CHAPTER 3

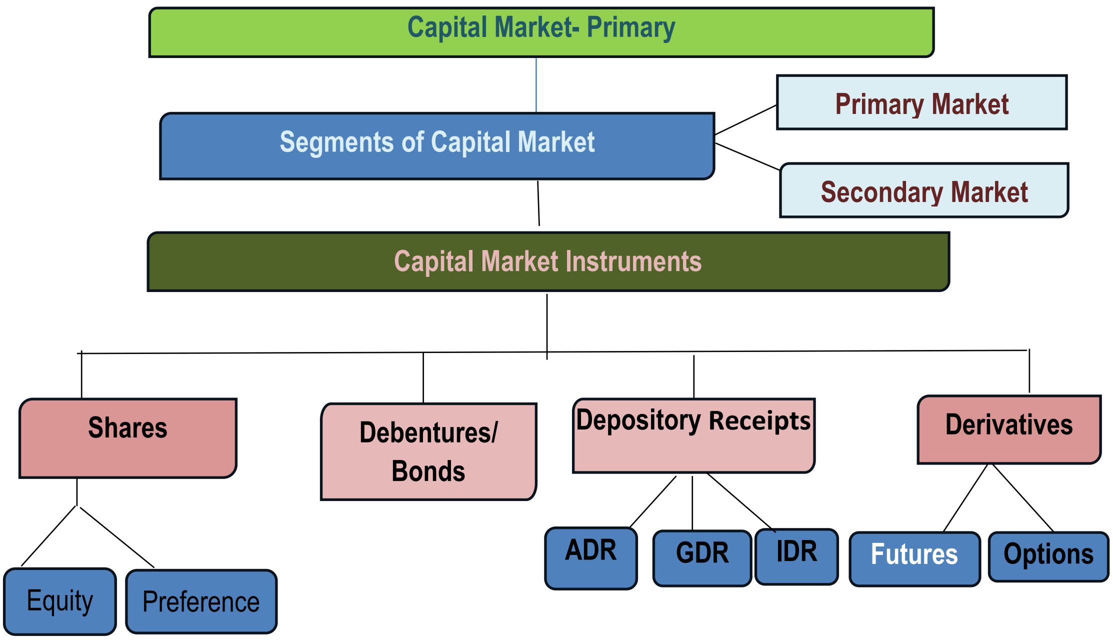
CAPITAL MARKET – PRIMARY

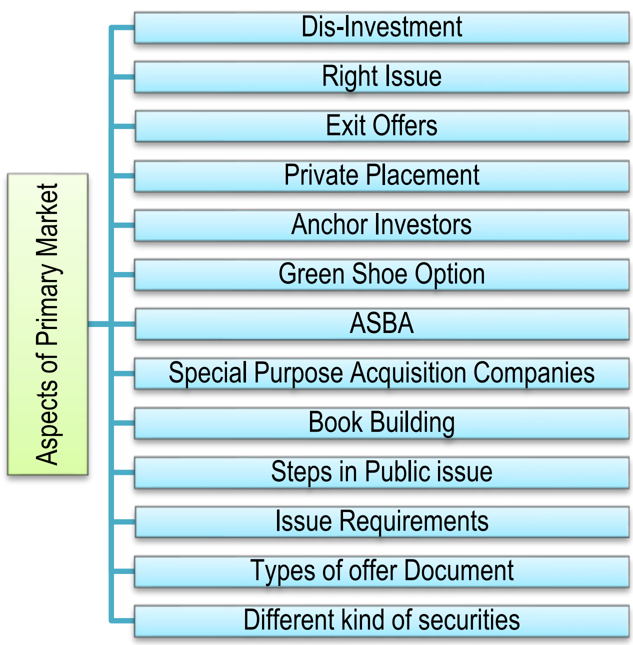
LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- 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) Special Purpose Acquisition Companies
  - (7) ASBA
  - (8) Green Shoe Option
  - (9) Anchor Investors
  - (10) Private Placement (includes QIP)
  - (11) Disinvestment
  - (12) Right Issue
  - (13) Exit Offers (Delisting Offers and Strategic Issues)

CHAPTER OVERVIEW





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 the 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 corporate 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 serve an important purpose as they help 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 the economic health of a country.

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 18^{th} 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 the capital market was limited because of the easy availability of loans from banks and financial institutions. The structure of the 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 three decades, since the early 1990's. The Financial Sector Reforms in general and the Capital Market Reforms 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 the National Stock Exchange happened in 1992. After that it was recognized as a Stock Exchange in April 1993. Since then, 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.

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. Stockbrokers 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. SEGMENTS OF CAPITAL MARKET

2.1 Primary Market

A primary market is a market where buying and selling of new securities take place for the first time. In other words, the market where the first public offering of equity shares or convertible securities by a company takes 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). The 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 the capital market 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 markets.

2.2 Secondary Market

A secondary market is a market in which the 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 the secondary market.

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 market are limited to first issuance, several securities and financial assets can be traded and retraded repeatedly. The main difference between the two is that, in the primary market, the involvement of the company is directly in the transaction, while in the secondary market, the company is not involved 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 in 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 take place between the investors.

3. The primary market deals 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. The 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 does not provide additional funds since the company is not involved in the transaction.

2.5 Similarities between Primary and Secondary Market

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 the secondary market can also be carried out only through the stock exchange platform. The Listing on stock exchanges provides liquidity as well as marketability for the securities and facilitates discovery of prices for them.

