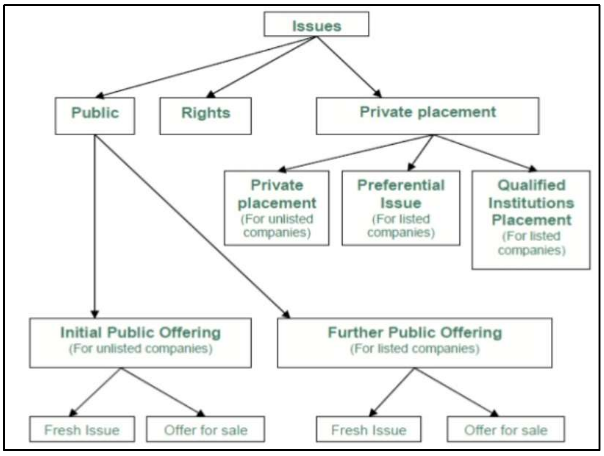
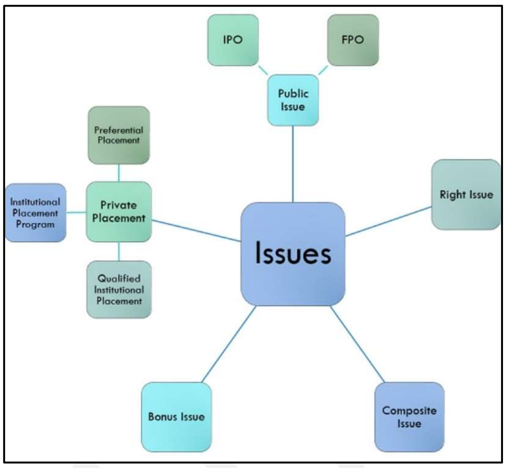
Primary Markets

- **Definition of primary market**
  - Primary market is a part of capital market that deals with the issuance and sale of equity-backed securities to investors directly by the issuer.
  - So here, the securities are created and the issuer might be a new or an existing company.
  - Here, the investor buys the securities that were never traded before.
  - It is also called the new issues market (NIM).
  - Once issued, the securities typically trade on a secondary market (where there are brokers) such as stock exchange, bond market or a derivatives exchange.
  - A company's equity capital is comprised of the funds generated by the sale of stock on the primary market.
- **Features of primary market**
  - It is related with new issues (shares that have never been traded before)
  - It has no particular place (there is no physical place, but the activity of bringing new issues is called primary market)
  - It has various methods of floating capital (IPOs, rights issues, preferential allotment etc.)
  - It comes before secondary market (these transactions are made first in the primary market, and then the shares are later traded in the secondary market)
- **Functions of primary market**
  - 1. Origination
    - It refers to investigation, analysis and processing of new project proposals.
    - This function is before an issue is actually floated in the market.
    - There are 2 aspects to this function:
      - ✓ A careful study of technical, economic and financial viability is necessary to ensure soundness of project.
      - ✓ Second aspect are the advisory services, which improve the quality of capital issues and ensure its success.
  - 2. Underwriting
    - It is an agreement where the underwriter promises to subscribe to a specific quantity of stock.
    - If the issue is fully subscribed then there is no liability for the underwriter.
    - If the part of the issue remains unsold, the underwriter will buy the unsold shares.
  - 3. Distribution
    - It is basically the sale of securities to ultimate investors.
- **Role of primary market**
  - Facilitate capital growth by enabling individuals to convert their savings into investment.
  - It provides a channel for the govt. to raise funds from the public to finance public sector projects.
  - Well established companies also become publicly traded companies to gain visibility and expansion.

- **Methods of entering primary market**





- **Public Issue**
  - It is issuance of shares or convertible securities in the primary market by company's promoters, so as to attract new investors.
  - The company issues a prospectus, and the investors who want to subscribe for the shares make an application to the company, which then allots shares to them.
  - **Initial Public Offering (IPO)**
    - ✓ It is the first time a company issues shares to the public.
    - ✓ This is when a private company decides to go "public".
    - ✓ In other words, a privately owned company is now publicly-traded company.
    - ✓ Before IPO, company has very few shareholders (founders, angel investors, venture capitalists etc.), but once IPO releases, company has now opened its shares to the public to buy.
    - ✓ An IPO allows company to tap into a large pool of investors and provide it with capital for future growth, repayment of debts, or working capital.
  - **Follow-On Public Offering (FPO)**
    - ✓ It is public issue of shares of an already listed company.
    - ✓ It is stock issue of additional shares made by the company that has already gone through the IPO stage.
  - **Difference between IPO and FPO**

Basis of Comparison	Initial Public Offering (IPO)	Follow-On Public Offering (FPO)
Meaning	Offer of securities by company to the public for subscription for the first time	Offer of securities to the public for subscription by a publicly traded enterprise
Issuer	Unlisted company	Listed company
Raising capital	Through the first time from public	Through a subsequent public contribution
Risk	High	Comparatively low
Objective	To raise capital through public investment	Subsequent public investment
Predictability	Less predictable	More predictable
Profit	Higher than FPO	Lower than IPO
Types	Equity shares and preferred shares	Dilutive offering and non-dilutive offering

- **Offer for Sale**
  - Promoters of a listed company sell their shares directly to public in a transparent manner.
  - Promoters can sell their shares and reduce their holdings from publicly listed companies.
  - Stakes are diluted.

