After going through the chapter student shall be able to understand

- Basics of Capital Market
- Segments of Capital Market
- Capital Market Instruments
- Aspects of Primary Market
  1. Different kinds of issue of securities
  2. Types of offer document
  3. Issue requirements
  4. Steps in Public Issue
  5. Book Building
  6. ASBA
  7. Green Shoe Option
  8. Anchor Investors
  9. Private Placement (includes QIP)
  10. Disinvestment
  11. Right Issue
  12. Exit Offers (Delisting Offers and Strategic Issues)
1. BASICS OF CAPITAL MARKETS (NEED, EVOLUTION AND CONSTITUENTS)

Capital Market is basically a part of financial market where buying and selling of long term debt or equity takes place. The main role of capital market is providing a platform where long term funds are raised. This fund raising exercise through the capital market is tapped by the governments, banks and corporates through the capital market. Therefore, the organizations which need money can raise funds with the help of the capital market by issuing shares and debentures. The investors then invest in the capital market by purchasing those shares and debentures.

Therefore, it appears from the above that capital market acts as a link between savers and investors. It plays an important role in mobilizing the savings of the investors and channelizing them for productive purposes. So, the capital markets serves an important purpose as it helps in diverting the resources from where surplus funds are available to areas where there is dearth of funding and money is needed on urgent basis.

So, we can say that capital market is the soul of an economy through which savings of people are invested in basically corporate form of organizations. And, corporates utilize such invested amounts by putting them to their most effective use by allocating them in profitable opportunities. Therefore, a vibrant capital market benefits both the investor as well as the corporate form of organization and it is an important indicator of economic health of a country.

In order to ensure that capital market work in an orderly manner, Securities and Exchange Board of India (SEBI) act as a watchdog to protect investors against market manipulation, unfair trading and fraud amongst others. The job of SEBI is to protect the interests of investors and guide them to make wise investment decisions. The task of SEBI is also to ensure that the companies follow its rules, regulations and guidelines diligently and help to make the Indian Capital Market best in the world in terms of transparency and investor friendly measures.

The Indian Capital Market is very old. It started in 18th Century when the Indian securities are traded in Mumbai and Kolkata. However, the actual trading of securities in Indian Capital Market started with the setting up of The Stock Exchange of Bombay in July 1875 and Ahmedabad Stock Exchange in 1884. The evolution and development of Indian Capital Market can be discussed under two categories:

(i) Indian Capital Market – Before 1990’s
(ii) Indian Capital Market – After 1990’s

1.1 Indian Capital Market – Before 1990’s

The Indian Capital Market was very inactive till 1990. The requirements of loan term loan of corporate sector were funded by Development Financial Institutions (DFI’s) namely IDBI, IFCI, ICICI as well as by other investment institutions like LIC, UTI, GIC etc. Working capital
requirements were funded by the Commercial Banks through an elaborate network of bank branches spread all over the country.

The scope of capital market was limited because of easy availability of loans from banks and financial institutions. The structure of interest rate was entirely controlled. But, three important legislations, namely, Capital Issues (Control) Act 1947, Securities Contracts (Regulation) Act, 1956, and Companies Act, 1956 (Now, Companies Act, 2013) were somehow managed to give a proper structure for the development of capital market in India. However, the market was a highly regulated one. The pricing of the securities which were issued to the public for the first time was decided by the Office of the Controller of Capital Issues. There were few stock exchanges and the dominant one was Bombay Stock Exchange (BSE). The BSE provided the trading platform under which the secondary market transactions operate under an open outcry system.

1.2 Indian Capital Market – After 1990’s

The Indian capital markets have witnessed a major transformation and structural change during the past two and a half decades, since the early 1990’s. The Financial Sector Reforms in general and the Capital Market Reforms in particular were initiated in India in a big way from 1991 – 1992 onward. These reforms have enabled the capital market to improve its efficiency, to enhance transparency in market operations, to check unfair trade practices and bring the Indian capital market in accordance with the International Standards. The Capital Issues (Control) Act, 1947 was repealed in May 1992, and the office of the Controller of Capital Issues was abolished in the same year. The incorporation of National Stock Exchange was happened in 1992. After that it was recognized as a Stock Exchange in April 1993. It has been playing a lead role as a change agent in transforming the Indian Capital Market to its present form.

The Securities and Exchange Board of India (SEBI) was set up in 1988 and acquired the statutory status in 1992. Since 1992, SEBI has emerged as an autonomous and independent statutory body with definite mandate such as:

(a) to protect the interests of investors in securities,
(b) to promote the development of securities market, and
(c) to regulate the securities market.

In order to achieve these objectives, SEBI has been exercising power under the Securities and Exchange Board of India Act, 1992; Securities Contracts (Regulation) Act, 1956; Depositories Act, 1996 and delegated powers under the Companies Act, 2013. Indian Capital Market has made commendable progress since the inception of SEBI and has been transformed into one of the most dynamic capital markets of the world.

1.3 Functions of the capital market

The major functions of capital market are:

1. To mobilize resources for investments.
2. To facilitate buying and selling of securities.
3. To facilitate the process of efficient price discovery.
4. To facilitate settlement of transactions in accordance with the predetermined time schedules.

1.4 Major constituents of the capital market

1. SEBI (regulator)
2. Stock exchanges
3. Clearing corporations (cc)/ clearing houses (ch)
4. Depositories and depository participants
5. Custodians
6. Stock-brokers and their sub-brokers
7. Mutual funds
8. Merchant bankers
9. Credit rating agencies
10. Financial institutions
11. Foreign institutional investors
12. Non-banking institutions
13. Issuers/ registrar and transfer agents
14. Investors

2. SEGMNETS OF CAPITAL MARKET

2.1 Primary Market

Primary market is a market where buying and selling of new securities are taken place for the first time. In other words, the market, where the first public offering of equity shares or convertible securities by a company take place which is followed by the listing of a company’s shares on a stock exchange is called a primary market. It is also known as ‘initial public offering’ (IPO). Issue of further capital by companies whose shares are already listed on the stock exchange also comes within the ambit of Primary market.

There are different types of intermediaries operating in this segment of capital market by providing a variety of services. For example, merchant bankers, brokers, bankers to issues, debenture trustees, portfolio managers, registrars to issues and share transfer agents, etc. They are also regulated by SEBI. Their contribution is immense in the development of capital market.
2.2 Secondary Market

Secondary market is a market in which purchase and sale of securities which are already issued to the public for the first time and listed on the stock exchange takes place. Therefore, secondary markets are called stock exchanges and the over-the-counter market. When the securities are transferred from the first holder to another, the securities are said to be traded in secondary markets.

2.3 Primary Market vs. Secondary Market

Both the primary and secondary markets are approached by the corporates for funding their capital requirements. While the functions in the primary stock exchange are limited to first issuance, a number of securities and financial assets can be traded and re-traded over and over again. The main difference between the two is that, in the primary market, the involvement of company is directly in the transaction, while in the secondary market, the company has no involvement because the transactions take place between the investors.

2.4 The difference between primary market and secondary market

1. The Primary market refers to the market in which new securities are issued by the company to the public for the first time while the secondary market refers to the market where new securities which are already issued are traded. Stocks, bonds, options and futures are usually traded on the secondary market.

2. There is direct involvement of the company in the primary market. Whereas, in the secondary market, the company has virtually no involvement since the transactions takes place between investors.

3. The primary markets deal with new securities, that is, securities, which were not previously available and are, therefore, offered to the investing public for the first time while the secondary market is a market for already issued securities.

4. Primary market provides additional funds to the issuing companies either for starting a new enterprise or for the expansion or diversification of the existing business. On the other hand, the secondary market can in no circumstance supply additional funds since the company is not involved in the transaction.

2.5 Similarities between Primary and Secondary Markets

Some of the similarities between them are as follows:

(a) Listing: The securities issued in the primary market are invariably listed on a recognized stock exchange for dealings in them. Further trading in secondary market can also be carried out only through the stock exchange platform. The listing on stock exchanges
provides liquidity as well as marketability to the securities and facilitates discovery of prices for them.

(b) Control by Stock Exchanges: Via the mechanism of Listing Agreement between the issuer companies and the stock exchange, the stock exchanges exercise considerable control over the new issues as well securities already listed on the stock exchange. Stock Exchanges ensure that there is continuous compliance by the issuer company of the clauses provided in the Listing Agreement.

