Chapter–3: Primary Market

Role of the Primary Market

The primary market provides the channel for sale of new securities. Primary market provides opportunity to issuers of securities, Government as well as corporates, to raise resources to meet their requirements of investment and/or discharge some obligation.

They may issue the securities at face value, or at a discount/premium and these securities may take a variety of forms such as equity, debt etc. They may issue the securities in domestic market and/or international market.

Face Value of a share/debenture

The nominal or stated amount (in Rs.) assigned to a security by the issuer. For shares, it is the original cost of the stock shown on the certificate for bonds, it is the amount paid to the holder at maturity. Also known as par value or simply par. For an equity share, the face value is usually a very small amount (Rs. 5, Rs. 10) and does not have much bearing on the price of the share, which may quote higher in the market, at Rs. 100 or Rs. 1000 or any other price. For a debt security, face value is the amount repaid to the investor when the bond matures (usually, Government securities and corporate bonds have a face value of Rs. 100). The price at which the security trades depends on the fluctuations in the interest rates in the economy.

Premium and Discount in a Security Market

Securities are generally issued in denominations of 5, 10 or 100. This is known as the Face Value or Par Value of the security as discussed earlier. When a security is sold above its face value, it is said to be issued at a Premium and if it is sold at less than its face value, then it is said to be issued at a Discount.

3.1 Issue of Shares

Public Issue

Most companies are usually started privately by their promoter(s). However, the promoters' capital and the borrowings from banks and financial institutions may not be sufficient for setting up or running the business over a long term. So companies invite the public to contribute towards the equity and issue shares to individual investors. The way to invite share capital from the public is through a 'Public Issue'. Simply stated, a public issue is an offer to the public to subscribe to the share capital of a company. Once this is done, the company allots shares to the applicants as per the prescribed rules and regulations laid down by SEBI.

Different Kinds of Issues

Primarily, issues can be classified as a Public, Rights or Preferential issues (also known as private placements). While public and rights issues involve a detailed procedure, private placements or preferential issues are relatively simpler. The classification of issues is illustrated below:

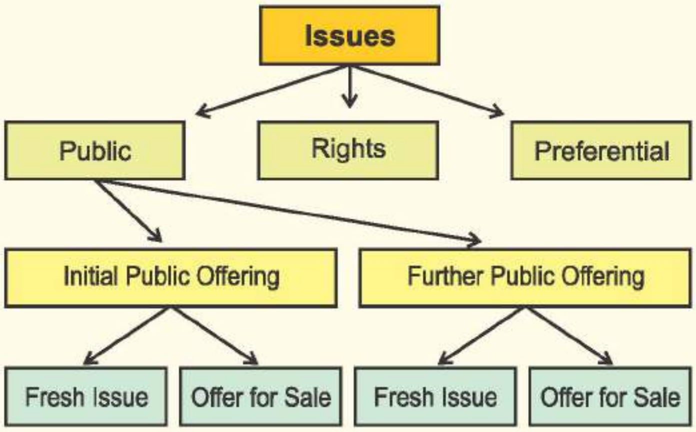
Initial Public Offering (IPO) is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.

A follow on public offering (Further Issue) is when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document.

Rights Issue is when a listed company which proposes to issue fresh securities to its existing shareholders as on a record date. The rights are normally offered in a particular ratio to the number of securities held prior to the issue. This route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders.

A Preferential issue is an issue of shares or of convertible securities by listed companies to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital. The issuer company has to comply with the Companies Act and the requirements contained in the Chapter pertaining to preferential allotment in SEBI guidelines which inter-alia include pricing, disclosures in notice etc.

Classification of Issues



Issue Price

The price at which a company's shares are offered initially in the primary market is called as the Issue price. When they begin to be traded, the market price may be above or below the issue price.

Market Capitalisation

The market value of a quoted company, which is calculated by multiplying its current share price (market price) by the number of shares in issue is called as market capitalization. E.g.

Company A has 120 million shares in issue. The current market price is Rs. 100. The market capitalisation of company A is Rs. 12000 million.

Difference Between Public Issue and Private placement

When an issue is not made to only a select set of people but is open to the general public and any other investor at large, it is a public issue. But if the issue is made to a select set of people, it is called private placement. As per Companies Act, 1956, an issue becomes public if it results in allotment to 50 persons or more. This means an issue can be privately placed where an allotment is made to less than 50 persons.

Initial Public Offer (IPO)

An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. It is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities. The sale of securities can be either through book building or through normal public issue.