(b) **Control by Stock Exchanges:** Through the SEBI (Investor Protection and Disclosure Requirement) Regulations, 2018 [ICDR] and SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015 [LODR], the stock exchanges exercise considerable control over the new issues as well as on the new securities which are already listed on the stock exchange. Stock Exchanges ensure that there is continuous compliance by the issuer company of the regulations provided in the LODR.

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. The mutual interdependence between primary market and secondary market from the economic point of view has following two dimensions:

❖ **One,** the quantum of trading and the participation of the investors on the stock exchange i.e., the secondary market has a significant bearing on the level of activity in the primary market and, therefore, its responses to capital issues.

❖ **Second,** because of the mutual interdependence, 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 market. 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 stockbrokers, 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 have 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 larger.

There are two main types of shares, equity shares and preference shares. An 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 the assets and earnings of the company than the equity shares. For example, an owner of Preference shares receives dividends before equity shareholders and has priority in the repayment of capital in the event of a company going bankrupt or 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 affairs 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 of companies are sometimes paid in the form of dividends. A higher proportion of shares in a company signifies a higher stake in the profits also. In case of bankruptcy and liquidation, shareholders receive what is left after all the creditors have been paid.

2) Another extremely important feature of a 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 them to pay back the money after a certain 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 either through 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 may not disclose the market value of the firm. 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) 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 a bond is a security which can be bought and sold in the open market. In fact, as already mentioned, a bond is a long-term security whose maturity period is generally more than one year. Bonds with maturities of 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. 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 (also called callable bonds) and repay them at a predetermined price before maturity. Bond issuers use this feature to protect themselves from paying more interest than they must 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, at the time of maturity of bonds, 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.

Bond Yields and its Calculation: There are several methods for calculating bond yield. But the most common method is the Yield to Maturity (YTM). Yield to maturity (YTM) is the total return anticipated on a bond if the bond is held until it matures. Yield to maturity is considered a long-term bond yield but is expressed as an annual rate. In other words, it is the internal rate of return (IRR) of an investment in a bond if the investor holds the bond until maturity, with all payments made as scheduled and reinvested at the same rate. *(Source: Investopedia)*

The formula for computation of YTM is as follows:

$$\text{YTM} = \frac{\text{Annual Interest} + \dfrac{\text{Redemption Value - Purchase Price}}{\text{Period of Holding}}}{(\text{Redemption Value} + \text{Purchase Value}) / 2}$$

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 several 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 an 8% ₹ 1000 bond has 15 years to maturity. Purchase Price is ₹ 800. The prevailing interest rate (on other investment vehicles) is 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 must be priced in such a way that the discount, when amortized over 15 years has a yield to maturity of 10%. That discount is a little under ₹ 200:

$$\text{YTM} = \frac{\text{Rs.}80 + (\text{Rs.}200/15\text{ years})}{(\text{Rs.}1000 + \text{Rs.}800)/2} = \frac{\text{Rs.}93.33}{\text{Rs.}900} = 10.4\%.$$

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." Further, there is an upside to this risk. If interest rates decline during the five years when the 8% bond is outstanding, the holder could sell it at a premium to make its YTM rate equal to the lower yields of recent issues. For instance, if 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 (ADR): 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:

- ADR 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.
- ADR facilitate share transfers. ADR are negotiable and can be easily transferred among the investors like any other negotiable instrument. The transfer of ADR automatically transfers the underlying share.
- The transfer of ADR 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 ADR in U.S. dollars.

A non-U.S. issuer must work with its US investment bankers, US depository bank, US and non-US legal counsel and independent accountant to prepare the registration documents and offering materials.

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, must be fulfilled.

Specified documents 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.

Example

India's ABC Ltd. is traded on both the BSE and NSE. To become listed on a US exchange, it offers its shares in large quantities to a bank there. ADR certificates, which are issued by the USA bank to interested investors via the exchange, are accepted in exchange for shares of ABC Ltd.

Through a process of American dollar-based bidding, investors determine the price of the ADR. Investors can only purchase and sell ADR shares once the major U.S. stock exchange lists the bank certificates for trading. The Securities Exchange Commission, which oversees the U.S. stock exchange, keeps an eye on any requirements that must be met by the foreign business, which is in this case, ABC Ltd.

(v) Global Depository Receipts (GDR): 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 must pay dividends to the depository in the domestic currency. The depository must then convert the domestic currency into dollars for onward payment to receipt holders. GDR bears 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 later. 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 realized.

(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 assets 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 75 stocks.

Futures

It 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 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 margin money (5-20 per cent of the contract) and take a larger exposure. However, it is meant for high net worth individuals.

In futures contracts, the buyer and the seller have an unlimited loss or profit potential. The buyer of an option can makes unlimited profit and face 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)

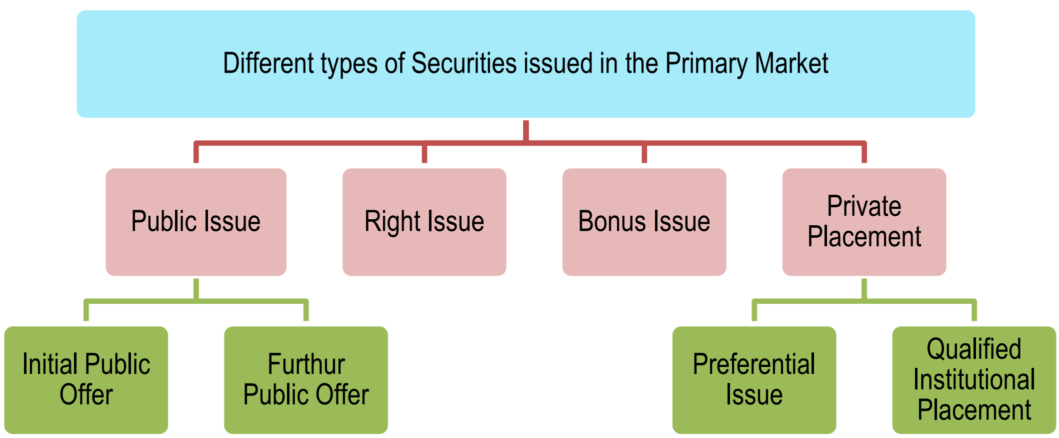
d) Bonus Issue

e) Private Placement

  (i) Preferential Issue

  (ii) Qualified Institutional Placement

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



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 issues 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 an 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 the 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 people not more than 50 but can extend upto 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 are of following:

(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 Institutional 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 Institutional 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 institutional placement if it satisfies the following conditions:

(a) A special resolution must be passed by the shareholders by approving the qualified institutional placement.

(b) The equity shares of the same class, which are proposed to be allotted through qualified institutional placement or pursuant to conversion or exchange of eligible securities offered through qualified institutional placement, have been listed on a recognized stock exchange 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 institutional placement if any of its promoters or directors is not a fugitive economic offender.

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

(e) The qualified institutional 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 institutional 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 institutional placement until the expiry of two weeks from the date of the prior qualified institutional 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 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 an 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.

(i) 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 ₹. 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 ₹ 15 crores as average operating profit during the preceding three years, with operating profit in each of these preceding three years.

(c) Net worth of at least ₹ 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.

If the company has issued Superior Rights (SR) equity shares to its promoters, it can go through an IPO subject to fulfillment of certain conditions which are provided in regulation 6(3) of SEBI (ICDR) Regulations, 2018.

Entry Norm II (Commonly known as "QIB Route")

To provide sufficient flexibility and 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.:

The Issue shall be made through the book-building route, with at least 75% of the 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.

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

(a) An issuer shall be eligible to make a further public offer, if it has not changed its name in the last one-year period immediately preceding the date of filing the relevant offer document. 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 about further public offer are given as below:

(i) It has made an application to one or more stock exchanges to seek an in-principal 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;

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

(c) 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)*

4.4 Minimum Promoter's contribution and lock-in

The promoters shall contribute to the public issue as follows:

a) 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.

b) in case of a composite issue (i.e., further public offer cum rights issue), 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.

The specified securities held by the promoters shall not be transferable (hereinafter referred to as "locked-in") for the periods as stipulated hereunder:

a) minimum promoters' contribution including contribution made by alternative investment funds, or foreign venture capital investors, as applicable, shall be locked in for a period of eighteen months from the date of allotment of the further public offer:

Provided that in case most of the issue proceeds excluding the portion of offer for sale is proposed to be utilized for capital expenditure, then the lock-in period shall be three years from the date of allotment in the initial public offer.

b) promoters' holding more than minimum promoters' contribution shall be locked-in for a period of six months:

Provided that in case most of the issue proceeds excluding the portion of offer for sale is proposed to be utilized for capital expenditure, then the lock-in period shall be one year from the date of allotment in the initial public offer:

(c) The SR equity shares shall be under lock-in until their conversion to equity shares having voting rights same as that of ordinary shares, provided they are complying with the other provisions of these regulations.

4.5 IPO Grading

The issuer may obtain grading for its initial public offer from one or more credit rating agencies registered with SEBI. Such a credit rating agency shall be registered with SEBI. Such a grading granted to the IPO of a company considers the relative assessment of fundamentals of an IPO. The IPO Grading so obtained must be disclosed 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. However, the prospectus/RHP must highlight the grades given to IPOs 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 considers 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, the following aspects are investigated by the rating agencies. However, the list is not exhaustive and may vary.

a. Business Prospects and Competitive Position (i. Industry Prospects ii. Company Prospects)

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 a case-to-case basis. Further, IPO Grading does not consider the price at which the shares are to be issued to the public. So, the investors must 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.

4.6 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 based on 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 based on 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 to the SEBI (ICDR) Regulations, 2018.

4.7 Intermediaries to the Capital Market

1. **Merchant Bankers/Lead Managers –** Merchant Bankers/Lead Managers manage the issue. They make the entire management regarding purchase and sale of securities. They also provide 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 must 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 in 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 act 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-

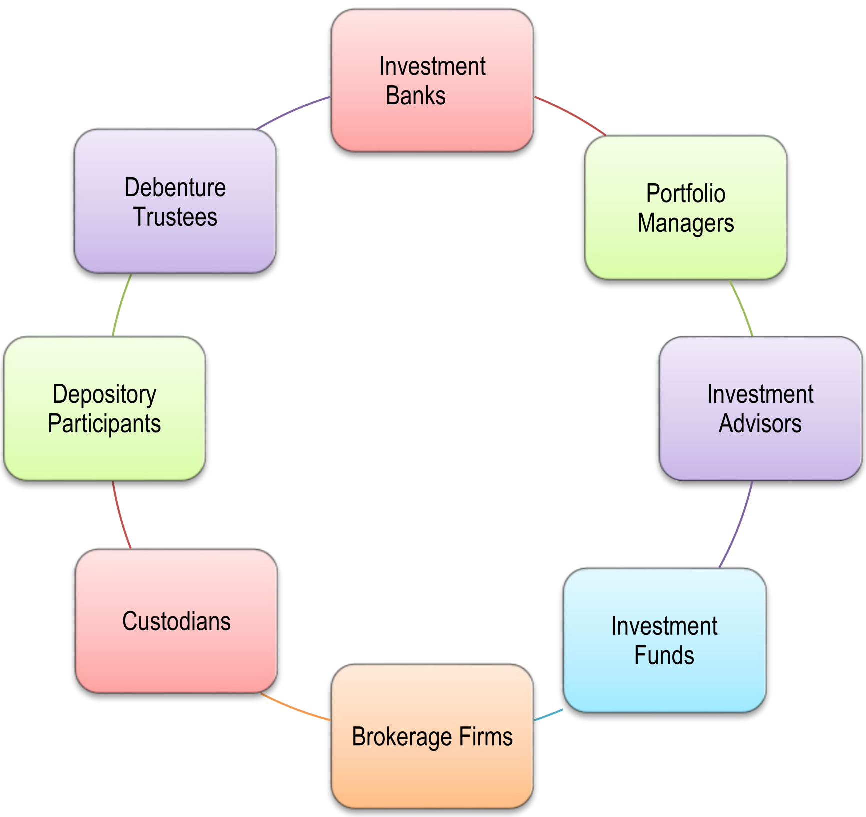
(a) determining the basis of allotment of securities in consultation with the stock exchange;