2.6 Interrelationship between Primary Markets and Secondary Markets

The markets for new and old securities are, economically, an integral part of a single market – the capital market. Their mutual interdependence from the economic point of view has following two dimensions:

- One, the quantum of trading and the participation of the investors on stock exchange has a significant bearing on the level of activity in the primary market and, therefore, its responses to capital issues.
- Second, the dimension of mutual interdependence is based on the fact that the level of activity in primary market has a direct impact on the level of activity in secondary market. As more and more companies issue their securities in the capital market, investment options for investors increase which leads to a wider participation by investors in the secondary market.

2.7 Participants in the Capital Market

- Investors: Investors are the lifeline of any capital markets. For a vibrant capital market, the capital market should be able to attract the savings of investors. Investors belong to various categories such as Retail Investors, Institutional Investors like mutual funds, insurance companies and Foreign Portfolio Investors.

- Stock Exchange: Stock Exchange is a place where securities issued by issuer companies are listed and traded. The term is synonymously used for secondary markets.

- Depository: A depository is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered Depository Participant. They also provide safekeeping of securities. They also help in other functions like pledge, hypothecation, stock lending and borrowing etc. In India there are two depositories namely National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL).

- Intermediaries: Intermediaries are those entities which offer various services in relation to the capital markets. There are various categories of intermediaries such as stock brokers, merchant bankers, underwriters etc.
3. CAPITAL MARKET INSTRUMENTS

Financial instruments (e.g. bonds and stocks) whose maturity is more than one year are traded in the capital market. They are a very large source of funds with bonds having long maturity and shares having indefinite maturity. It also helps in increasing capital formation in the country. The following instruments are available for investors in the capital market:

- Shares (Equity and preference)
- Debentures/ Bonds
- Depository Receipts (ADR’s, GDR’s and IDR’s)
- Derivatives

The above instruments are discussed as below:

(i) Shares: Share is a type of security, which signifies ownership in a corporation and represents a claim on the part of the corporation’s assets and earnings. As one acquires more shares, his or her ownership stake in the company becomes greater.

There are two main types of shares, equity shares and preference shares. Equity share usually entitles the owner to vote at shareholders’ meetings and to receive dividends. Preference shares generally do not have voting rights, but have a prior preference on assets and earnings of the company than the equity shares. For example, an owner of Preference shares receive dividends before equity shareholders and have priority in the event of a company goes bankrupt or is liquidated.

**Basic Features of Shares**

It is a general belief that on becoming a shareholder of a company, the shareholder has a say in the day to day running of the business. However, on the contrary, an individual retail investor has very little control over the running of the business. Various features of shares are laid down as below:

1) Profits are sometimes paid out in the form of dividends. Higher proportion of shares in a company signifies higher stake in the profits also. In case of bankruptcy and liquidation, you'll receive what's left after all the creditors have been paid.

2) Another extremely important feature of share is its limited liability, which means that, as an owner of a share, you are not personally liable if the company is not able to pay its debts.

3) Companies issue shares to raise capital as it does not require the company to pay back the money after a certain time period (other than redeemable preference shares) or make interest payments continuously. Equity shares can be held by the company till perpetuity.

4) Equity shares are traded on the cash segment of the capital market. The investors in equity shares make money via dividends or through capital appreciation in the price of the shares.
Equity shares are very high risk instruments with no guaranteed returns. There is always a risk of downside in the value of equity investments.

5) Shares are traded at market value on stock exchanges. Market Value per share is the current price at which the share is traded. For actively traded stocks (liquid stocks), market price quotations are readily available due to continuous demand and supply for those shares. However, for inactive stocks (illiquid stocks) that have very thin markets, prices are very difficult to obtain. Even when obtainable, the information may reflect only the sale of a few shares and not typify the market value of the firm as a whole. Market value per share of an equity share is generally a function of the expectations of the market about the future earnings of the company and the perceived risk on the part of investors.

(ii) Preference Shares: These shares form part of the share capital of the company which carry a preferential right to be paid in case a company goes bankrupt or is liquidated. Preference shareholders have got very negligible voting rights. But they do have a higher claim on the assets and earnings of the company.

(iii) Debentures/Bonds: One of the most popular long term debt securities among corporates is bond. In case of a bond issue, the buyer of bonds lends the required amount to the issuer of bonds. The certificate itself is evidence of a lender-creditor relationship. It is a “security” because unlike a car loan or home-improvement loan, the debt can be bought and sold in the open market. And bond is a security which can be bought and sold in the open market. In fact, as already mentioned, bond is a long term security whose maturity period is generally more than one year. Bonds with maturities less than one year are generally called money market instruments.

As the intention of a bond issue is that the securities shall be bought and sold, all the certificates of a bond issue contain a master loan agreement. This agreement between issuer and investor (or creditor and lender), called the “bond indenture” or “deed of trust,” contains all the information one would normally expect to see in any loan agreement, which includes the following:

- **Amount of the Loan:** The “face amount” “par value” or “principal” is the amount of the loan - the amount that the bond issuer has agreed to repay at the bond’s maturity.

- **Rate of Interest:** Bonds are issued with a specified “coupon” or “nominal” rate, which is determined largely by market conditions at the time of the bond’s primary offering. So, once the coupon rate is fixed, it is applicable for the entire life of the bond. The amount of the interest to be paid can be arrived at by multiplying the rate of interest (coupon) by the face value of the bond. For example, the interest which a bond issuer pays to the bondholder in case of a bond issue with face value of ₹ 100,000 and a coupon of 8% is ₹ 8000 per year.

- **Schedule or Form of Interest Payments:** Interest is paid on most bonds at six-month intervals, usually on either the first or the fifteenth of the month. The ₹ 8000 of annual interest on the bond in the previous example would probably be paid in two installments of ₹ 4000 each.
Term: A bond’s “maturity,” or the length of time until the principal is repaid varies greatly but is always more than five years. Debt that matures in less than a year is a “money market instrument” - such as commercial paper or bankers’ acceptances. A “short-term bond,” on the other hand, may have an initial maturity of five years. A “long-term bond” typically matures in 20 to 40 years. The maturity of any bond is predetermined and stated in the trust indenture.

Call Feature (if any): A “call feature,” if specified in the trust indenture, allows the bond issuer to “call in” the bonds and repay them at a predetermined price before maturity. Bond issuers use this feature to protect themselves from paying more interest than they have to for the money they are borrowing. Companies call in bonds when general interest rates are lower than the coupon rate on the bond, thereby retiring expensive debt and refinancing it at a lower rate.

Suppose, IDBI had issued 6 years ₹ 1000 bonds in 1998 @14% p.a. But now the current interest rate is around 9% to 10%. If the issuer wants to take advantage of the call feature in the bond’s indenture it will call back the earlier issued bonds and reissue them @9% p.a. The sale proceeds of this new issue will be used to pay the old debt. In this way IDBI now enjoys a lower cost for its borrowed money.

Some bonds offer “call protection”; that is, they are guaranteed not to be called for five to ten years. Call features can affect bond values by serving as a ceiling for prices. Investors are generally unwilling to pay more for a bond than its call price, because they are aware that the bond could be called at a lower call price. If the bond issuer exercises the option to call bonds, the bond holder is usually paid a premium over par for the inconvenience.

Refunding: If, when bonds mature, the issuer does not have the cash on hand to repay bondholders; it can issue new bonds and use the proceeds either to redeem the older bonds or to exercise a call option. This process is called refunding.

Yields and its Method of Calculation: There are number of methods for calculating yields. But the most common method is the Yield to Maturity (YTM). Although this is another name of IRR. The formula is as follows:

\[
YTM = \frac{\text{Coupon Rate} + \frac{\text{Redemption Value} - \text{Purchase Price}}{\text{Period of Holding}}}{(\text{Redemption Value} + \text{Purchase Value})/2}
\]

Determinants of Bond Prices: While Yield To Maturity (YTM) enables traders and investors to compare debt securities with different coupon rates and terms to maturity, it does not determine price. Bond prices depend on a number of factors such as the ability of the issuer to make interest and principal payments and how the bond is collateralized. An across-the-board factor that affects bond prices is the level of prevailing interest rates.
Illustration 1

Suppose a 8% ₹ 1000 bond had 5 years left to maturity when it was purchased for ₹ 800. The prevailing interest rate (on other investment vehicles) was about 8%. Further assume that current prevailing interest rates are about 9%. Why should investors buy a five-year old bond yielding 8% when they can buy a newly issued 9% bond?