- **Difference between Fresh Issue (IPOs and FPOs) and Offer for Sale**

Basis of Comparison	Fresh Issue	Offer for Sale
Objective	Raises capital by issuing new shares for the public.	Raises capital by selling existing shares of promoters.
Time	3-5 days.	Single trading session.
Price	Company defines a price band within which the bids should be placed.	Company decides floor price below which bids will be rejected.
Application	Application made by investors in advanced.	Bids can be placed on the day of sale.
Multiple bids	Investors cannot place multiple bids.	Shares are sold in bundles; so investors need to bid for bundles and not individual shares.
Prospectus	Requires company to issue a prospectus and obtain approval from SEBI.	Doesn't require any formal paperwork.
Charges	SEBI filing fees; hiring intermediaries	Brokerage charges
Payment	Full payment done only after allotment of shares.	Payment is done upfront when the bid is placed; money is returned to the buyer who is not allotted shares.

- **Rights Issue**
  - It is an offer of new securities by a listed company to its existing shareholders at a concessional rate, on a specific date.
  - The main aim of issuing right shares is to raise additional funds by offering shares to existing shareholders, in proportion of their holdings, rather than make a fresh issue.
  - It can also be viewed as a reward to shareholders with an investment opportunity.
  - Company issues right shares due to the following reasons:
    - ✓ The company wants to get their issues fully subscribed to.
    - ✓ Reward their shareholders.
    - ✓ It is possible that the market price does not reflect the stock's true price (i.e. it is overpriced) and that's why the offer price of right shares are kept low.
    - ✓ Want to hike their stake in the company, thus avoiding preferential allotment which has a lot of restrictions.
    - ✓ Funds can be raised without diluting the stakes of its existing shareholders as well as promoters.
- **Bonus Issue**
  - These shares are issued as a gift to existing shareholders in proportion of the shares held by them.
  - They are basically issued free of cost.
  - Bonus shares do not inject any fresh capital into the company.
  - It also doesn't make any changes to the net worth of the entity.
  - Thus, the total number of shares per shareholder increases but the proportion of shares held by them remains the same.

- **Difference between Rights Issues and Bonus Issues**

Basis of Comparison	Rights Issues	Bonus Issues
Meaning	Shares available to existing shareholders in proportion to their holdings, which can be bought at a discounted price for a definitive period of time.	Shares available to existing shareholders in proportion to their holdings, which are given to them free of cost.
Creation	These are additional shares created.	Created out of accumulated profits and reserves.
Purpose	To raise new funds for the company.	To bring the market price of the shares down (because they were actually overpriced, and it wasn't attractive to public).
Minimum Subscription	It is mandatory.	It is not necessary.
Renounce	Rights can be renounced either partially or completely.	No such option exists.
Paid Up Value	Either fully paid or partly paid.	Always fully paid up.

- **Private Placement**
  - If the company offers shares to selected group of investors which can be mutual funds, banks, insurance companies, pension funds etc., to raise capital, then it is called private placement.
  - It can seek subscription from a maximum of 50 members only.
  - Time and cost of issue from private placement is much less to the issuer for raising resources.
  - Privately placed issues can be tailor made to suit the requirements of both, the issuer and the investor.
  - Gives each party greater flexibility than public issues or rights issues.
  - **Private Placement (unlisted companies)**
    - ✓ The offering of securities by a company to a specific group of investors.
  - **Preferential Issue (listed companies)**
    - ✓ Preferential allotment is where a publicly listed enterprise allots shares to selected group of investors such as individuals, venture capitalists, etc. on a preferential basis.
  - **Difference between private placement and preferential allotment**

Basis of Comparison	Private placement	Preferential allotment
Minimum subscription fee	Has minimum subscription fee.	Has no minimum subscription fee.
Article authorisation	No authorisation.	Requires authorisation.
Bank account required?	Maintaining a separate bank account for keeping the application money.	Has no requirement of maintaining a separate bank account.
Valuation report required?	Needs a valuation report.	No valuation report required.
Offer letter	Private placement offer letter should be required.	Has no such documentation.
Relationship with IPOs	Analogous to IPO in terms of being an unlisted company, but caters to specific group.	Not related to IPOs.
Relationship with rights issues	Not related to rights issues.	Analogous to rights issues in terms of being a listed company, but caters to specific investors based on preference.