Pricing of an Issue

Indian primary market ushered in an era of free pricing in 1992. Following this, the guidelines have provided that the issuer in consultation with Merchant Banker shall decide the price. There is no price formula stipulated by SEBI. SEBI does not play any role in price fixation. The company and merchant banker are however required to give full disclosures of the parameters which they had considered while deciding the issue price. There are two types of issues, one where company and Lead Merchant Banker fix a price (called fixed price) and other, where the company and the Lead Manager (LM) stipulate a floor price or a price band and leave it to market forces to determine the final price (price discovery through book building process).

Price Discovery through Book Building Process

Book Building is basically a process used in IPOs for efficient price discovery. It is a mechanism where, during the period for which the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price. The offer price is determined after the bid closing date.

Difference Between offer of Shares through Book Building and Offer of Shares through Normal Public Issue

Price at which securities will be allotted is not known in case of offer of shares through Book Building while in case of offer of shares through normal public issue, price is known in advance to investor. Under Book Building, investors bid for shares at the floor price or above and after the closure of the book building process the price is determined for allotment of shares.

In case of Book Building, the demand can be known everyday as the book is being built. But in case of the public issue the demand is known at the close of the issue.

Cut-Off Price

In a Book building issue, the issuer is required to indicate either the price band or a floor price in the prospectus. The actual discovered issue price can be any price in the price band or any price above the floor price. This issue price is called "Cut-Off Price". The issuer and lead manager decides this after considering the book and the investors appetite for the stock.

Floor price in case of book building

Floor price is the minimum price at which bids can be made.

Price Band in a book built IPO

The prospectus may contain either the floor price for the securities or a price band within which the investors can bid. The spread between the floor and the cap of the price band shall not be more than 20%. In other words, it means that the cap should not be more than 120% of the floor price. The price band can have a revision and such a revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing a press release and also indicating the change on the relevant website and the terminals of the trading members participating in the book building process. In case the price band is revised, the bidding period shall be extended for a further period of three days, subject to the total bidding period not exceeding ten days.

Deciding the price band

It may be understood that the regulatory mechanism does not play a role in setting the price for issues. It is up to the company to decide on the price or the price band, in consultation with Merchant Bankers.

Minimum number of days for which a bid should remain open during book building

The Book should remain open for a minimum of 3 days.

System to be used for book building

As per SEBI, only electronically linked transparent facility is allowed to be used in case of book building. The open out cry system is no longer valid. It is further clarified that an individual investor can use the book building facility to make an application.

Allotment of shares

As per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 the Basis of Allotment should be completed with 8 days from the issue close date. As soon as the basis of allotment is completed, within 2 working days the details of credit to demat account / allotment advice and despatch of refund order needs to be completed. So an investor should know in about 11 days time from the closure of issue, whether shares are allotted to him or not.

Timeframe to get the shares listed after issue

It takes 12 working days after the closure of the book built issue.

Role of a 'Registrar' to an issue

The Registrar finalizes the list of eligible allottees after deleting the invalid applications and ensures that the corporate action for crediting of shares to the demat accounts of the applicants is done and the dispatch of refund orders to those applicable are sent. The Lead Manager coordinates with the Registrar to ensure follow up so that that the flow of applications from collecting bank branches, processing of the applications and other matters till the basis of allotment is finalized, dispatch security certificates and refund orders completed and securities listed.

Role of NSE to facilitate IPO

NSE's electronic trading network spans across the country providing access to investors in remote areas. NSE decided to offer this infrastructure for conducting online IPOs through the Book Building process. NSE operates a fully automated screen based bidding system called NEAT IPO that enables trading members to enter bids directly from their offices through a sophisticated telecommunication network.

Book Building through the NSE system offers several advantages:

- The NSE system offers a nation wide bidding facility in securities
- It provide a fair, efficient & transparent method for collecting bids using the latest electronic trading systems
- Costs involved in the issue are far less than those in a normal IPO
- The system reduces the time taken for completion of the issue process

  The IPO market timings are from 10.00 a.m. to 5.00 p.m.

Prospectus

A large number of new companies float public issues. While a large number of these companies are genuine, quite a few may want to exploit the investors. Therefore, it is very important that an investor before applying for any issue identifies future potential of a company. A part of the guidelines issued by SEBI (Securities and Exchange Board of India) is the disclosure of information to the public. This disclosure includes information like the reason for raising the money, the way money is proposed to be spent, the return expected on the money etc. This information is in the form of 'Prospectus' which also includes information regarding the size of the issue, the current status of the company, its equity capital, its current and past performance, the promoters, the project, cost of the project, means of financing, product and capacity etc. It also contains lot of mandatory information regarding underwriting and statutory compliances. This helps investors to evaluate short term and long term prospects of the company.

Draft Offer document mean

Offer document' means Prospectus in case of a public issue or offer for sale and Letter of Offer in case of a rights issue which is filed with the Registrar of Companies (ROC) and Stock

Exchanges (SEs). An offer document covers all the relevant information to help an investor to make his/her investment decision.

