[Academic Script]

Corporate Securities Part - 1

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Public Issue through Prospectus:

Public issue, which is also called public offer, is a process of raising capital by offering securities to general public at a certain stipulated price. The applicants have a stipulated time period in which they have to submit their application and payment.

Now, before opting for public issue, every company has to fulfil the legal formalities with **SEBI(Securities and Exchange Board of India)**.The SEBI has the full authority to let or to not let companies enter in primary market. The method of public issue requires the production of ***prospectus*.**

Now let's see what prospectus is,

[Prospectus refers to an information booklet or offer document, which has all relevant details including price and number of shares being offered, on the basis of which an investor invests in the securities of an issuer company. It is a formal legal document, which is required by and filed with the SEBI .It provides details about an investment offering available for sale to the public.]

It is also called an "offer document." Section 2 (70) of the Companies Act 2013 defines the prospectus as "any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

Prospectus consist information like background of the company, experience of the promoters and company's past performance. Prospectus enables the public to decide whether to invest or not in a company.

The prospectus has to be vetted and approved by the SEBI before public issue, and then merchant banker has to draft the prospectus and get clearance from the officials. In companies Act 2013, Chapter- III, Sections 25 to 40 deals with the issue of prospectus.

The Companies Act Section 26 suggests that the copy of prospectus has to be signed by the directors of the Company and then this document will be released on the fixed date. It also tells us about the registration of prospectus. The copy of the prospectus has to be registered with registrar before the publication. The copy of registration has to be accompanied by the approval of experts and also copy of contract of regarding compensation of a managing director, a copy of every material contract, consents of auditor, legal attorney and so on.

According to the Companies Act 2013, Chapter III, Section 26 (9) there will be a legal liability on the part of the promoters, directors and also the experts if any false information is found in prospectus. The shareholders can claim the damages if there are any misstatements in the prospectus. The company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Now let’s move to our next topic for the day i.e **Green Shoe Option**. Do you know what is Green Shoe Option?

Green shoe option is the option available to the company for allocating shares in excess of the shares included in the public issue and operating a post – listing price stabilising mechanism through a stabilising agent like underwriter.

[Green Shoe Option is a price stabilizing mechanism in which shares are issued in excess of the issue size, by a maximum of 15%. From an investor's perspective, an issue with green shoe option provides more probability of getting shares and also that post listing price may show relatively more stability as compared to market fluctuation.]

The GSO i.e Green Shoe facility was introduced in India by the SEBI in 2003. This facility was likely to be a major policy initiative which was taken to reassure investors against any unexpected developments in the economy which may have an adverse impact on price of newly listed securities. The facility of green shoe option helps the investment bankers to stabilize the post listing price of the security offered. This measure is expected to reduce anticipated stock market fluctuation and increase investor's confidence in the securities offered by the company.

Our next topic for the day is **Offer For Sale.**

Now, OFS i.e Offer for sale is a method by which new securities are offered to general public but not directly by the company but by an intermediary who buys a whole lot of securities from the company. It provides an exchange based bidding platform to promoters to sell their holdings in listed companies in a transparent manner.

[Except the promoters of the company, all market participants like individuals, mutual fund's operators, foreign institutional investors (FIIs), insurance companies and even corporates, HUFs, other qualified institutional bidders (QIBs etc) all of them can participate in this process. However the promoters of the company can only participate as the sellers in the process.]

Now, the sale of securities in this process takes place in two steps: **first** when the company issues securities to the intermediary at face value and **second** when intermediaries issue securities to general public at a higher price to earn profit.
By the method of Offer for Sale, company is saved from the formalities and complexities of issuing securities directly to public.

Now, our next topic for today is **Private Placement.**

Do you know what is Private Placement?

It is the opposite of public issue in which securities are made available for sale in the open market. Private Placement is method which is very useful when small companies are issuing their shares, as they can avoid the floating expenses and place their shares without any hassles. It is also an excellent mechanism for floating an issue when market is in depression and the issue is not likely to get proper response.
According to companies Act 2013, Chapter III, section 42 "private placement" means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified. it is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital]

Under this method first, the securities are sold by the company to an intermediary at a fixed price and in second step intermediaries sell these securities not to general public but to select clients at a higher price. Investors involved in private placements are usually banks, mutual fund operators or insurance companies

The private placement method is an economical method as company is saved from the expenses of underwriter fees, manager fees, agents' commission, listing of company's name in stock exchange etc. Small and new companies prefer private placement as they cannot afford to raise from public issue.

Now let's move to our next topic for the day, i.e **Rights issue**

When a company raises funds from its existing shareholders by selling them new/fresh securities, it is called rights issue.

[The rights issue is an offer of additional shares by a listed company to existing shareholders in proportion to their shareholding in the company. A rights issue is mandatory for companies under Companies Act 2013.]

In a rights offering, the subscription price at which each share may be purchased is, generally at a discount compared to the current market price. Rights are often transferable, allowing the holder to sell them on the open market. Right issue is kept open usually for 30-60 days.