Solution

The only way the holder of an 8% bond can find a buyer is to sell the bond at a discount, so that its yield to maturity is the same as the coupon rate on new issues. Let’s say interest rates increase from 8% to 10%. With 15 years to maturity, an 8% bond has to be priced so that the discount, when amortized over 15 years has a yield to maturity of 10%. That discount is a little under ₹ 200:

\[
YTM = \frac{\text{Coupon Rate} + \text{Prorated Discount}}{\text{Face Value + Purchase Price}} = \frac{\₹ 80 + (₹ 200/15 \text{ years})}{(₹ 1,000 + ₹ 800)/2} = \frac{₹ 93.33}{₹ 900} = 10.4%.
\]

The 8% bond with 15 years to maturity must sell at a little over ₹ 800 to compete with 10% bonds. The possibility that interest rates will cause outstanding bond issues to lose value is called “Interest rate risk.” Yet there is an upside to this risk. If interest rates decline during the five years that the 8% bond is outstanding, the holder could sell it for enough of a premium to make its YTM rate equal to the lower yields of recent issues. For instance, should interest rates decline to 7%, the price of the 8% bond with 15 years to maturity will increase by about ₹ 100.

(iv) American Depository Receipt (ADRs): An American Depository Receipt (ADR) is a negotiable receipt which represents one or more depository shares held by a US custodian bank, which in turn represent underlying shares of non-US issuer held by a custodian in the home country. Investors of USA who are willing to invest in the securities of non USA issuers finds ADR as an attractive means of investment for the following reasons:

- ADRs provide a means to US investors to trade the non-US company’s shares in US dollars. ADR is a negotiable receipt (which represents the non US share) issued in US capital market and is traded in dollars. The trading in ADR effectively means trading in underlying shares.
- ADRs facilitate share transfers. ADRs are negotiable and can be easily transferred among the investors like any other negotiable instrument. The transfer of ADRs automatically transfers the underlying share.
- The transfer of ADRs does not involve any stamp duty and hence the transfer of underlying share does not require any stamp duty.
- The dividends are paid to the holders of ADRs in U.S. dollars.

The listing of such an issue is done on the NYSE or AMEX to enable trading. Quotations on NASDAQ can also be used for trading purposes. Any requirement with respect to Blue Sky Law, if not exempted, has to be fulfilled.

Specified document and information must be provided to NASDAQ to enable it to review the terms of the offering and determine whether the underwriting arrangements are fair and reasonable. The filing documents with NASDAQ are the responsibility of managing underwriter.

(v) Global Depository Receipts (GDRs): Global Depository Receipts are negotiable certificates issued by a depository based outside India to non-resident investors with publicly traded equity shares or foreign currency convertible bonds of the issuer in India as underlying security. An issue of depository receipts would involve the issuer, issuing agent to a foreign depository. The depository, in turn, issues GDR to investors evidencing their rights as shareholders. Depository receipts are denominated in foreign currency and are listed on an international exchange such as London or Luxembourg. GDR enable investors to trade a dollar denominated instrument on an international stock exchange and yet have rights in foreign shares.

The principal purpose of the GDR is to provide international investors with local settlement. The issuer issuing the shares has to pay dividends to the depository in the domestic currency. The depository has to then convert the domestic currency into dollars for onward payment to receipt holders. GDR bear no risk of capital repayment.

GDR is also issued with warrants attached to them. Warrants give the investors an option to get it converted into equity at a later date. Warrants help the issuer to charge some premium on the GDR sold and it also helps to increase the demand of the GDR issue. The other advantage to the issuer is that it will not have to pay dividends on the warrants till the conversion option is exercised. The disadvantage to the issuer lies in delayed receipt of full proceeds from the issue and in case the conversion option is not exercised the expected proceeds will not be realised.

(vi) Derivatives: A derivative is a financial instrument which derives its value from some other financial price. This ‘other financial price’ is called the underlying. The most important derivatives are futures and options.

These are derivative instruments traded on the stock exchange. The instrument has no independent value, with the same being ‘derived’ from the value of the underlying asset. The asset could be securities, commodities or currencies. Its value varies with the value of the underlying asset. The contract or the lot size is fixed. For example, a Nifty futures contract has 50 stocks.

Futures

This means you agree to buy or sell the underlying security at a ‘future’ date. If you buy the contract, you promise to pay the price at a specified time. If you sell it, you must transfer it to the buyer at a specified price in the future.

The contract will expire on a pre-specified expiry date (for example, it is the last Thursday of the month for equity futures contracts). Upon expiry, the contract must be settled by delivering the
underlying asset or cash. You can also roll over the contract to the next month. If you do not wish to hold it till expiry, you can close it mid-way.

Options

This gives the buyer the right to buy/sell the underlying asset at a predetermined price, within, or at end of a specified period. He is, however, not obliged to do so. The seller of an option is obliged to settle it when the buyer exercises his right.

There are two types of options — call and put. Call is the right but not the obligation to purchase the underlying asset at the specified price by paying a premium. The seller of a call option is obliged to sell the underlying asset at the specified strike price. Put is the right but not the obligation to sell the underlying asset at the specified price by paying a premium. However, the seller is obliged to buy the underlying asset at the specified strike price. Thus, in any options contract, the right to exercise the option is vested with the buyer of the contract. The seller only has the obligation.

Investing in F&O needs less capital as you are required to pay only a margin money (5-20 per cent of the contract) and take a larger exposure. However, it is meant for high networth individuals.

In futures contracts, the buyer and the seller have an unlimited loss or profit potential. The buyer of an option can make unlimited profit and faces limited downside risk. The seller, on the other hand, can make limited profit but faces unlimited downside. (Source: Business Standard)

4. ASPECTS OF PRIMARY MARKET (NEW ISSUE MARKET)

Various aspects of primary market i.e. new issue market have been discussed in detail in the following paragraphs. Discussion mainly takes places in Indian context. However, global aspects are also covered at suitable places.

4.1 Different kinds of issue of securities

Primarily, issues made by an Indian company can be classified as Public, Rights, Bonus and Private Placement. While right issues by a listed company and public issues involve a detailed procedure, bonus issues and private placements are relatively simpler. The classification of issues is illustrated as below:

a) Public Issue
   (i) Initial Public Offer (IPO)
   (ii) Further Public Offer (FPO)

b) Rights Issue

c) Composite Issue (Combination of public and right issue)
d) Bonus Issue

e) Private Placement

   (i) Preferential Issue
   (ii) Qualified Institutional Placement
   (iii) Institutional Placement Programme

Different types of Securities issued in the Primary Market can be succinctly shown in the following diagram:

![Diagram showing different types of Securities issued in the Primary Market]

The diagram as depicted above has been briefly discussed as below:

(a) **Public Issue**: When shares or convertible securities are issued to new investors, it is called a public issue. Public issue can be further sub-divided into Initial Public Offer (IPO) and Further Public Offer (FPO). The significant features of each type of public issue are illustrated below:

   (i) **Initial Public Offer (IPO)**: When the shares and debentures of a company are issued to the public for the first time, it is called an IPO. It then set the stage for listing and trading of the issuer’s shares or convertible securities on the Stock Exchanges.

   (ii) **Further Public Offer (FPO) or Follow on Offer**: When an already listed company makes either a fresh issue of shares or convertible securities to the public or an offer for sale to the public, it is called a FPO.

(b) **Right Issue (RI)**: When an issue of shares or convertible securities is made by an issuer to its existing shareholders as on a particular date fixed by the issuer (i.e. record date), it is called a right issue. The rights are offered in a particular ratio to the number of shares or convertible securities held as on the record date.

(c) **Composite Issue**: When the issue of shares or convertible securities by a listed issuer on public cum-rights basis, wherein the allotment in both public issue and rights issue is proposed to be made simultaneously, it is called composite issue.
(d) **Bonus Issue**: When an issuer makes an issue of shares to its existing shareholders without any consideration based on the number of shares already held by them as on a record date, it is called a bonus issue. In Bonus Issue, the shares are issued out of the Company’s free reserve or share premium account in a particular ratio.