(b) finalizing 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.

Capital Market Intermediaries



4.8 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, then the consent of the shareholders must be obtained. For this purpose, a meeting of the shareholders will be called.

3. **Appointment of Merchant Banker and other intermediaries and entering MOU with them:** To initiate the process, the Company must pass a Board Resolution and proceed to appoint a Merchant Banker, with whom an MOU may be entered. 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 must 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 with the Lead Manager, Underwriters, Bankers, Registrars, and Brokers to the issue has to be filed with SEBI and the Registrar of Companies (ROC) 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 must 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 investors can collect the application forms alongwith 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, then the application money shall be repaid within a period of not later than four days from the closure of the issue, as per Regulation 45 (2) of SEBI (ICDR) Regulations. If any such money is not repaid within such period, the company shall 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, must 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 must 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 must 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.

4.9 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 the 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 the case of Book Building, the demand can be known every day as the book is built. But in case of public issues, 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, the offer price of securities is determined based on 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 an online 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 the 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 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 stock exchange's 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 must pay 100% advance along with the application.

Price discovery under book building process

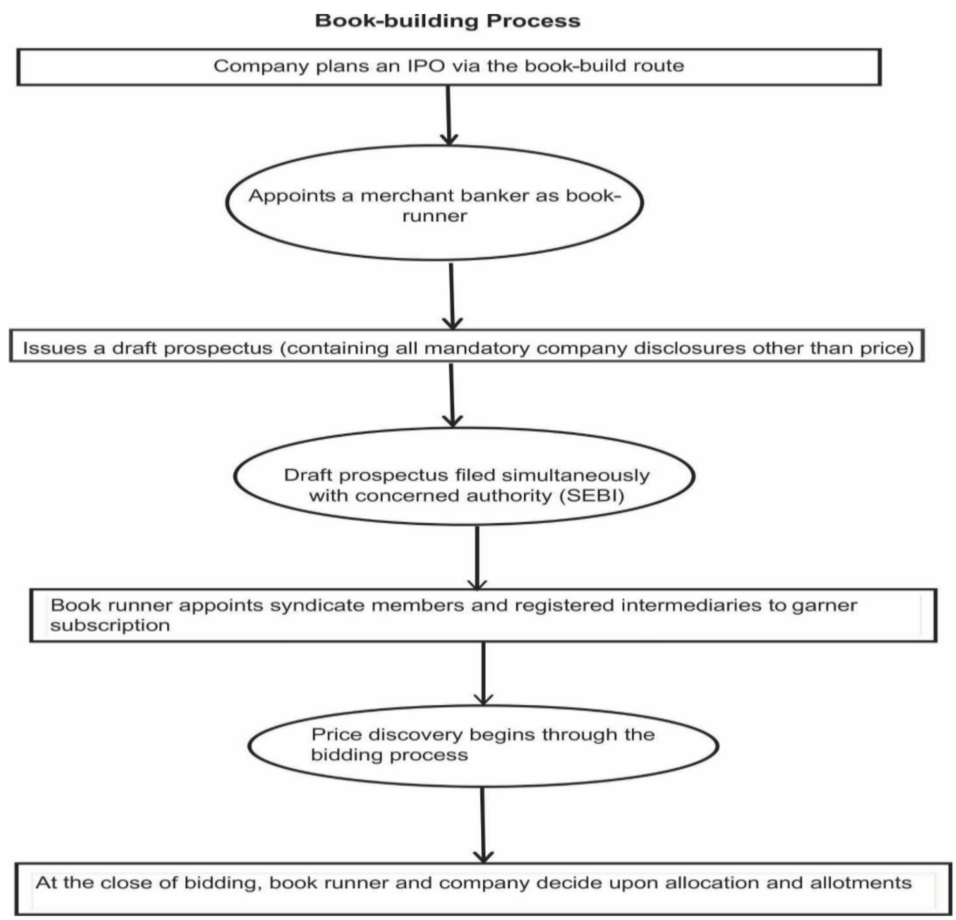
Suppose a company comes with the public offer of 3,000 shares. The company chooses the book building process for price discovery and decides the price band of ₹. 20 – 24. The company received the bidding as depicted in the table given below:

Bid Quantity	Bid Price	Cumulative Quantity	Subscription
500	24	500	16.67%

1,000	23	1,500	50.00%
1,500	22	3,000	100.00%
2,000	21	5,000	166.67%
2,500	20	7,500	250.00%

Now, based on the above table, the company would obviously want to sell all the shares at the highest price of ₹. 24, but at this price, it would be able to sell only 500 shares and at ₹. 23, it would be able to sell only 1500 shares only. To sell all 3000 shares, it has issued to the public, the company would have to further lower the price by ₹. 1. It means that the company has received 3,000 bids from people interested in buying the stock at ₹. 22. In this case, ₹. 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.