The stock exchange does not permit the existing companies to go for new issue of shares without offering rights issue to its existing shareholders because if new issue is directly issued to new subscribers then the existing equity shareholders may lose their share in capital and control of company i.e., it would liquidate their percentage of equity holdings and rights. To stop this, the pre-emptive or right issue is compulsory for existing company.

Our next topic for the day is **On Line IPO**

On line IPO is a very interesting topic. It is a new method of issuing new securities through on-line system of stock exchange. Under this method the corporate has to appoint registered brokers for accepting applications and placing orders. The company issuing security has to apply for listing of its securities on any exchange other than the exchange it has offered its securities to earlier. The manager coordinates the all the activities through various intermediaries connected with the issue.

Now, for online IPO the company has to enter into an agreement with the stock exchanges, specifying their mutual rights or duties or responsibilities as well as obligation. It may also provide for a dispute resolution mechanism between them. The stock exchanges then have to appoint SEBI registered stock brokers of the exchange in order to accept application and place orders with the company, considering them as collection centres where the clients can pay money for shares allocated. The company would pay brokers a commission for their services.

[The company also has to appoint registrar to the issue with electronic connectivity with all the stock exchanges through which the securities are offered under the system. The company may list its securities on an exchange through which it offers its securities to public via, the online system.]

The appointment of various intermediaries by the issuer includes a prerequisite that such members do have the required facilities to accommodate such an online issue process.

Our next topic for the day is **Dutch and French Auction**

Any idea what these auctions are?

Dutch auction is also known as an **open descending price auction**. It uses a bidding process to find the best market price for the stock i.e the highest price at which the issuing company can sell all the available shares.
[In the traditional Dutch auction the auctioneer starts with a high bidding price which is lowered until some participant is willing to accept the auctioneer's price , or when the predetermined price (the seller's minimum acceptable price) is reached. The winning participant is supposed to pay the last announced price.]

In Dutch auction, all the bids equal to or above the cut-off price are accepted at the cut-off price.
To summarise, Dutch auction is a substitute to the old traditional method of price negotiation that was used by underwriters to set IPO prices. This method was named after the famous auctions of Dutch tulip bulbs in the 17th century. And it was devised by Nobel prize winning economist William Vickrey.
In French Auction, investors have to bid above the predetermined floor price. The allotment is done on the basis of the price investors bid, where each investor pays the bid price, but the priority is given to investors whose bid is the highest. Hence all bids equal to or above the cut-off price are accepted at the price quoted by the bidder.
[French Auction is also known as Multiple Price based auction. In this offering, the firm announces a minimum (reserve) price. Any bid above the maximum price is eliminated as a virtual market order. The bidders who bid between the minimum and maximum price are awarded shares on a pro rata basis, each paying the minimum price]

Through this method, thus, the issuers can realize a higher price for their shares, viz a viz the Book Building method, where there is both a floor and a cap. Here, in effect, each investor is charged their reserve price.

The next topic we need to cover is **Book Building**

Book Building is a process by which demand for the proposed issue is stimulated and built up. Under Book Building, the price of the share is determined on the basis of bids received rather than being predetermined by company or underwriters.

It operates like as a price discovery mechanism, basically an auction of shares.

[Under this method, issuers don't fix up a single price for the securities but provide a price range. Investors put their bid within the price range and depending on the demand and supply of the units, the final price is decided. The lowest price of the range is called the floor price and the highest price is called as cap price. Cut off price is the price at which the shares are finally allotted.]

The process that is usually followed in case of Book Building starts with appointment of lead Merchant Banker who acts as a Book Runner by the company. The Book Runner conducts several awareness campaigns, Road Shows etc. to generate demand for the issue. He also appoints Syndicate Member, who will help him in building the book. Investors who wish to put in the company's shares must communicate their demands to any of the syndicate members, along with the volume of shares they are interested in.

Pricing of the issue under book building is slightly different than the normal pricing under public issues. Here price is not fixed upfront but rather the Company either gives an indicative floor price which is the minimum bid price Or the Company may fix a

price band i.e a floor price and a cap price; in simple words the minimum and the maximum price.
Book building is a very common practice in developed countries and it has recently been making its way into developing markets as well.
Now our next topic for the day is **Disinvestment of PSU (Public Sector Undertaking)**
The term “Disinvestment” is the exact opposite of “Investment”. Investment is an acquisition of an earning asset with the help of money. In case of investment money is converted into earning asset to earn income. On the other hand in disinvestment an earning asset is converted into liquid cash.
[By disinvestment of PSU i.e Public Sector Undertaking, we mean the sale of shares of public sector undertakings by the government. When the shares of government companies held by the government are sold to get cash and when the earning assets are converted into cash it is called Disinvestment of PSU.]