(e) **Private Placement**: When an issuer makes an issue of shares or convertible securities to a select group of persons not more than 50 but can extend up to 200, it is called a private placement. It should not either be a right issue or a public issue. Private placement of shares or convertible securities by listed issuer can be of three types:

(i) **Preferential Allotment**: When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter V of SEBI (ICDR) Regulations, 2018, it is called a preferential allotment. The issuer is required to comply with various provisions which inter-alia include pricing, disclosures in the notice, lock-in etc., in addition to the requirements specified in the Companies Act.

(ii) **Qualified Institutions Placement (QIP)**: When a listed issuer issues equity shares or non-convertible debt instruments along with warrants and convertible securities other than warrants to Qualified Institutions Buyers only, in terms of provisions of Chapter VI of SEBI (ICDR) Regulations, 2018, it is called a QIP.

A listed issuer may make qualified institutions placement if it satisfies the following conditions:

(a) A special resolution has to be passed by the shareholders by approving the qualified institutions placement;

(b) The equity shares of the same class, which are proposed to be allotted through qualified institutions placement or pursuant to conversion or exchange of eligible securities offered through qualified institutions placement, have been listed on a recognized stock exchange having nationwide trading terminal for a period of at least one year prior to the date of issuance of notice to its shareholders for convening the meeting to pass the special resolution.

(c) An issuer shall be eligible to make a qualified institutions placement if any of its promoters or directors is not a fugitive economic offender.

(d) A qualified institutions placement shall be managed by merchant banker(s) registered with the Board who shall exercise due diligence.

(e) The qualified institutions placement shall be made at a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class quoted on the stock exchange during the two weeks preceding the relevant date.

(f) The minimum number of allottees for each placement of eligible securities made under qualified institutions placement shall not be less than:

(i) two, where the issue size is less than or equal to two hundred and fifty crore rupees;
(ii) five, where the issue size is greater than two hundred and fifty crore rupees.

Provided that no single allottee shall be allotted more than 50% of the issue size.

(g) The tenure of the convertible or exchangeable eligible securities issued through qualified institutional placement shall not exceed sixty months from the date of allotment.

(h) The issuer shall not make any subsequent qualified institutions placement until the expiry of six months from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

(Source: SEBI website)

4.2 Types of Offer Documents

‘Offer document’ is a document which contains all the relevant information about the company, promoters, projects, financial details, objects of raising the money, terms of the issue, etc and is used for inviting subscription to the issue being made by the issuer. ‘Offer Document’ is called “Prospectus” in case of a public issue and “Letter of Offer” in case of a rights issue.

Terms used for offer documents vary depending upon the stage or type of the issue where the document is used.

The terms used for offer documents are defined below:

(i) Draft offer document is an offer document filed with SEBI for specifying changes, if any, in it, before it is filed with the Registrar of companies (ROCs). Draft offer document is made available in public domain including websites of SEBI, concerned stock exchanges, or concerned Merchant Banker for enabling public to give comments, if any, on the draft offer document.

(ii) Red herring prospectus is an offer document used in case of a book built public issue. It contains all the relevant details except that of price or number of shares being offered. It is filed with ROC before the issue opens.

(iii) Prospectus is an offer document in case of a public issue, which has all relevant details including price and number of shares or convertible securities being offered. This document is registered with ROC before the issue opens in case of a fixed price issue and after the closure of the issue in case of a book built issue.

(iv) Letter of offer is an offer document in case of a Rights issue of shares or convertible securities and is filed with Stock exchanges before the issue opens.

(v) Abridged prospectus is an abridged version of offer document in public issue and is issued along with the application form of a public issue. It contains all the salient features of prospectus.

(vi) Abridged letter of offer is an abridged version of the letter of offer. It is sent to all the shareholders along with the application form.
(vii) **Shelf prospectus** is a prospectus which enables an issuer to make a series of issues within a period of 1 year without the need of filing a fresh prospectus every time. This facility is available to public sector banks, scheduled banks and Public Financial Institutions.

(viii) **Placement document** is an offer document for the purpose of Qualified Institutional Placement and contains all the relevant and material disclosures.  
(Source: SEBI website)

**Key disclosure requirements of offer document**

Key disclosures required to be made in an offer document i.e. in a prospectus are given as below:

(i) names and addresses of the registered office of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters etc;

(ii) dates of the opening and closing of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time;

(iii) a statement by the Board of Directors about the separate bank account where all monies received out of the issue are to be transferred and disclosure of details of all monies including utilized and unutilized monies out of the previous issue;

(iv) details about underwriting of the issue;

(v) the authority for the issue and the details of the resolution passed therefor;

(vi) procedure and time schedule for allotment and issue of securities;

(vii) capital structure of the company;

(viii) main objects of public offer and terms of the present issue;

(ix) Main objects and present business of the company and its location, schedule of implementation of the project;

(x) Particulars relating to management perception of risk factors specific to the project, gestation period of the project, extent of progress made in the project and deadlines for completion of the project;

(xi) minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash;

(xii) details of directors including their appointments and remuneration,

(xiii) sources of promoter's contribution.

**4.3 Issue Requirements**

SEBI has laid down entry norms for entities making a public issue/offer. The same are detailed below -

**Entry Norms:** Entry norms are different routes available to an issuer for accessing the capital market by way of a public issue. They are meant for protecting the investors by restricting fund raising by companies if they do not satisfy the entry requirements.
An unlisted issuer making a Public Issue (i.e. IPO) is required to satisfy the following provisions:

**Entry Norm I (commonly known as “Profitability Route”)**

The Issuer Company shall meet the following requirements:

(a) Net Tangible Assets of at least Rs. 3 crores in each of the preceding three full years of which not more than 50% are held in monetary assets. However, the limit of fifty percent on monetary assets shall not be applicable in case the public offer is made entirely through offer for sale.

(b) Minimum of Rs. 15 crores as average pre-tax operating profit in at least three of the immediately preceding five years.

(c) Net worth of at least Rs. 1 crore in each of the preceding three full years.

(d) If the company has changed its name within the last one year, at least 50% revenue for the preceding 1 year should be from the activity suggested by the new name.

To provide sufficient flexibility and also to ensure that genuine companies are not limited from fund raising on account of strict parameters, SEBI has provided the alternative route to the companies not satisfying any of the above conditions, for accessing the primary Market, as under:

**Entry Norm II (Commonly known as “QIB Route”)**

Issue shall be through book building route, with at least 75% of net offer to the public to be mandatorily allotted to the Qualified Institutional Buyers (QIBs). The company shall refund the subscription money if the minimum subscription of QIBs is not attained.

**A listed issuer making a public issue (i.e. FPO) is required to satisfy the following requirements:**

(a) If the company has changed its name within the last one year, at least 50% revenue for the preceding 1 year should be from the activity suggested by the new name.

An issuer not satisfying the condition as stated above may make a further public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent of the net offer, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

Certain other general conditions to be satisfied by the issuer with regard to further public offer are given as below:

(i) It has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of Schedule XIX;
(ii) It has entered into an agreement with a depository for dematerialization of specified securities already issued and proposed to be issued;

(c) All its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

(d) It has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for the specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.  

(Source: SEBI Website)

However, there are no entry norms for a listed company making a right issue.

4.4 Mandatory provisions to be complied with before making a public issue

An issuer making a public issue is required to inter-alia comply with the following provisions:

(i) Minimum Promoter’s contribution and lock-in: In a public issue by an unlisted issuer, the promoters shall contribute not less than 20% of the proposed issue size or to the extent of 20% of the post issue capital which should be locked in for a period of 3 years. “Lock-in” indicates a freeze on the shares. In case of a composite issue (i.e. further public offer cum rights issue), minimum promoter’s contribution is either to the extent of twenty per cent of the proposed issue size or to the extent of twenty per cent of the post issue capital excluding the rights issue component. In cases where the promoters contribution has been brought in and utilized, then a cash flow statement disclosing the use of funds in the offer document should be included. This provision ensures that promoters of the company have some minimum stake in the company for a minimum period after the issue or after the project for which funds have been raised from the public is commenced.

(ii) IPO Grading: IPO Grading is the credit rating granted by a credit rating agency to the Initial Public Offer of a company. Such a credit rating agency shall be registered with SEBI. Such a grading granted to the IPO of a company takes into account the relative assessment of fundamentals of an IPO. In comparison to other listed equity shares, the IPO Grading so obtained has to be disclosed mandatorily by the companies going for an IPO.