Draft Offer document' means the offer document in draft stage. The draft offer documents are filed with SEBI, atleast 30 days prior to the registration of red herring prospectus or prospectus with ROC. SEBI may specify changes, if any, in the draft Offer Document and the issuer or the lead merchant banker shall carry out such changes in the draft offer document before filing the Offer Document with ROC. The Draft Offer Document is available on the SEBI website for public comments for a period of 21 days from the filing of the Draft Offer Document with SEBI.

Abridged Prospectus

Abridged Prospectus' is a shorter version of the Prospectus and contains all the salient features of a Prospectus. It accompanies the application form of public issues.

Prospectus/Offer Documents

Generally, the public issues of companies are handled by 'Merchant Bankers' who are responsible for getting the project appraised, finalizing the cost of the project, profitability estimates and for preparing of 'Prospectus'. The 'Prospectus' is submitted to SEBI for its approval.

Lock-in

'Lock-in' indicates a freeze on the sale of shares for a certain period of time. SEBI guidelines have stipulated lock-in requirements on shares of promoters mainly to ensure that the promoters or main persons, who are controlling the company, shall continue to hold some minimum percentage in the company after the public issue.

Listing of Securities

Listing means admission of securities of an issuer to trading privileges (dealings) on a stock exchange through a formal agreement. The prime objective of admission to dealings on the exchange is to provide liquidity and marketability to securities, as also to provide a mechanism for effective control and supervision of trading.

Listing Agreement

At the time of listing securities of a company on a stock exchange, the company is required to enter into a listing agreement with the exchange. The listing agreement specifies the terms and conditions of listing and the disclosures that shall be made by a company on a continuous bas1 is to the exchange.

Delisting of securities

The term 'Delisting of securities' means permanent removal of securities of a listed company from a stock exchange. As a consequence of delisting, the securities of that company would no longer be traded at that stock exchange.

Procedure for filing an issue by the company

Any company making a public issue or a listed company making a rights issue of value of more than Rs 50 lakh is required to file a draft offer document with SEBI for its observations. The company can proceed further on the issue only after getting observations from SEBI. The validity period of SEBI's observation letter is three months only i.e. the company has to open its issue within three months period.

Role of SEBI in an issue

SEBI does not recommend any issue nor does take any responsibility either for the financial soundness of any scheme or the project for which the issue is proposed to be made or for the correctness of the statements made or opinions expressed in the offer document. SEBI mainly scrutinizes the issue for seeing that adequate disclosures are made by the issuing company in the prospectus or offer document.

Investor duty

The investors should make an informed decision purely by themselves based on the contents disclosed in the offer documents. SEBI does not associate itself with any issue/issuer and should in no way be construed as a guarantee for the funds that the investor proposes to invest through the issue. However, the investors are generally advised to study all the material facts pertaining to the issue including the risk factors before considering any investment. They are strongly warned against relying on any 'tips' or news through unofficial means.

3.2 Foreign Capital Issuance

Foreign currency resources

Indian companies are permitted to raise foreign currency resources through two main sources: a) issue of foreign currency convertible bonds more commonly known as 'Euro' issues and b) issue of ordinary shares through depository receipts namely 'Global Depository Receipts (GDRs)/American Depository Receipts (ADRs)' to foreign investors i.e. to the institutional investors or individual investors.

American Depository Receipt

An American Depositary Receipt ("ADR") is a physical certificate evidencing ownership of American Depositary Shares ("ADSs"). The term is often used to refer to the ADSs themselves.

ADS

An American Depositary Share ("ADS") is a U.S. dollar denominated form of equity ownership in a non-U.S. company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares, subject to the terms specified on the ADR certificate.

One or several ADSs can be represented by a physical ADR certificate. The terms ADR and ADS are often used interchangeably.

ADSs provide U.S. investors with a convenient way to invest in overseas securities and to trade non-U.S. securities in the U.S. ADSs are issued by a depository bank, such as JP Morgan Chase Bank. They are traded in the same manner as shares in U.S. companies, on the New York Stock Exchange **(NYSE)** and the American Stock Exchange (AMEX) or quoted on **NASDAQ** and the over-the-counter **(OTC)** market.

Although ADSs are U.S. dollar denominated securities and pay dividends in U.S. dollars, they do not eliminate the currency risk associated with an investment in a non-U.S. company.

Global Depository Receipts

Global Depository Receipts (GDRs) may be defined as a global finance vehicle that allows an issuer to raise capital simultaneously in two or markets through a global offering. GDRs may be used in public or private markets inside or outside US. GDR, a negotiable certificate usually represents company's traded equity/debt. The underlying shares correspond to the GDRs in a fixed ratio say 1 GDR=10 shares.