth effect of private equity placement in Singapore. Contrary to the evidence in other markets they find private equity placement results in negative wealth effect and also a reduction in ownership concentration. This they ascribe to the regulation in Singapore that restricts sales to management and existing blockholders. There result thus is consistent with alignment of interest hypothesis and signaling hypotheses.

Krishnamurthy et al (2005) find higher announcement returns when the shares are placed with affiliated investors rather than the unaffiliated investors, thus showing the relevance of investor identity in stock performance.

Cheng-Yi et al (2013) show that firms making private placement to insiders (owner-managers or non-executive directors) are associated with better post-announcement stock returns as well as operating performance in comparison to private placement made to outsiders. They show that placement made to outside investors is unlikely to improve the operating performance of the company.

Lee-Young et al (2014) find that in Taiwan, private equity placement to long-term institutional investor's results positive abnormal returns while placement to short-term investors results in underperformance. The results also suggest that firms with long-term institutional investors acquire monitoring benefits resulting in reduction of information asymmetry.

Gupta (2012) finds positive abnormal returns for firms making private equity placement in India. This placement is also accompanied by dilution in shareholding of the promoters. Further they find a negative relation between the growth opportunities of the firm and the abnormal returns confirming that the placement does not affect the growth opportunities of the firms.

Tuli & Shukla (2014) show that in India QIPs is done by firms that are bigger, are followed by more number of institutional investors and have shorter incorporation and listing history in comparison to the firms making a rights offering.

The literature on seasoned offerings has not investigated the characteristics of firms which are privately placing equity using different methods. Most of the literature has concentrated between private placement and public offering like rights or follow on offer. This research would throw light on the firm characteristic that determine the type of offering in private placement.

3. Data and Methodology

The study considers data between the period 2010 to 2017 for Qualified Institutional Placements and preferential offers. The name of companies that have gone for QIP's and Preferential offers is taken up from prowess. This data is then matched with the data from Bombay Stock Exchange (BSE) corporate announcement site. Only the companies for which the detailed data for the issue is available from the BSE site are retained in the sample. The detailed data included issue date, relevant date (announcement date), issue price and no. of shares issued is taken by going through the Bombay Stock Exchange (BSE) announcements.

Variable Considered

For the above companies the firm level data for the following variables is then collected from prowess:

Mcap: Market capitalization of the company near the closest month ending to the issue date.

Fraction placed: no. of shares issued as a % of total outstanding shares (past shares+new shares issued). The outstanding shares are taken near the closest quarter ending to the issue date.

Proshare: Promoter shareholding near the closest quarter to the issue date

Inshare: Institutional Shareholding near the closest quarter to the issue date.

DE: debt to equity ratio of the company near the closest year ending to the issue date.

PB: price to book value ratio of the company at the issue date.

Age: Age of the company

L-age: Age in terms of listing at BSE

From BSE corporate announcement site information for 107 QIP issue was extracted. This was matched with firm level data from prowess. Post completion of the matching exercise the final sample reduced to 75 due to unavailability of firm level data. In case of preferential offer data for a total of 197 companies were extracted. This was matched with firm level data from prowess. For around 41 companies the equity was negative. These were excluded from the sample. Out of the remaining 156, firm level data on debt was not available for 41 more companies reducing the sample to 115. Out of this mcap was not available for 4companies and promoter shareholding was not available for one reducing the sample to 110. Further observations with standardized scores exceeding (±)5 were removed from the sample. Post this exercise and further filtration, the final sample was reduced 94 companies. If we also remove companies for which Institutional shareholding data was not available then the sample reduces to 88 companies. So out of the sample of 197, 41 companies were removed on account of negative equity and 68 more were removed on account of non-availability of data.

For preferential offer a sample of 106 was taken. Further observations with standardized scores exceeding (±)5 were removed from the sample reducing the sample to 88 observations. Thus our study has taken a sample of 75 firms for QIP's and 88 firms for preferential offers.

We use logistic regression to determine the characteristics of firms going for preferential offer versus private placement. The following model is used

$$\ln\frac{P}{1-P} = \beta_1 + \beta_2 Proshar + \beta_3 Inshar + \beta_4 mcap + \beta_5 fraction + \beta_6 pmcap + \beta_7 DE + \beta_8 nyri + \beta_9 nyrbse$$

Here P =Pr (Y=1) denotes the probability of using Preferential ratio as a method of raising equity. Y=0 for preferential offer and Y=1 for QIP's.