<u>The Flowchart given as under explains the book building process</u>



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, the price of a public issue may be different from the price offered in right issue. However, justification for such a 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 issuer in consultation with the book running lead manager determines the issue price on the bid received.

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

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

4.10 Special Purpose Acquisition Companies (SPACs)

In their most basic form, SPACs are listed shell corporations established specifically to buy unlisted or private enterprises and then merge with them. SPACs was founded to raise money through an initial public offering, or IPO, to later purchase private companies. They do not currently operate a business or generate any revenue of their own. Like a typical IPO, this is accomplished by selling shares to the public. Additionally, investors might decide to buy a warrant, which grants them the right to later acquire additional shares at a predetermined price.

These are sometimes known as "blank cheque companies" since SPAC investors are unaware of the destination or purpose of their money. After funds are raised, they are held in trust until a target is identified and purchased. Investors receive their money back from a SPAC if it is unable to locate a suitable acquisition candidate in a period of two years.

Due to their lack of commercial activities and track record, SPACs are primarily supported by well-known CEOs or celebrities who can attract investors for an initial public offering (IPO). To reward themselves, the sponsors purchase up to a fifth of SPAC's capital or shares at a significant discount on the issue price. For instance, sponsors receive the same share at Re 1 or even less if a typical investor pays ₹100 per share. In business jargon, the fee is referred to as "Promote" and lowers regular shareholders' long-term returns by diluting their interest.

How do SPACs generate revenue or give investors a return?

Following their IPO, SPACs uses the money it raised to buy and combine with a private company. This occurs after the company is listed on the stock exchanges. Following the merger, the SPAC modifies its name and brand to better align with the acquired entity's commercial activities. The acquired company's operations and financial status are now reflected in the SPAC's share price.

Sponsors of SPACs assert that by leveraging their expertise and experience, they may purchase a highly promising private business for less money than it would have cost to list through a conventional IPO. They claim that this significantly increases SPAC investors' post-listing (or merger) returns.

For instance, the space company Virgin Galactic, backed by venture capitalist Chamath Palihapitiya, and Richard Branson merged to list on the stock exchanges in 2019. Since becoming public, the price of Virgin Galactic shares has tripled, while the S&P 500 index has increased by 50% over the same time.

There has been a surge in the number of new SPACs, particularly in the US, as a result of Virgin Galactic's success. Since the year 2020 began, SPACs has raised almost $100 billion, according to Bloomberg.

What makes SPACs contentious?

SPAC is perceived by detractors as a means by which the wealthy and well-known evade regulatory oversight and profit unfairly at the expense of common shareholders who are sold shares at par or full value.

Typically, an initial public offering (IPO) is how a private company becomes listed. It takes four to six months and involves a long list of disclosures about the company's finances, operations, prospects, and background of the promoter or promoters. As a result, the market regulator, financial analysts, and the media begin to closely examine the company.

SPACs allow private companies to list directly, evading the entire process. In addition to saving money on hiring merchant bankers to underwrite the IPO, this also saves businesses time. The main attraction of SPACs is its quick route to listing, particularly during the post-pandemic period when IPOs has experienced a significant surge and tech company valuations are at an all-time high.

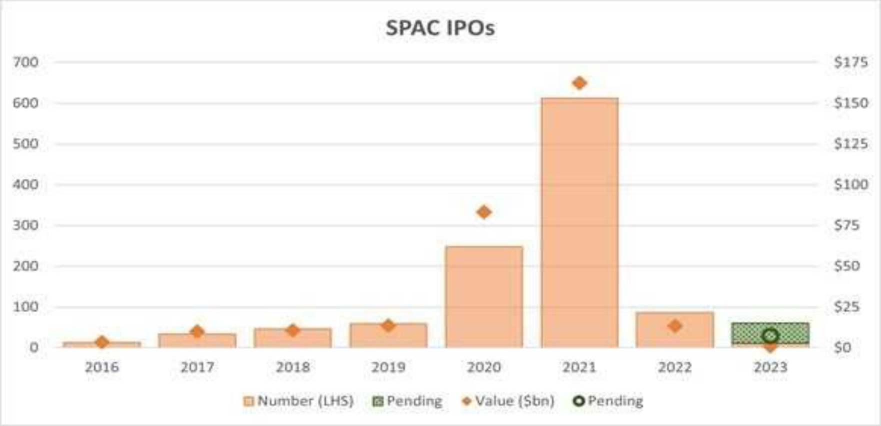
Some view SPAC as a way for well-known and wealthy bankers and CEOs to profit from their fame without having to risk any of their own money. Palihapitiya, for instance, purchased shares in his SPAC for 0.002 cents each, whereas common shareholders paid $10 for the same shares.