- **Qualified Institutions Placement (listed companies)**
    - ✓ Emerged as new fund raising investment for listed companies in India.
    - ✓ Way for listed companies to raise capital without having to submit legal paperwork to regulators.
    - ✓ Access to capital is much faster than FPO.
    - ✓ Funds can be raised from foreign without getting listed on foreign exchange, which is a cumbersome process.
    - ✓ Listed enterprise offers equity shares to qualified institutional buyer for sale to raise capital.
    - ✓ QIs includes mutual funds, venture capitalist funds, insurance funds, pension funds etc.

- **Difference between FPOs, OFSs, and QIPs**

OFS	FPO	QIP
Mechanism used by promoters to reduce their own stake and offer shares to other participants.	Mechanism used by promoters to raise capital for expansion of the company.	Mechanism used by listed company from various QIBs (…buyers) for various other uses.
Doesn't plan to raise capital. Transfers ownership from one shareholder to another.	Intends to raise capital and increase fund base for the company.	Intends to raise capital from QIBs and increase fund base for the company.
Bidder has to pay full amount upfront in order to complete transaction.	Payment is done after allocation.	Payments are done internally as transactions are between QIBs and issuer.
Issuer decides price band within which bids are accepted.	Issuer decides floor price below which bids are rejected.	Company decides floor price at which the placement will be done; this price is generally discounted.

- **Players of primary market**
    - **Merchant bankers (Managers to the issue) - IMP**
        - A merchant banker is a book running lead manager (BRLM), and must be registered with SEBI.
        - A merchant banker performs most of the pre-issue and post-issue activities.
        - Pre-issue activities such as:
            - ✓ Due diligence of company's operations
            - ✓ Drafting offer document
            - ✓ Finalising prospectus
            - ✓ Drawing up marketing strategies
            - ✓ Ensuring completion of legal formalities with stock exchanges and registrar of companies (RoC)
        - Post-issue activities such as:
            - ✓ Management of accounts
            - ✓ Intimation of allocation
            - ✓ Dematerialising of securities
            - ✓ Listing and trading of securities
            - ✓ Coordinating all this with other intermediaries
    - **Bankers to the issue - IMP**
        - They are appointed by merchant bankers in all mandatory collection centres.
        - They collect application forms and money in cash, cheque etc., dispatch refund amounts etc.
        - Depending on size of the issues, there may be many collection centres and their respective bankers.
        - Infrastructure, manpower, past experience, location of branches, efficiency, cost, effectiveness are parameters for selection of bankers to the issue.

- **Registrars to the issue - IMP**
  - It is their duty to collect application forms from bankers to the issue, process them for allotment and issue certificate of allotment.
  - Basically, they finalise the list of eligible allottees, ensure crediting of shares to their demat accounts and dispatch refund orders.
- **Promoters**
  - It is the promoter who is responsible for conception or discovery of the idea.
  - They work up details, formulate the financial plan and finally have to procure funds to put the proposition into active operation.
- **Underwriters**
  - It is an agreement where the underwriter promises to subscribe to a specific quantity of stock.
  - If the issue is fully subscribed then there is no liability for the underwriter.
  - If the part of the issue remains unsold, the underwriter will buy the unsold shares.
- **Brokers**
  - Brokers are the people who actually bring the prospective investors and the company together.
  - Success or failure of a public issue depends to a large extent on the strategy of the brokers.
- **Publicity and Advertising agents**
  - Public issue is an effort to motivate and persuade members of the public to invest in the shares of the company.
  - It is, therefore, essential that the general public is made aware of the company, its activities, and its plans for future, etc.
  - It is of vital importance that publicity is done before the public issue by giving:
    - ✓ Newspaper advertisements
    - ✓ TV Advertisements
    - ✓ Press Releases
    - ✓ Press Conference
    - ✓ Leaflets
    - ✓ Brochures,
    - ✓ Posters
- **Other agencies**
  - The company will also have to interact with other agencies such as:
    - ✓ Auditors
    - ✓ Legal advisors
    - ✓ Taxation committee
    - ✓ Technical experts
  - Their names and statements are mentioned in the prospectus.

- **Difference between primary and secondary market**

Topic	Primary market	Secondary market
Meaning	Market place for new shares	Place where formerly issued securities are traded
Another name	New Issues market (NIM)	After Issues market (AIM)
Type of purchasing	Direct connection between issuer and investor	Indirect, through stock exchange
Financing	It helps to raise funds for new and up-coming companies, as well as helps existing companies for expansion and diversification	It does not provide funding to enterprises
How many times securities can be sold?	Only once	Multiple times
Buying and selling	Buying and selling is between company and investors	Buying and selling is only between investors
Who will gain the amount by the sale of shares?	Company	Investors
Intermediary	Underwriters	Brokers
Price	Fixed price	Fluctuates, depends on demand and supply force
Organisational difference	Not rooted in any specific location or geographical spot	It has physical existence
Liquidity	Doesn't provide liquidity for the stock	Provides liquidity for the stock