4. Results

Table 1, Panel A shows the descriptive statistics for each of the mechanism of Preferential offer and QIP. The mean offer size for preferential offer is around Rs. 200mn while the median is much lower value of Rs. 42mn. This contrasts with mean of Rs.5383mn and median of 200 for QIP's. Clearly the offering size is much more in QIP's than preferential placements. The market capitalization of the companies going for preferential offer is Rs.6366mn while for those going for QIP's is Rs. 57,550mn. Thus clearly QIP companies tend to be bigger on an average. The institutional shareholding in case of preferential offer is around 7% while as expected the institutional shareholding for QIP is higher at 15%. Clearly since QIP's are subscribed to by institutional investors, QIP firms generally would have higher institutional shareholding. In terms of fraction of shares placed though the mean is more or less same, the range is much wider in case of preferential offer as compared to QIP's. Also as observed, Debt to equity ratio for preferential offer firms tend to be on an average higher than QIP firms. In terms of age as well as age since listing, QIP and preferential offer firms do not exhibit any significant difference.

The results of the logistic regression are as shown in table 2

Three alternative models are given for the purpose of robustness check. As per model 1, the coefficient of Market capitalization is negative and significant indicating that firms with higher market capitalization are more likely to use QIP as a method of fund raising. Fraction of shares placed also shows a negative coefficient and significant coefficient indicating that when firms intend to issue higher proportion of shares they tend to go for QIP. The coefficient of debt to equity is positive and significant indicating that higher debt to equity firms are more likely to raise equity through preferential allotment rather than QIP. Institutional ownership shows a negative coefficient though not significant. This provides a sense that firms with higher institutional ownership are more likely to use QIP as a method of raising equity. In model 2 we also make use of variables of promoter shareholding and capital raised as a percentage of market capitalization. The coefficient signs and significance is more or less in line with the first model. However in the presence of promoter shareholding the coefficient of institutional shareholding also turns significant. Negative and significant coefficient of promoter shareholding also indicates that higher promoter shareholding firms are more likely to use QIP rather than preferential allotment.

5. Conclusion

QIP and Preferential allotments are two methods of issue seasoned equity in India on private placement basis. The study looks at the QIP and preferential allotment issues that were made by companies in India for the period 2010 to 2017. A total of 75 QIP's and 88 preferential allotments were considered. We find that QIP as a method of placement is being used by firms whose market capitalization is significantly higher than the firms using preferential allotment. Also we find that both promoter holding as well as institutional shareholding in QIP firms are higher. Further firms leverage for QIP firms is lower indicating that QIB's prefer firms with less risk.

The research brings out that smaller size firms with lower institutional holdings raise capital either from promoters or other non-institutional players. The Indian Institutional players who ideally are considered experts are largely subscribing to equity issues of bigger size companies with less leverage. Further this behavior of the investors is being rewarded with the regulator allowing the QIP companies to place shares at a discount and also have no provision of lock-in while no such provision being allowed in case of companies making preferential allotment. Thus the smaller players face a difficult fund raising environment as compared to bigger players as far as equity private placement is concerned.

Table 1: Panel A: Preferential Offer
(Fig in mn except ratios)

Variable	N	Mean	Median	StdDev	Minimum	Maximum
proshar	94	51.74	53.52	15.82	2.94	74.99
inshare	88	7.06	2.12	11.01	-	58.77
mcap	94	6,366.50	1,967.30	13,811.97	67.77	112,291.03
Fraction placed	94	0.11	0.07	0.12	0.00	0.62
de	94	0.94	0.42	1.62	0.00	9.87
pmcap	94	0.07	0.03	0.11	0.00	0.60
pb	94	3.30	1.57	4.51	0.09	25.79
nyri	94	31.36	27.00	16.48	5.00	97.00
nyrnse	64	11.19	9.00	6.97	(1.00)	22.00
nyrbse	94	18.35	21.00	9.22	1.00	36.00

Panel: B: QIP's

Variable	N	Mean		StdDev	Minimum	Maximum
Size	74	5,383.58	2,000.00	9,554.82	16.00	49,961.91
proshar	74	56.71	55.88	15.09	17.74	87.10
inshare	74	15.74	13.72	11.91	0.00	44.42
mcap	74	57,550.18	17,534.00	108,400.86	184.00	455,512.77
Fraction placed	74	0.12	0.10	0.06	0.00	0.26
de	74	0.49	0.26	0.55	0.00	2.40
pmcap	74	0.13	0.11	0.07	0.00	0.32
pb	74	4.89	3.21	5.38	0.40	34.29
nyri	74	33.85	28.00	20.69	6.00	110.00
nyrnse	73	10.79	10.00	7.09	(2.00)	23.00
nyrbse	74	17.54	14.00	11.15	1.00	49.00

Table 2:

Explanatory Variable	Model-1	Model-2	Model-3
Intercept	1.34***	4.02***	4.18***
Mcap	-0.6E-4***	-6E-4***	-0.6E-4***
Fraction placed	-2.98*	-0.37	
de	0.51*	0.66**	0.70**
Inshar	-0.02	-0.04*	-0.036
Proshar		-0.03**	-0.31**
Pmcap		-11.14***	-11.38***
nyri			-0.014
nyrbse			0.01
LR Statistic	53.5***	80.4***	81.36***
Fraction of Correct Prediction	0.836	0.892	0.894
N	162	162	162

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