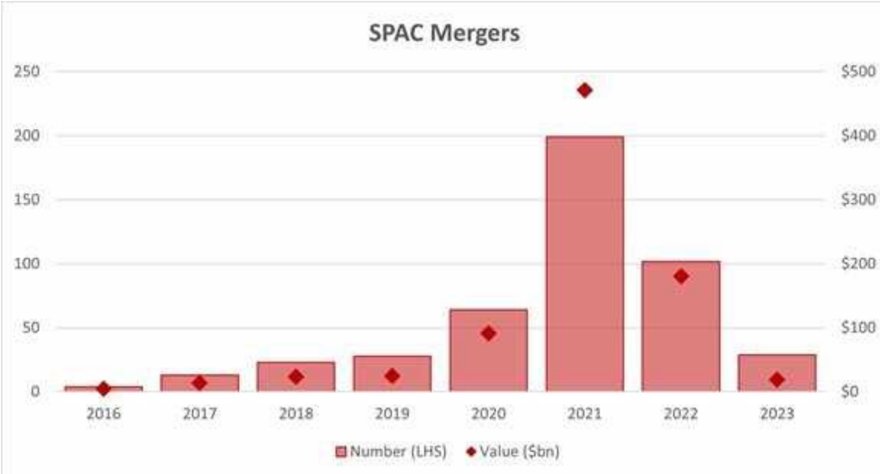
As a result, SPAC is now at the center of the discussion on income and wealth inequality, a topical political issue in the US and many other nations.

What is the performance of SPACs in exchanges?

Market expansion

SPACs were a little-known, specialized kind of capital market investment for a long time. This started to change in 2017, as more and more SPAC initial public offerings (IPOs) and mergers were made as sponsors saw them as a desirable substitute for traditional IPOs for taking (mainly tech-focused) companies public. Due to a few high-profile mergers and increased investor interest, the momentum persisted in the ensuing years, and SPACs were able to raise unprecedented amounts of money.





Source: SPAC Research

Performance

Investors saw this as a low-risk opportunity to invest in unlisted companies despite all the hype, particularly in the technology sector where there was theoretically huge growth potential. After a merger, most SPACs have underperformed. After dropping -45% in 2021, the De-SPAC Index—which evaluates the performance of businesses made public through SPAC mergers—fell nearly -75% in 2022.

It is possible to attribute some of the losses to general market weakness. SPACs are frequently used to bring public speculative, fast-growing, and cash-flow negative companies. These growth companies have been disproportionately affected as central bank tightening, rising inflation, and recession concerns have buffeted the broader financial markets.

As a result, a lot of investors have pulled out of the market. SPACs offer their shareholders two choices: either they sell their units in the secondary market while the SPAC is still searching for a merger target, or they reject the proposed merger and redeem their shares to get their investment back plus interest. Companies have suffered disproportionately.

The final word

Is it the end of the SPACs? Nope. SPACs have been around for decades and do play a crucial role in the capital markets, despite the recent overhype. Put simply, they can be viewed as an alternative to traditional initial public offerings (IPOs) for financing venture capital, offering certain advantages. However, a trifecta of unpredictability in the regulatory environment, sponsors suffering financial blows from liquidations, and generally subpar performance making investors far more cautious have created obstacles and will alter the sector's future. With SPACs regaining their former position as a riskier but potentially more profitable option for deals, many underwriters will turn back to traditional IPOs. Space will keep changing, and regulations will become clearer.

Will SPACs be arriving in India?

Currently, India prohibits shell companies, or SPACs, from using initial public offerings (IPOs) to raise money. This could alter, though, since a lot of Indian startups intend to use SPACs to become US listed companies. As a result, a lot of people have petitioned SEBI to permit SPACs or comparable investment vehicles to raise money via an IPO. To facilitate the potential listing of Indian companies in the nation through this channel, the government is currently considering establishing a regulatory framework for Special Purpose Acquisition Companies in the statutes.

4.11 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 gets 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.

<u>The process of ASBA has been explained with the help of an example:</u>

(i) An ASBA investor shall apply 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.

4.12 What is a Green Shoe Option?

It is an overallotment mechanism. Green Shoe Option is an option to allocate shares more than 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 100000 shares, the company will enter into an agreement regarding an overallotment option (green shoe option) with one of the stabilizing agents (mostly underwriters) to the extent of 15000 shares (maximum of 15% of the issue size).
2. According to the agreement, the promoters would lend 15000 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 (100000 shares issued by the company and 15000 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 15000 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 100000 shares remain listed on the stock exchange after 30 days.
5. However, on listing, if the share prices rise, and the stabilizing agent doesn't buy shares from the market, then at the end of 30 days period, the overallotment 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 Worldwide 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 can 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 the 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, 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, several companies have implemented the Green Shoe Option in their initial public offerings.

Illustration 1

ABC Ltd. issued 15 lakh shares of ₹ 100 each. The green shoe option was exercised by the company prior to the issue. After listing, the share prices of ABC Ltd. plunged to ₹. 90. Stabilizing agents decided to buy shares in 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.

4.13 Anchor Investors

Who is an anchor investor?

Anchor investors are Qualified Institutional Buyers (QIB) who purchase 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 the 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?

Many companies now have a complex structure and are not necessarily profitable at the net level — Sadhbhav 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 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 must 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 ₹10 crores 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 the entire application money as margin money on application on which the payment has to be made 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 not be refunded to the anchor investors and the anchor investor shall be allotted the securities at the same price at which the allocation was made to it.
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. Further, even after 30 days, they can sell only 50% of their holdings and the remaining half can be sold only after 90 days.
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 IndiGo airlines, 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 ₹ 832 crore via the anchor investor allocation, also known as the anchor book, selling shares at ₹ 765 per share at the upper end of the ₹.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 ₹ 1165.66 crore to retire some of the exiting aircraft lease obligations. The company also tent to utilize ₹ 34.25 crore for the purchase of ground support equipment for its airline operations and the remaining amount for general corporate purposes.

The anchor investors include among others Harvard University Endowment Fund, Goldman Sachs Group Inc., Ruane Cunniff & Goldfarb Inc., Fidelity Investments, BlackRock Inc., Dutch pension fund APG and GIC Pte. Ltd, and Singapore's sovereign wealth fund. Domestic investors include HDFC Mutual Fund and Sundaram Mutual Fund.