The IPO Grading is generally granted on a five point scale with a higher scale indicates stronger fundamentals and vice versa. This has been shown as below:

IPO grade 1 - Poor fundamentals
IPO grade 2 - Below-Average fundamentals
IPO grade 3 - Average fundamentals
IPO grade 4 - Above-average fundamentals
IPO grade 5 - Strong fundamentals
The purpose of IPO Grading is to make available additional information to the investors. This will help them to assess the fundamentals of a company more judiciously.

The IPO Grading can be done either before filing the offer document with SEBI or later on. However, the prospectus/RHP must highlight the grades given to IPO’s by the Credit Rating Agencies. Further, the companies coming out with an IPO are required to bear the expenses required for grading an IPO.

However, it is noted that w.e.f. February 4, 2014, IPO Grading has been made optional.

The IPO grading process takes into account the following points:

(i) Prospects of the industry in which the company operates.
(ii) Competitive strengths of the company
(iii) Company’s financial position.

To arrive at an IPO Grade, following aspects are looked into by the rating agencies. However, the list is not exhaustive and may vary.

b. Financial Position
c. Management Quality
d. Corporate Governance Practices
e. Compliance and Litigation History
f. New Projects—Risks and Prospects

It can be reiterated that the above lists may vary on case to case basis. Further, IPO Grading does not take into account the price at which the shares are to be issued to the public. So, the investors have to make an independent judgement regarding the price at which shares are to be bid during the IPO process.

Therefore, it can be said that though the objective of a credit rating agency is to give an opinion about an IPO, the investors are also required to take safeguards by studying the prospectus including risk factors very carefully by making an independent judgement.

Further, it is to be noted that SEBI does not play any role in the grading process of the CRA. The grading is entirely an independent and unbiased opinion of CRA. Therefore, SEBI’s opinion of the IPO document is entirely independent of the opinions expressed or grades given by CRAs.

4.5 Pricing of an Issue

Before 1992, pricing of the issue was decided by the Controller of Capital Issues (CCI) under the Capital Issues (Control) Act, 1947. In 1992, the Capital Issues (Control) Act, 1947 was repealed.
And, then, the public issues came out of the shackles of CCI. Pricing of Issues can be freely arrived at by the companies in consultation with the Merchant Banker.

The offer document discloses the parameters on the basis of which the price is arrived at. These are EPS, PE multiple, return on net worth etc. The parameters as stated above are also compared with the peer group companies.

The public issue can be segregated into either a fixed price issue or a book built issue. If the price is already mentioned in the offer document, it is called a fixed price issue. Conversely, when the price is discovered on the basis of demand received from the investors at different levels of price, it is called a ‘Book Built Issue’.

The price is disclosed in the fixed price issue in the draft prospectus. And, the floor price or price band in the case of a book built issue is disclosed in the Red Herring Prospectus. Where the issuer opts not to make the disclosure of the floor price or price band in the red herring prospectus, the issuer shall announce the floor price or the price band at least two working days before the opening of the issue in the same newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the format prescribed under Part A of Schedule X.

4.6 Intermediaries to the Capital Market

1. **Merchant Bankers/Lead Managers** – Merchant Banker/Lead Manager actually manages the issue. He makes the entire management regarding purchase and sale of securities. He also provides corporate advisory services in relation to issue management. Pre issue and post issue due diligence of the public issue is also handled by the Merchant Banker.

2. **Underwriters** – The IPO underwriters generally hire specialists in their staff. The underwriters who are generally investment banks have to ensure that all the regulatory requirements are complied with.

   Secondly, the investment banker pursues the large institutional investors such as mutual funds, pension funds and insurance companies to invest in the company. The amount of interest generated by these large institutional investors into the company’s shares helps the underwriter to set the price of IPO of the company’s stock.

3. **Bankers to an Issue** – They are scheduled banks who carry any one or more of the following activities:

   (i) acceptance of application and application monies;
   (ii) acceptance of allotment or call monies;
   (iii) refund of application monies;
   (iv) payment of dividend or interest warrants.
4. **Brokers to an issue** – the brokers to an issue acts as an agent to the investor. He charges commission for the services rendered by him. So, the task of brokers is to execute buy or sell orders.

5. **Debenture Trustees** – As per SEBI Regulations, “Debenture Trustee” means a trustee appointed in respect of any issue of debentures of a body corporate. They should either be a schedule commercial bank, a public financial institution, an insurance company or a body corporate. It is also required to be registered with SEBI.

6. **Registrars to Issue** – According to SEBI Regulations, “Registrar to an Issue” means the person appointed by a body corporate or any person or group of persons to carry on the following:
   
   (i) collecting applications from investors in respect of an issue;
   
   (ii) keeping a proper record of applications and monies received from investors or paid to the seller of the securities and
   
   (iii) assisting body corporate or person or group of persons in-
   
   (a) determining the basis of allotment of securities in consultation with the stock exchange;
   
   (b) finalizing of the list of persons entitled to allotment of securities;
   
   (c) processing and dispatching allotment letters, refund orders or certificates and other related documents in respect of the issue.

7. **Portfolio Managers** – The job of a portfolio manager is to invest in a mutual fund, exchange traded fund or any suitable investments in securities. Further, they help their clients in developing an investment strategy, implementing the strategy developed, and manage day to day portfolio trading.
4.7 Steps involved in public issue

The various steps involved in public issue of shares are enumerated below:

1. **Board Meeting and Passing a Board Resolution for Public Issue**: Before initiating the process of public issue, a company is required to call a Board meeting and pass a Board Resolution for raising the money through Public Issue.

2. **Holding of General Meeting**: If it is required by the Articles of Association, that consent of shareholder has to be obtained. For this purpose, meeting of the shareholders will be called.

3. **Appointment of Merchant Banker and other intermediaries and entering into MOU with them**: To initiate the process, the Company has to pass a Board Resolution and proceed to appoint a Merchant Banker, with whom an MOU may be entered into. It is also necessary to appoint various intermediaries i.e. underwriters, Bankers to the Issue, Registrars, and brokers to the issue for marketing the same and to enter into an agreement with them.

4. **Preparation of Draft Prospectus and its approval by Board**: A draft Prospectus has to be prepared and approved by the Board. Apart from the notice of offer to issue shares to public, prospectus should also disclose:
   (a) Justification of Premium, if called
   (b) Net Asset value (NAV)
   (c) High and Low price of the shares of the company for the last two years
   (d) Highlights of the issue, as well as the "Risk Factors"
   (e) A clause that company shall refund the entire application money if minimum subscription is not received
   (f) A statement by the lead managers that in their opinion the assets of the underwriters are adequate to meet their obligations

5. **Filing of prospectus with the SEBI/Registrar of Companies**: The draft prospectus along with the copies of the agreements entered into with the Lead Manager, Underwriters, Bankers, registrars and Brokers to the issue has to be filed with SEBI and the Registrar of Companies of the state where the registered office of the company is located, along with the fees & other prescribed requirements, (with due diligence by merchant banker).

6. **Intimation to Stock Exchange**: A copy of the Memorandum and Articles of Association of the company has to be sent to the Stock Exchanges where the shares are to be listed, for approval.

7. **Finalization of collection centers**: The lead manager finalizes the collection centers so that prospective investor can collect the application forms along with prospectus.

8. **Printing and Distribution of Prospectus and Application Forms**: After Receipt of Acknowledgement card from the SEBI and the intimation from Registrar of Companies regarding
registration of prospectus, the company should take steps to issue the prospectus within 90 days of its registration with ROC.

9. **Announcement and Advertisement**: Announcement regarding the proposed issue should be made at least ten days before the subscription list opens. No advertisement should include Brand Names for the issue except the normal commercial name of the company or commercial brand names of the company or commercial brand names of its products already in use.

10. **Subscription List**: As stipulated by SEBI Regulations, the subscription list for public issue is to be kept open for at least 3 working days and for a total period not exceeding 10 working days, which is to be disclosed in prospectus as well. In case of a book built issue, bid is open for a maximum period of 7 working days which can be extended by 3 days in case of revision in price band.

11. **Separate Bank Account**: A separate bank account is opened for the purpose of collecting the proceeds of the issue. Further, the date of opening and closing of the subscription list should be intimated to all the collecting and controlling branches of the bank with whom the company has entered into an agreement for the collection of application forms.

12. **Minimum Subscription**: Section 39 of the Companies Act, 2013 prohibits allotment of securities where the minimum amount as stated in the prospectus has not been subscribed. If the stated minimum amount has not been subscribed and the sum payable on application is not received within the period specified therein, then the application money shall be repaid within a period of fifteen days from the closure of the issue, and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally liable to repay that money with interest at the rate of fifteen percent per annum.

