De Jure

May 23, 2020

Capital Market – Persevere

Rajani Associates
simple solutions

Capital Markets will not look the same in 2020 than it did last year. It will be dismal. As though the mayhem of 2019 was not sufficient, 2020 has thrown a spanner in the wheel, what with the lockdown and resulting recession in the economy because of COVID-19. We are under complete shutdown of economic activities in both domestic and international trade, which is unprecedented in the history of mankind.

India is staring at the worst economic crisis since 2008 and is looking for a million people to be pushed below the poverty line, doing irreversible damage to the economy and undoing a lot of the gains achieved in past many years in poverty alleviation and increased standard of living. Unfortunately, the economic brunt will be borne by the poor and low-income earning segment of the population.

The Indian regulators, be it SEBI, MCA or even the IBBI have announced various relaxations and waivers from compliance requirements, waivers on interest payments and moratorium on loans. The RBI reduced the fixed rate reverse repo rate by 25 basis points and announced special liquidity facility for mutual funds to the tune of Rs.50,000 crores because of the heightened volatility in capital markets. But will this revive the capital markets or is the system's plumbing broken?

The world rotates on the axis of capital markets, where capital markets channel the wealth to those who can put it to long-term productive use, such as companies and governments. The direction of wealth is used not only to strengthen businesses but also to improve personal standards of living. Without capital markets, life would be mundane and monotonous.

When someone mentions "capital markets", the first thing that comes to mind is "initial public offerings" or IPOs, similar to when you mention you are a lawyer and the immediate question is in which court do you practice. But "capital markets" is more than IPOs. "Capital markets" encompasses IPOs, private equity, bonds, stock markets, personal loans, equity and debt markets, money markets and such other products.

2019 was an election year and announcement of an interim budget prior to the election. The budget announced on February 1, 2020 did not excite investors and return of the Modi Government for the second term was a compulsion rather than a choice. Markets reacted adversely to the budget restrictions, additional compliances and difficultly in doing business in India.

The severe growth slump that gripped the Indian economy even surprised the International Monetary Fund. India's economic indicators have been flashing distress signals for a while now. We must remember that even ahead of the crisis 2 months ago, our growth had slowed. Now it has completely stopped. If India grew at 5% last year and we are now looking at negative (or zero) growth, there is a decline of 5% growth. This is huge.

The adverse market conditions were not only because of a lack-luster budget, but also because of investor caution, IL&FS fiasco and US-China trade war. IPOs hit an all-time low in 2019. Some of the issues which received SEBI nod to launch their IPOs aborted them; some reduced their issue size, while others extended the time to keep the issue open hoping to meet the minimum subscription. This sentiment hit even the other avenues of fund raising, whether by debt or equity.

With the fall of IL&FS and Franklin Templeton closing 6 of its funds, investors have become cautious about making investments or taking too much of a credit risk. Few debt categories have been facing the heat for the past 18 months because some companies have faced difficulty paying regular interest and, in some cases, returning the principal.

While the Indian market showed great volatility in 2019, not all grapes were sour. 2019 marked the biggest investment commitment from foreign funds in the Indian economy. Among the emerging markets, India stood second highest (next only to China) in attracting Foreign Portfolio Investments. Foreign Institutional Investors turned out to be net buyers of US$12.49 billion up to December 2019. Companies such as Chalet Hotels Limited, Metropolis Healthcare Limited, Polycab India Limited, Spandana Sphoorty Financial Limited and Sterling and Wilson Solar Limited launched their IPOs with full subscriptions.

Recognising the snail pace at which the economy was dawdling, the Government moved swiftly and rolled back the surcharge on foreign portfolio investors, withdrew the surcharge on long and short-term capital gains to encourage domestic and foreign investments in capital markets. The Government also consolidated certain public sector banks to strengthen the banking system, reduced corporate tax rate with an aim to propel capital inflows, reinvigorate private investments, thereby boosting economic growth.

The Government incentivised new businesses with a reduced income tax rate of 15% against the earlier rate of 25% and relaxed norms for new domestic manufacturing companies. These incentives are subject to the manufacturing companies forgoing other exemptions. These steps were aimed at creating enhanced profitability, inspire investors trust and spur capital investment and at the same time leave companies with additional liquidity.

The Government also considered the hardships faced by the banking system to resolve and recover outstanding dues from stressed assets. It introduced a revised recovery and resolution process under the Insolvency and Bankruptcy Code and Framework Regulation for stressed assets. The Government then announced infusion of Rs.70,000 crores into the public sector banks to enable them to have adequate liquidity to lend to the public.

All these initiatives are welcomed by companies and the markets and one could see shoots of revival in the economy but unfortunately, COVID struck. This has resulted in foreign investors selling off substantial equities and debt holdings in India and in other emerging markets.

As global interconnectivity and ubiquitous access to financial markets increase, the capital markets must function well and deep. Capital market players must address the changing market forces and demonstrate that they can operate within this new equilibrium. To restore public confidence and position businesses for long-term success, the players must adorn a leadership role in shaping the new equilibrium by driving creation of new utilities, transform entrenched businesses and relentlessly execute against today's imperatives in order to meet industry and client needs. Staying the same is no longer an option.

The challenges are vast and include pressure from clients, stakeholders and regulators and a continuous pressure to increase client profitability and adapt to new technologies.

As we sail into the new financial year, the timeline of the full-fledged opening of the economy is still unclear and an educated guess does not suggest normalcy in day-to-day life before 6 months. Any expectation for capital markets to return to normalcy before that may be highly optimistic.

It is expected that India will witness V curved recovery once the pandemic ends and the turnaround in India will be faster than other economies because this is not a natural disaster constraint. Capital has not been destroyed. Factories are working. Shops are standing. People are waiting to return to work. With a V shaped recovery, India will have a better chance than other countries.

Contributed by:
Sangeeta Lakhi, Partner: sangeeta@rajaniassociates.net
Jessica Katyal Senior Associate: jkatyal@rajaniassociates.net

AREAS OF PRACTICE

| Capital Markets | Private Equity | Mergers and Acquisitions | Corporate Litigation & Arbitration | Projects & Project Finance |
| Real Estate & Trust | Corporate & Commercial | Banking & Finance | Structuring | TMT | IPR | Employment

DISCLAIMER

This update only contains a summary/ limited description of the topic dealt with hereinabove for general information purposes and should not be construed as a legal opinion or be relied upon in absence of specific legal advice. For further information or legal advice please feel free to contact us.

CONTACT US

Rajani Associates

simple solutions

Address: Krishna Chambers
59 New Marine Lines
Churchgate
Mumbai 400020
Maharashtra, India
Telephone: (+91-22) 40961000
Facsimile: (+91-22) 40961010
Email: dejure@rajaniassociates.net
Website: www.rajaniassociates.net