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 been attracted to the issue.

InterGlobe is seeking to raise ₹3,000 crore from the IPO, including the anchor book. IndiGo had a total debt of ₹3,912 crore, 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 the purchase of ground support equipment for its airline operations and the remaining amount for general corporate purposes.

(Adapted from Business Standard and Livemint)

4.14 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 which satisfies the conditions specified in section 42 of the Companies Act, 2013.

The proposed offer of securities or invitation to subscribe to 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. 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 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.

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 the company and give your report containing a comparative of advantages and disadvantages of both options to enable the company to take appropriate decisions.

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 to raise funds is called a 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 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.

(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 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.

4.15 Disinvestment

It means sale of equity shares of Public Sector Undertakings (PSU's) which leads to dilution of government'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 the fiscal deficit.

(ii) At the same time, to retain control over management.

(iii) To improve the management of the PSU.

(iv) To broad base equity.

(v) To increase the availability of resources for PSUs.

4.16 Right Issue

The rights issue involves selling 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 by registered post or speed post or through electronic mode to all 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 an offer letter to all the existing members as on the date of offer through registered post or speed post or through electronic mode at least three days before the opening of the issue.

3. Receive acceptance/renunciations/rejection of rights from members to whom the 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 PAS 3 (Return of Allotment) to ROC for allotment.

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

Examples of Right Issues and their implications

Rights offers have come to the forefront of corporate financing after the overwhelming response to Reliance Industries Ltd's ₹ 53,124 crore issue, making it the most preferred fundraising route for Indian companies in the aftermath of the Covid-19 crisis. Over, half a dozen entities including Tata Power, Mahindra & Mahindra Finance, PVR, Aditya Birla Fashion and Shriram Transport have initiated to raise up to ₹ 10,000 crores through such offers. A record amount was raised through rights issuances in FY20.

Most companies are looking to reduce debt and strengthen balance sheets following the impact of Covid-19-related disruptions as the proceeds from the rights issues can be used to pay down existing debt, especially when they are unable to borrow more money and make the balance sheet look more acceptable to investors.

These companies are raising capital, not only to fortify the balance sheet for the current situation but also to take advantage of possible opportunities that can emerge in the crisis as SEBI has provided some relaxations to companies coming out with a right issue considering the difficulties they are facing in view of the pandemic. Such offers allow companies to raise capital by giving shareholders the right to subscribe to newly issued shares at a pre-determined price, normally at a discount, in proportion to their existing holdings.

After the aftermath of Covid – 19, many companies need capital either for working capital or to reduce debt. A right issue gives confidence to the lenders and customers that the promoters have faith in their business and are willing to bring their own money. Given that the stock prices have come down significantly in case of number of companies, right issue tend to reward the existing shareholders of the company and, at the same time, also help the companies to raise capital and improve their balance sheet position.

4.17 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 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 the 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 under which 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 Indian 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 which are as follows:

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 small companies not frequently traded or with a small number of shareholders.

These regulations are applicable to delisting 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 after the proposed delisting from a recognized stock exchange, if the equity shares remain listed on any other recognized stock exchange which has nationwide trading terminals, no exit opportunity needs to be given to the public shareholders.

4.17.1 Understanding delisting and the terms associated with it

The shareholders generally have queries about how reverse book building works and what happens to the shares after delisting? Here are some FAQs to clarify the concept of delisting:

What is a reverse book building?

Reverse book building is a process used for efficient price discovery. Once a company announces a delisting plan, public shareholders can tender their shares at or above the floor price. Shareholders can do this through an online bidding system on the stock exchanges, which stays open for five days.

What is the exit offer price or discovered price?

The exit offer price or discovered price is one at which the shares tendered take the holding of the promoter or acquirer to at least 90% of the paid-up capital. In the case of Vedanta, about 900 million shares were tendered at below ₹ 160 a piece, another 150 million shares were tendered at between ₹ 160 and ₹ 300 each, while about 320 million shares were offered at ₹ 320. These 320 million shares took the total cumulative number of shares to 1.34 billion, the quantity needed to meet the 90% threshold. So, the discovered price was ₹ 320.

What's next?

The promoter can accept or reject the discovered price within five working days. If the discovered price is accepted, then the shareholders must be paid within 10 working days. Where the bids are not accepted, the shares offered must be returned within 10 working days. The shares returned can be tendered to the promoter within a year of the delisting date at the discovered price.

What is a counteroffer?

If the discovered price is not acceptable, the promoter can make a counteroffer within two working days. The counteroffer should be above the company's book value and below the discovered price. Shareholders can withdraw the shares they tendered during the reverse book building within 10 working days of the counteroffer. Public shareholders who hadn't tendered their shares during the reverse book building can do so during the counteroffer. The company should publicly announce the counteroffer within four working days of the closure of reverse book building and the process must start within seven working days of the announcement. Counter-offer bidding will remain open for five days and the result should be announced in five working days. *(Source: Economic Times)*

4.17. 2 Explained: Failure of Vedanta Delisting

Vedanta announced on October 2020 that it had failed to garner the number of shares required to complete its delisting process from the stock market. Let us look at the process of delisting and how Vedanta fell short of garnering the threshold amount of 90% of shares of the company, even after public records initially showed that offers by shareholders had crossed that threshold.

How does the delisting process work?