13. **Promoters’ contribution**: A certificate to the effect that the required contribution of the promoters has been raised before opening the issue, has to be obtained from a Chartered Accountant, and duly filed with SEBI.

14. **Allotment of Shares**: A return of allotment in the prescribed form as given under the Companies Act, 2013 should be filed with Registrar of companies within 30 days of the date of allotment along with the prescribed fees. In case, the issue is oversubscribed, the basis of allotment has to be decided in consultation with the stock exchange authorities as per the guidelines laid down by the stock exchanges.

15. **Compliance Report**: As stipulated by SEBI guidelines, within 45 days of the closure of issue, a report in the prescribed form along with a compliance certificate from statutory auditor/practicing chartered accountant or by a company secretary in practice has to be forwarded to SEBI by the lead managers.

16. **Issuance of Share Certificates**: As per provisions of the Companies Act, 2013, the company should deliver the share certificates within 2 months from the date of allotment of shares.
4.8 Public Issue of Shares - Book Building Route

Book Building is a process undertaken to assess a demand for the securities proposed to be issued by a corporate body is elicited and built up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document.

In book building process, the price at which securities will be issued to the public is not known while in case of offer of shares through normal public issue, price is known in advance to investor. In case of Book Building, the demand can be known everyday as the book is built. But in case of the public issue, the demand is known at the close of the issue. The Book should remain open for a minimum of 3 working days.

**Book Building Method**

Book building is a method of price discovery. In this method, offer price of securities is determined on the basis of real demand for the shares at various price levels in the market. “Book building” means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be, in accordance with SEBI (ICDR) regulations;

In book building method, the final issue price is not known in advance. Only a price band is determined and made public before opening of the bidding process. The spread of price between floor price and cap in the price band should not be more than 20%. It means that the cap should not be more than 120% of the floor price. Issuing Company appoints a merchant banker as Book Runner Lead Manager (BRLM), who may be assisted by other co-managers and by a team of syndicate members acting as underwriters to the issue.

The BRLM sends copies of Red Herring Prospectus to the Qualified Institutional Buyers (QIBs), large Investors, SEBI registered Foreign Institutional Investors (FIIs) and to the syndicate members. BRLM also appoints brokers of the stock exchanges, called bidding centres. They accept the bids and application forms from the investors. These bidding centres place the order of bidders with the company through BRLM. They are liable for any default, if any, made by their clients, who have applied through them. Brokers/ Syndicate members collect money from clients/investors. Money received by them at the time of accepting bids is called margin money. Bids can be made through on-line and transparent system of National Stock Exchange and Bombay Stock Exchange depending upon the agreement of the issuer with the stock exchange(s).

A public issue shall be kept open for three working days but not more than ten working days. An issue through book building system remains open for three to seven working days. In case of revision of price band, the issue period disclosed in the red herring prospectus can be extended for a minimum period of three working days. However, the total bidding period shall not exceed ten working days. In other words, in case of a book built issue, bid is open for a minimum period of three working days and maximum period of seven working days, which may be extended to a maximum of ten working days, in case the price band is revised.
Difference between fixed price method and Book Building methods of the pricing of public issue.

(a) In Fixed price method, Price at which the securities are offered and would be allotted is made known in advance to the investors while in book building method, a 20% price band is offered by the issuer within which investors are allowed to bid and the final price is determined by the issuer only after closure of the bidding.

(b) In Fixed Price method, Demand for the securities offered is known only after the closure of the issue while in book building method Demand for the securities offered, and at various prices, is available on a real time basis on the BSE website during the bidding period.

(c) In fixed price method, 100% advance payment is required to be made by the investors at the time of application, while in book building method, 10% advance payment is required to be made by the QIBs along with the application, while other categories of investors have to pay 100% advance along with the application.

Price discovery under book building process

Suppose a company comes with the public offer of 3,000 shares. The company chooses the book building process for price discovery and decides the price band of Rs. 20 – 24. The company received the bidding as depicted in the table given below:

<table>
<thead>
<tr>
<th>Bid Quantity</th>
<th>Bid Price</th>
<th>Cumulative Quantity</th>
<th>Subscription</th>
</tr>
</thead>
<tbody>
<tr>
<td>500</td>
<td>24</td>
<td>500</td>
<td>16.67%</td>
</tr>
<tr>
<td>1,000</td>
<td>23</td>
<td>1,500</td>
<td>50.00%</td>
</tr>
<tr>
<td>1,500</td>
<td>22</td>
<td>3,000</td>
<td>100.00%</td>
</tr>
<tr>
<td>2,000</td>
<td>21</td>
<td>5,000</td>
<td>166.67%</td>
</tr>
<tr>
<td>2,500</td>
<td>20</td>
<td>7,500</td>
<td>250.00%</td>
</tr>
</tbody>
</table>

Now, on the basis of the above table, the company would obviously want to sell all the shares at the highest price of Rs. 24, but at this price, it would be able to sell only 500 shares and at Rs. 23, it would be able to sell only 1500 shares only. In order to sell all 3000 shares it has issued to the public, the company would have to further lower the price by Rs. 1. It means that the company has received 3,000 bids from people interested in buying the stock at Rs. 22. In this case, Rs. 22 becomes the cut–off price. Now the company will price the IPO at 22 or lower, but not at a higher price since it didn’t receive enough bids to be able to get offering fully subscribed. This is known as the price discovery mechanism of the book building process, and the way most IPOs are priced these days.
The Flowchart given as follows explains the book building process:

1. **Company plans an IPO via the book-build route**
2. **Appoints a merchant banker as book-runner**
3. **Issues a draft prospectus (containing all mandatory company disclosures other than price)**
4. **Draft prospectus filed simultaneously with concerned authority (SEBI)**
5. **Book runner appoints syndicate members and registered intermediaries to garner subscription**
6. **Price discovery begins through the bidding process**
7. **At the close of bidding, book runner and company decide upon allocation and allotments**
Some interesting facts about the book building process

(i) The issuer may mention the floor price or price band in the red herring prospectus.

(a) If the issuer chooses not to disclose price band or floor price in the red herring prospectus, the price band or the floor price shall be disclosed at least two working days in the case of initial public offer and at least one working day in the case of further public offer before the opening of the bid.

(b) Where the issuer opts for price band instead of floor price, it shall ensure that spread between floor and cap of the price band should not be more than 20 percent. This price band denotes the range of bidding.

(ii) In case of a composite issue, price of a public issue may be different from the price offered in right issue. However, justification for such price difference shall be provided in the offer document.

(iii) The bidding terminal shall contain on-line graphical display of demand and bid prices updated at periodical intervals, not exceeding thirty minutes.

(iv) At the end of each day of the bidding period, the demand including allocation made to anchor investors shall be shown graphically in the bidding terminals of syndicate members and websites of recognized stock exchanges offering electronically linked transparent bidding facility, for information of public.

(v) The investors except ASBA investors may revise their bids.

(vi) The issuer in consultation with the book running lead manager determines the issue price on the bid received.

(vii) On the determination of the price, the number of securities to be offered shall be decided.

(viii) Once the final price is determined, those bidders whose bids have been successful (bid at or above the final price), shall be entitled for allotment of securities.

4.9 Applications Supported by Blocked Amount (ASBA)

It is an alternate payment system for book built issue launched by SEBI in August 2008. Initially, ASBA was mandatory for public issues going through the book building route. And, it was optional for other public issues. But now, Payment through ASBA i.e. Application Supported by Blocked Amount has been made mandatory by SEBI for applying to any public issue of equity shares from January 1st, 2016.

ASBA is basically an application by investors for subscribing to an issue containing an authorization to block the application money in a bank account.

An alternative payment mode for applying in primary issues, ASBA has helped investors do away with getting Demand Drafts or Cheques made for payment of application money. Therefore, one’s money stays in one’s bank account until allotment of the issue takes place. There is no hassle of
refunds - in case of less or no allotment of shares. The advantage is that one get to earn interest even on the blocked amount until it is debited for allotment.

Vadodara-based 20 Microns Ltd was the first company to come out with an initial public offer (IPO) through the new Securities and Exchange Board of India (SEBI) guidelines of Applications Supported by Blocked Amount (ASBA) in September, 2008.