The Department of Disinvestment was set up as a separate department in December, 1999 and was later renamed as Ministry of Disinvestment from September, 2001. From May, 2004, the Department of Disinvestment became a sub-department under the Ministry of Finance.
Against an aggregate target of Rs. 54,300 crore to be raised from PSU disinvestment from 1991-92 to 2000-01, the Government managed to raise just Rs. 20,078.62 crore (less than half).
The reasons for such low proceeds from disinvestment against the actual target set were: Unfavourable market conditions, Lack of attractive offers for private sector investors, Lot of opposition

on the valuation process, No clear-cut policy on disinvestment, Strong opposition from employee and trade unions and so on.
From year 2000-01 to 2003-04 it was the period when maximum number of disinvestments took place. These took the shape of either strategic sales (involving an effective transfer of control and management to a private entity) or an offer for sale to the public, with the government still retaining control of the management. Some of the companies which witnessed a strategic sale included:

BHARAT ALUMINIUM CO.LTD.
CMC LTD.
HINDUSTAN ZINC LTD.
HTL LTD.
IBP CO.LTD.
INDIA TOURISM DEVELOPMENT CORP.LTD.
INDIAN PETROCHEMICALS CORP.LTD.
JESSOP & CO.LTD.
LAGAN JUTE MACHINERY CO.LTD.
MARUTI SUZUKI INDIA LTD.
MODERN FOOD INDUSTRIES (INDIA) LTD.
PARADEEP PHOSPHATES LTD.
TATA COMMUNICATIONS LTD.

The valuations realized by this route were found to be substantially higher than those from minority stake sales. During this period, against an aggregate target of Rs. 38,500 crore to be raised from PSU disinvestment, the Government managed to raise Rs. 21,163.68 crore.

From year 2003-04 to 2009-09 the issue of PSU disinvestment remained a combative issue through this period. As a result, the disinvestment agenda stagnated during this period. In the 5 years from 2003-04 to 2008-09, the total receipts from disinvestments were only Rs. 8515.93 crore.

From year 2009-10 to year 2013-14 the scenario was different. A stable government and improved stock market conditions initially injected a renewed energy in disinvestment process. The Government started the process by selling minority stakes in listed and unlisted (profit-making) PSUs. This period saw disinvestments in companies such as NHPC Ltd., Oil India Ltd., NTPC Ltd etc. through public offers.

However, from 2011 onwards, disinvestment activity slowed down considerably. As against a target of Rs.40,000 crore for 2011-12, the Government was able to raise only Rs.14,000 crore. However, the subsequent years saw some improvement and the Government was able to raise Rs. 23,857 crore against a target of Rs. 30,000 crore in 2012-13 and Rs. 21,321 against a target of Rs. 54,000 in 2013-14. And, the achieved target dropped to Rs. 24,338 crore against a target of Rs. 58,425 crore in 2014-15. Here its important to note that these targets were revised considering the economic scenario.

However the chances of improvement in current scenario seem brighter as the NDA Government has set an ambitious disinvesment target of Rs. 69,500 crore..

Our next topic for the day is **Employees Stock Options**

This is a scheme which encourages employees to participate in the management of the company by offering shares of the Company at a discount compared to the market prices. However the scheme is optional and the shares are offered after the lock-in period is over. These shares are a part of their consideration for spending certain number of years in the company.

["Employee stock option" means the option given to the whole-time Directors, Officers or employees of a company which gives the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price. It is a right to buy shares at a pre-determined price. The option granted under the plan advises a right but not an obligation on the employee.]

Employee stock option as a scheme was started to ensure continued efficient services of employees to the company. This scheme worked as an extra incentive by making employee a partner and allows him to share profits of the business.

Now, employee stock option can be an issue of concern for existing shareholders of the company in terms of equity holdings, their consent is required before a company goes for such a scheme.

Also, government has attached certain guidelines for the companies issuing stock options like; only employees of the company are eligible for it or shares allotted cannot exceed 5% of paid up capital in any one year and capital gains arising out of sale of shares should be taxed accordingly.

Employee stock options are subject to certain lock-in period requiring continued service over a specified period of time. Upon vesting of options, employees can exercise the options to get shares, by paying the pre-determined exercise price.

Our last topic for this session is **Preferential Issue**:

Now, When a listed company issues shares or debentures to a select group of persons it is referred to as a preferential issue/ allotment.

The biggest advantage of an preferential issue is that it enables quick fund raising and that too at the minimal of cost and it can also be quite handy as it is the best formula to allow the business partners of the Company on it's Board.

As preferential allotment can be target of potential abuse, the issuer company has to comply with the Companies Act and the requirements contained in the same pertaining to preferential allotment in SEBI guidelines which related to pricing, disclosures in notice etc.

The preferential issue of equity shares/ Fully Convertible Debentures (FCDs) / Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into or exchanged with equity shares at a later date, by listed companies whose equity share capital is listed on any stock exchange, to any select group of persons under section 42 (2) of the Companies Act 2013 on private placement basis shall be governed by these guidelines.

Now, it is the time to conclude today's session.

Today's session was all about primary markets and corporate securities in India. As we talked today, primary market is a market where new securities are issued for the first time. All the topics that we talked about today like, Public Issue through Prospectus, Green shoe option, Offer for sale, Private Placement, Book Building, Rights Issue, Online IPO, Preferential issue, Dutch and French auction etc. are corporate securities and are a part of primary market and are governed by certain laws and guidelines as well.

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