In the delisting process, the promoters of a company launch a reverse book building process in which shareholders can tender their shares for purchase by promoters at a set price. The discovered price is the price tendered by shareholders at which the company can cross the threshold of 90% stake required to complete the delisting process. Therefore, the lowest price at which the company can complete the acquisition of 90% of shares is the discovery price.

What were the problems in the Vedanta delisting?

Vedanta announced that it was able to garner offers for only around 125 crore shares instead of the 134 crore shares required for the delisting process to go through. Earlier public records, however, show that Vedanta had received offers of over 137 crore shares. Experts note this discrepancy was a result of certain offers of share sales not being confirmed by foreign shareholders.

The Foreign shareholders hold shares through a custodian, but custodians are not allowed to participate in the secondary market and therefore bids are tendered by brokers. Therefore, any bids placed by the broker were required to be confirmed by the custodians and in this case, there were an unusually large number of unconfirmed bids leading to the company not meeting the 134 crores share threshold.

An expert also viewed that this process could be used to artificially reach the 90% threshold in cases where some bidders do not even own the shares, thereby giving a push to smaller shareholders to participate in a delisting process that they believe is likely to succeed. The expert noted that that the investigation ordered by SEBI was necessary to ascertain why there had been such many unconfirmed bids.

Were unconfirmed bids the only reason the delisting failed?

The key issue according to some experts was the discovered price at which Vedanta would be required to acquire a significant portion of shares. While several institutional investors had offered their stakes at around ₹ 170, LIC, which holds a 6.37% stake in Vedanta, and some smaller investors had offered shares at a price of ₹ 320. Therefore, Vedanta would have been required to pay well over the ₹ 160-₹170 per share they had budgeted for a significant proportion of shares and would likely have rejected the offer at the end of the process even if they had been able to meet the 90% threshold of shares offered through the process.

Another expert opined that key issue was that while the promoters wanted to delist at a price of around ₹ 160, they were only able to collect bid at this level for around 96 crore or 70% of the shares as some shareholders may have felt that the value of the stock was much higher as it was trading at around ₹ 320 in 2018. *(Source: Indian Express)*

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. ……….. of the anchor investor portion shall be reserved for domestic mutual fund.

    (a) one – half

    (b) one – third

    (c) one – fourth

    (d) one – fifth

2. An anchor investor shall make an application of a value of at least ……… in the public issue.

    (a) ₹ 10 crores

    (b) ₹ 15 crores

    (c) ₹ 20 crores

    (d) ₹ 25 crores

3. In case the price band is revised, the bid period for book building can be extended for a maximum period of …………..
   (a) seven working days
   (b) ten working days
   (c) twelve working days
   (d) fifteen working days
4. Reverse Book Building is used for …………
   (a) Initial Public Offer
   (b) Further Public Offer
   (c) Delisting
   (d) Anchor Investing
5. Green Shoe Option is a ……………
   (a) Price stabilizing mechanism
   (b) Over allotment option
   (c) both (a) and (b)
   (d) A mechanism to arrive at a fair value
6. SPACs are also called blank cheque companies because ……….
   (a) investors are required to issue blank cheques to companies in which they invest
   (b) investors are not aware of the acquisition targets
   (c) investors are fully aware of the acquisition targets
   (d) investors are partially aware of the acquisition targets
7. Which among the following statements is correct?
   (a) A shell company has a reasonable track record of profitability
   (b) India's mergers and acquisitions have an edge in comparison to that of developed nations

(c) The sponsor should be able to identify an acquisition target within two years and buy it up

(d) SPAC is only an American phenomenon

Theoretical Questions

1. What is an offer document? What are the key disclosure requirements of the offer document?
2. Briefly discuss the various steps involved in a public issue.
3. Explain the concept of ASBA with the help of an example.
4. Who is an anchor investor and why anchor investors are important?
5. What are Special Purpose Acquisition Companies? How do SPACs generate revenue or give investors a return?

Practical Problems

1. XYZ Ltd. wants to make a public issue of 10,00,000 equity shares of ₹ 100 each at par. The applications are received for 15,00,000 shares. The company wants to explore the Green Shoe Option (GSO). IPO price i.e., listing price is ₹ 120.

   (i) What is the maximum number of shares that can be issued through green shoe option?

   (ii) If the market price post listing comes down to ₹ 90, what the stabilizing agent can do in this situation?

   (iii) If the market price post listing goes up to ₹ 110, what is the option before the stabilizing agent?

ANSWERS/SOLUTIONS

Answer to Multiple Choice Questions

1.	**(b)**	**2.**	**(a)**	**3.**	**(b)**	**4.**	**(c)**	**5.**	**(c)**
6.	**(b)**	**7.**	**(c)**						

Answers to the Theoretical Questions

1. Please refer paragraph 4.2

2. Please refer paragraph 4.8

3. Please refer paragraph 4.11

4. Please refer paragraph 4.13

5. Please refer paragraph 4.10

Answers to the Practical Questions

1. **(i)** Maximum number of shares that can be issued through the green shoe option = 10,00,000 x 15% = 1,50,000

(ii) If the market price post listing comes down to ₹ 90, the stabilizing agent will purchase shares on the market to boost the demand for the shares. This will induce the investors to start purchasing the shares of XYZ Ltd. and consequently, the market price of shares will go up. So, basically, green shoe option is a price stabilizing mechanism. The shares borrowed from the promoters will then be returned to them.

(iii) If the market price post listing goes up to ₹ 110, the stabilizing agent will do the same thing as discussed in point (ii) above. However, if the post listing market price goes above ₹ 120, the best course of action for the stabilizing agent is to wait for 30 days after the date of listing and then take steps to allot further shares. The shares borrowed from the promoters will then be returned to them.