**The process of ASBA has been explained with the help of an example:**

(i) An ASBA investor shall submit an application to the Self-certified Syndicate Bank (SCSB) with whom the bank account to be blocked is to be maintained.

(ii) The SCSB will then block the application money in the bank account specified in the ASBA. The application money will remain blocked in the bank account till the allotment of securities or till the withdrawal/failure of the issue or till withdrawal or rejection of the application.

(iii) The SCSB shall upload the details in the electronic bidding system of the BSE or NSE.

(iv) After the basis of allotment is finalized, the Registrar to an Issue shall send a request to the SCSB for unblocking the bank account and transferring the allotment money to the issuers escrow account. In case of withdrawal of issue, the bank account shall be unblocked on the information received from pre issue merchant bankers.

### 4.10 What is a Green Shoe Option?

It is an over-allotment mechanism. Green Shoe Option is an option to allocate shares in excess of the shares which have already been issued to the public. It is a price stability mechanism to provide post listing price stability to an initial public offering.

**The process of Green Shoe Option can be explained with the help of following example:**

1. If a company is issuing 100,000 shares, the company will enter into an agreement regarding over-allotment option (green shoe option) with one of the stabilizing agents (mostly underwriters) to the extent of 15,000 shares (maximum of 15% of the issue size).

2. According to the agreement, the promoters would lend 15,000 shares to the stabilizing agents for a limited period of 30 days from the date of listing.

3. Allotment would be made to the extent of 1,15,000 shares (100,000 shares issued by the company and 15,000 shares borrowed from the promoters).

4. On listing, if the market price falls below the issue price, the stabilizing agent may buy shares from the market to the extent of 15,000 shares. This may help to increase the market price of shares by reducing the selling pressure. The shares purchased by the stabilizing agent are then returned to the promoters. So, only 100,000 shares remain listed on the stock exchange after 30 days.

5. However, on listing, if the share prices rises, and the stabilizing agent doesn't buy shares from the market, then at the end of 30 days period, the over allotment option is exercised.
The company allots 15000 more shares which are then returned to the promoters. Thus, 1,15,000 shares remain listed on the exchange.

Thus, Green Shoe Option acts as a price stabilizing mechanism. Further, over-allotment options are known as Green Shoe options because, in 1919, Green Shoe Manufacturing Company (now part of Wolverine World Wide Inc.), was the first to issue this type of option. A Green Shoe option can provide additional price stability to a security issue because the underwriter has the ability to increase supply and smooth out price fluctuations. It is the only type of price stabilization measure permitted by the Securities and Exchange Commission (SEC) in USA.

Simply put, it is a price stabilization mechanism whereby a company over-allots shares to investors participating in the issue, with a view to have the merchant banker buy them back from the open market after listing, in order to arrest any fall in the share prices below the issue price. SEBI introduced the Green Shoe mechanism in Indian capital markets in 2003 vide a circular SEBI/CFD/DIL/DIP/Circular No. 11 dated 14th August, 2003. Since then, a number of companies have implemented the Green Shoe Option in their initial public offerings.

Illustration 1

ABC Ltd. issued 15 lakh shares of Rs 100 each. Green shoe option was exercised by the company prior to the issue. After listing, the share prices of ABC Ltd. plunged to Rs. 90. Stabilizing agents decided to buy shares from the market. How many shares can be purchased by the stabilizing agents to arrest the reduction in share prices?

Solution

Here, in the above illustration, Green Shoe Option was exercised. Therefore, the stabilizing agents can purchase upto a maximum of 225000 shares i.e. 1500000 x 15/100.

4.11 Anchor Investors

Who is an anchor investor?

Anchor investors are Qualified Institutional Buyers (QIB) who purchases shares one day before the IPO opens. They help in arriving at a fair price and instill confidence in the minds of the investors. As the name suggests, they are supposed to ‘anchor’ the issue by agreeing to subscribe to shares at a fixed price so that other investors may know that there is demand for the shares offered. SEBI introduced the concept of anchor investors in June, 2009 to enhance issuing company’s ability to sell the issue. The Adani Power IPO in July 2009 was the first issue in the country to attract investors under the anchor investor scheme.

Why anchor investors are important?

Today, many companies have a complex structure and are not necessarily profitable at the net level — Sadbhav Infrastructure Projects, Adlabs Entertainment and Café Coffee Day are examples. In such cases, the anchor investors can guide other investors.
Unlike analysts, brokerages or investment bankers who may put out reports on an IPO, anchor investors have their own skin in game. They have actually subscribed to the shares at the published price. As the anchor portion of an issue is usually taken up by serious institutions such as mutual funds, insurance companies and foreign funds, their valuation signals can be useful. If the issue has problems, say, of corporate governance, or asks for a stiff price, the issue will face a tepid response from anchor investors.

For example - Prabhat Dairy’s offer failed to draw anchor investors as the price was at a sizeable premium to listed peers and there were challenges in growing the business. In the case of Adlabs Entertainment IPO too, anchor investors had bid at the lower end of the price band. In the public issue which opened a day later, poor retail response forced the company to lower its price band to get subscribed. (Source: Business Line)

**Guidelines for Anchor Investors**

The following guidelines have to be complied with to bring in anchor investors in public issue:

1. An anchor investor shall make an application of a value of at least Rs. 10 crore in the public issue.
2. An issuer can now allot up to 60% of shares reserved for qualified institutional buyers (QIBs) to anchor investors. So, the QIB portion in an IPO is 50%, anchor investors can buy up to 30% of an IPO.
3. One-third of the anchor investor portion shall be reserved for domestic mutual fund.
4. The bidding for anchor investors shall open one day before the issue opens.
5. Anchor investors shall pay at least 25% margin money on application. Balance has to be paid within two days of the date of closure of the issue.
6. Allocation of shares to anchor investors shall be completed on the day of bidding itself.
7. If the price arrived at after the book building issue is higher than the price at which shares were allocated to anchor investors, then in that situation, the anchor investor shall bring in the additional amount. But, if the price arrived at after the book building process is lower than the price at which shares were allocated to anchor investors, the excess amount shall be refunded to the anchor investors.
8. Anchor investors, however, cannot sell their shares for a period of 30 days from the date of allotment as against IPO investors who are allowed to sell on listing day.
9. Lastly, the merchant bankers or any person related to the promoter/promoter group/merchant bankers in the concerned public issue cannot apply under the anchor investor category.
Case Study of InterGlobe Aviation Ltd (Indigo Airlines) regarding Anchor Investors

InterGlobe Aviation Ltd, owner of India’s most profitable airline IndiGo, received demand for around eight times the shares it offered to so-called anchor investors, including domestic and foreign institutions, a day before the start of its initial public offering (IPO).

The company raised Rs.832 crore via the anchor investor allocation, also known as the anchor book, selling shares at Rs.765 per share at the upper end of the Rs.700-765 price band.

The company intended to use the proceeds of the fresh issue of shares primarily to retire its aircraft lease obligations. It utilized Rs 1165.66 crore to retire some of the exiting aircraft lease obligations. The company will utilize Rs 34.25 crore for purchase of ground support equipment for its airline operations and the remaining amount for general corporate purposes.


The IPO of Inter Globe Aviation Ltd is one of the largest anchor books for an Indian IPO and over 40 investors have subscribed to it. The demand for the main IPO book was very strong before the issue date and given the names of the anchor investors, retail investors have also attracted to the issue.

Inter Globe is seeking to raise ₹ 3,000 crore from the IPO, including the anchor book. IndiGo had total debt of ₹ 3,912 crore as of 31 August, all of which was aircraft-related. The company intended to use the proceeds of the fresh issue of shares primarily to reduce its aircraft lease obligations. It utilized ₹ 1165.66 crore to pay some of the exiting aircraft lease obligations. The company will utilize ₹ 34.25 crore for purchase of ground support equipment for its airline operations and the remaining amount for general corporate purposes.

(Adapted from Business Standard and Livemint)

4.12 Private Placement of Shares

Private placement is the process of raising capital directly from institutional investors. A company that does not have access to or does not wish to make use of public capital markets can issue stocks, bonds, or other financial instruments directly to institutional investors. Institutional investors include mutual funds, pension funds, insurance companies, and large banks.

Private placement means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in section 42 of the Companies Act, 2013.

The proposed offer of securities or invitation to subscribe securities needs to be approved by the shareholders of the Company by way of a Special Resolution, for each of the Offers/Invitations.
Advantages of Private Placement

The primary advantage of the private placement is that it bypasses the stringent regulatory requirements of a public offering. Public offerings must be done in accordance with the Companies Act, 2013 and regulations made thereunder. Private placements are negotiated privately between the investors and the issuing company.

Another advantage of private placement is the reduction in the time of issuance and the cost of issuance. Issuing securities publicly can be time-consuming and may require certain expenses. A private placement foregoes the time and costs that come with a public offering.

Also, because private placements are negotiated privately between the investors and the issuing company, they can be tailored to meet the financing needs of the company and the investing needs of the investor. This gives both parties a degree of flexibility.

Why private placements of shares are frequently resorted to by the companies?

Private Placement of shares offers many advantages. Primary advantage of the private placement is that it bypasses the stringent regulatory requirements of a public offering. Public offerings must be done in accordance with SEBI regulations. Private placements are negotiated privately between the investors and the issuing company. For Private placements, the companies need to comply with the companies Act, 2013 provisions but they do not have to register with the SEBI.

Another advantage of private placement is the reduced time of issuance and the reduced costs of issuance. Issuing securities publicly can be time-consuming and may require certain expenses. A private placement forgoes the time and costs that come with a public offering.

Also, because private placements are negotiated privately between the investors and the issuing company, they can be tailored to meet the financing needs of the company and the investing needs of the investor. This gives both parties a degree of flexibility.

Case Study on Private Placement

Springer Limited is a US based company and is a famous manufacturer of electric appliances. The Board of Directors of Springer Company decided to expand the company market area and decided to enter new markets such as India and other south Asian countries and Latin American countries. The company decided to incorporate a company in India named Springer India Limited. Springer India Limited decided to raise money from Indian market. The company has two options i.e. to raise money through private placement of shares or to raise money from public issue.

Evaluate the two options available to company and give your report containing the comparative of advantages and disadvantages of both options so as to enable company to take appropriate decision.
Answer to the question raised above on the Case Study on Private Placement

Questions raised in the case study on private placement have been answered in the following points:-

(i) **Meaning of Public Issue:** The sale of equity shares or other financial instruments by an organization to the public in order to raise funds is called public issue. Any offer to more than 200 people in India is termed as public offer. In India, Public offer is governed by Securities and Exchange Board of India (SEBI).

(ii) **Meaning of Private Placement of Shares:** When a company issues financial securities such as shares and convertible securities to a particular group of investors (not more than 200 persons in a financial year), it is known as private placement. Any offer of securities or invitation to a selected group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in section-42 of the Companies Act, 2013.

(iii) **Advantages of Public Offerings:** One of the major advantages of a public offering is that it allows a company to raise a large amount of money. This is because anyone who can afford to invest can purchase the company's stock through a broker. Moreover, the shares in the company will be highly liquid. For the same reason, there will always be buyers and sellers in the market. There is prestige in an IPO, and it can bring wide exposure and a great deal of information about a company to the forefront.

(iv) **Disadvantages:** When it comes to a public offering, such as an IPO, a potential disadvantage is time. The public offer process is very time consuming and it takes a lot of time. Public offer calls for tough compliances of stock exchange regulations (prescribed by SEBI) on a continuous basis.

(v) **Advantages of Private Placements:** A private placement will probably be cheaper and faster. Public companies must fulfill strict reporting and registration requirements, while companies that sell equity through a private placement face fewer reporting requirements. With a private placement, it might be easier to decide to whom owners sell equity, and to keep certain information about the company a secret.

(vi) **Disadvantages of Private Placement:** One disadvantage of a private placement as against public offering is that it significantly narrows the range of investors, the company may reach. Since the number of investors is not large, it becomes difficult for the company to arrange large funds as each investor will probably be required to have comparatively more capital to invest in the company.

**4.13 Disinvestment**

It means sale of equity shares of PSU's which leads to dilution of govt.'s shares in such PSU's. The disinvestment programme was initiated by the Govt. of India in 1992-94.
The purpose of the disinvestment programme of the Govt. of India was to garner funds which can be utilized for development purpose. Another purpose was to make the loss making PSUs came out of the doldrums and contribute to the Indian economy.

The primary objectives of the disinvestment programme of the Govt. of India are enumerated as below:

(i) To raise funds to finance fiscal deficit.
(ii) At the same time, to retain control over management.
(iii) And, improve the management of the PSU.
(iv) To broad base equity.
(v) To increase the availability of resources for PSUs.

4.14 Right Issue

The rights issue involves selling of securities to the existing shareholders in addition to their current holding. As per section 62 of the Companies Act, 2013, where, at any time, a company having a share capital, proposes to increase its Subscribed Capital by the issue of further shares, such shares shall be offered to persons who, on the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:-

(i) The offer shall be made by a notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;
(ii) Unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (above) shall contain a statement of this right;
(iii) After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose them off in such manner which is not dis-advantageous to the shareholders and the company.
(iv) The notice referred to above shall be dispatched through registered post or speed post or through electronic mode to the entire existing shareholders at least three days before the opening of the issue.

Procedure for allotment of right issue of shares

1. Call a Board meeting by issue notice of meeting and approve right issue including “letter of offer”, which shall include right of renunciation also.
2. Send offer letter to all existing members as on the date of offer through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.

3. Receive acceptance/renunciations/rejection of rights from members to whom offer has been sent & also from persons in whose favour right has been renounced.

4. Call a Board meeting by issue of notice. Approve allotment by passing a Board Resolution.

5. Attach list of allottees in form PAS-3, mentioning Name, Address, occupation, if any, and number of securities allotted to each of the allottees and the list shall be certified by the signatory of the form PAS - 3.

6. File E-form MGT 14 for issue of Share (Allotment of shares & Issue of Share Certificate) & PAS 3 (Return of Allotment) to ROC for allotment.

7. Make Allotment within 60 days of receiving of Application Money, otherwise it will be treated as deposits as per deposit rules.

4.15 Exit Offers (Delisting Offers and Strategic Issues)

With reference to capital market, the term ‘exit offers’ refers to delisting. So here we would be explaining the term delisting and provision/issues relating to delisting.

Delisting is actually the reverse of listing. So, what is the meaning of the term listing? Listing is basically a platform provided to the newly issued securities of the company in which sale and purchase of the securities of a company takes place. On the other hand, delisting means to permanently remove the securities of a listed company from a stock exchange.

Delisting of companies signifies a listed company moving out of the listing status on the stock exchanges. Broadly, delisting falls under two categories. One is voluntary delisting by the promoters of the company on a voluntary basis. There is no regulatory compulsion under any statutory provisions to initiate delisting. The second category is mandatory delisting, which gets triggered due to some regulatory compulsion under statutory provisions.

Delisting in India capital market is governed by the SEBI (Delisting of Equity Shares) Regulations, 2009. These Regulations provide three different sets of provisions for delisting of equity shares under different circumstances.

1. ‘Voluntary delisting’ means delisting of equity shares of a company voluntarily on application of the company under these regulations. The main delisting provision pertains to the voluntary delisting sought by the promoters of a company from the only recognized stock exchange giving exit opportunity to all public shareholders.

2. ‘Compulsory delisting’ means delisting of equity shares of a company by a recognized Stock exchange on any ground prescribed in the rules made under section 21A of the Securities Contracts (Regulation) Act, 1956.
3. Special provision for delisting of small companies not frequently traded or with small number of shareholders.

These regulations are applicable to delisting of equity shares of a company from all or any of the recognized stock exchanges where such shares are listed. However these does not apply to any delisting made pursuant to a scheme sanctioned by the Board for Industrial and Financial Reconstruction under the SICA or by the NCLT under the Companies Act, 2013, if such scheme specify procedure to complete the delisting; or provides an exit option to the existing public shareholders at a specified rate.

According to the SEBI Delisting Regulations, a company cannot apply for delisting of its equity shares pursuant to Buy back of its equity shares, or preferential allotment made by the company. A company cannot go for delisting unless a period of three years has elapsed since the listing of that class of equity shares on any recognized stock exchange; or if any instruments issued by the company, which are convertible into the same class of equity shares that are sought to be delisted, are outstanding. No delisting of Convertible securities may be done.

Also, the above regulations further emphasize that if after the proposed delisting from a recognized stock exchange, the equity shares would remain listed on any recognized stock exchange which has nationwide trading terminals, no exit opportunity needs to be given to the public shareholders.