Chapter 1

Initial Public Offerings (IPOs) in Indian Stock Market

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Initial Public Offerings (IPOs) In Indian Stock Market

This chapter describes the basic aspects of primary market in India. This includes the definition, types, procedures, regulatory aspects and the various terms associated with the issue of initial public offerings (IPOs) in Indian stock market.

1.1. Capital Market

The capital market is an important constituent of the financial system. Capital market is one of the significant aspects of every financial market. It is a market for the long term funds- both debt and equity – and funds raised within and outside the country. It provides long term debt and equity finance for the government and the corporate sector. The capital market aids economic growth by mobilizing the savings of the economic sectors and directing the same towards channels of productive use. Capital market can be classified into primary and secondary markets. The primary market is a market for new shares, where as in the secondary market the existing securities are traded. Capital market institutions provide rupee loans, foreign exchange loans, consultancy services and underwriting. Capital Market plays an important role in the economy of a country as it serves two functions all at once. First, Capital Market serves as an alternative for a company's capital resources. The capital gained from the public offering can be used for the company's business development, expansion, and so on. Second, Capital Market serves as an alternative for public investment. People could invest their money according to their preferred returns and risk characteristics of each instrument. Hence the development of an efficient capital market is necessary for creating a climate conducive to investment and economic growth.

Indian capital market started its journey from the eighteenth century and has faced many problems, scams during the journey. However, the Indian capital market at present is well organized, fairly integrated, mature, more global and modernized. The Indian equity market is one of the best in the world in terms of technology.

1.2. Primary market in India

A good capital market is an essential prerequisite for the industrial and commercial development of a country. Capital market is a central coordinating and directing mechanism for free and balanced flow of financial resources into the economic
system operating in a country. It helps the companies who require capital to expand, modernize or diversify their business. To get the capital that is required by the company it usually goes for the issue of shares and the process of issuing of shares is done in the primary market. The primary market in the simplest terms can be defined as a market where the securities are sold in order to raise the funds or the capital required by the company. It is a market for new issues i.e. a market for fresh capital. It provides the channel for sale of new securities. The securities can be in many forms such as equity shares, preference shares, debt instruments, bonds etc.

The primary issue market is that component of the capital markets that deals with the issuance of new securities. Companies, governments or public sector institutions can obtain funding through the sale of a new stock. In the case of a new stock issue, this sale is an initial public offering (IPO). Primary markets create long term instruments through which corporate entities borrow from capital market. Primary market provides opportunity to issuers of securities, government as well as corporate, to raise resources to meet their requirements of investments and/or discharge some obligation. Primary market also known as New Issue Market as it deals with new securities which are not previously available and are offered for the investment to the public for the first time. The primary market enjoys neither any tangible form nor any administrative organizational set-up and is not subject to any centralized control and administration for the execution of its business. It is recognized by the services that it renders to the lenders and borrowers of capital. As the new issue market directs the flow of savings into long term investments, it is of paramount importance for the economic growth and industrial development of a country. The availability of financial resources for corporate enterprises, to a great extent, depends upon the status of new issue market in the country.

The growing number of companies in the primary equity market represents the growth of the economy of the country itself. The growth of the primary equity market is remarkable in the developed countries. In the primary market, securities are issued on an exchange basis. The underwriters, that is, the investment banks, play an important role in this market: they set the initial price range for a particular share and then supervise the selling of that share. Investors can obtain news of upcoming shares only on the primary market. The issuing firm collects money, which is then used to finance its operations or expand business, by selling its shares. Before selling a security on the
primary market, the firm must fulfill all the requirements regarding the exchange. After trading in the primary market the security will then enter the secondary market, where numerous trades happen every day. The primary market accelerates the process of capital formation in a country’s economy.

The primary market categorically excludes several other new long-term finance sources, such as loans from financial institutions. Many companies have entered the primary market to earn profit by converting its capital, which is basically a private capital, into a public one, releasing securities to the public. This phenomena is known as “public issue” or “going public.”

When a company lists its shares on a public exchange, it will almost invariably look to issue additional new shares in order at the same time. The money paid by investors for the newly-issued shares goes directly to the company (in contrast to a later trade of shares on the exchange, where the money passes between investors). An offer in primary market, therefore, allows a company to tap a wide pool of stock market investors to provide it with large volumes of capital for future growth. The company is never required to repay the capital, but instead the new shareholders have a right to future profits distributed by the company and the right to a capital distribution in case of dissolution.

The existing shareholders see their shareholdings diluted as a proportion of the company's shares. However, they hope that the capital investment will make their shareholdings more valuable in absolute terms. In addition, once a company is listed, it is able to issue further shares via a rights issue, thereby again providing itself with capital for expansion without incurring any debt. This regular ability to raise large amounts of capital from the general market, rather than having to seek and negotiate with individual investors, is a key incentive for many companies seeking to list.

The comparison between primary and secondary stock market lies in the process in which funds are raised from the capital market. Securities are offered to the public in the form of subscription with the intention of raising money in the Primary stock market whereas secondary market refers to the market where trading of already existing securities take place. The secondary market is often referred to as dealer market or an auction market. Examples of an auction market is the stock exchange whereas an OTC or over the counter exemplifies a dealer market. In a primary market,
the securities, stocks or bonds are bought directly from the company issuing all of the above. These are usually bought at a “par value”. In the secondary market, the existing securities, bonds or stocks are traded again. For instance, if an individual had purchased bonds or any other investment instruments from the primary stock market a year back and the individual now wants to avail of the principal amount the bonds may be sold off in secondary market.

1.3. Initial Public Offerings (IPOs)

A corporate may raise capital in the primary market by way of an initial public offer, rights issue or private placement. An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. It is the largest source of funds with long or indefinite maturity for the company. Requirement of funds in order to finance the business activities motivates small entrepreneurs to approach the new issue market. Initial Public Offer (IPO) is a route for a company to raise capital from investors to meet the expenses for its projects and to get a global exposure by listed in the Stock Exchange. An Initial Public Offer (IPO) is the selling of securities to the public in the primary stock market. Company raising money through IPO is also called as company ‘going public’. From an investor’s point of view, IPO gives a chance to buy shares of a company, directly from the company at the price of their choice (In book build IPO’s). Many a times there is a big difference between the price at which companies decides for their shares and the price on which investor are willing to buy shares and that gives good listing gain for shares allocated to the investor in IPO. From a company’s perspective, IPO’s help them to identify their real value which is decided by millions of investors once their shares are listed on stock exchanges. IPO’s also provide funds for their future growth or for paying their previous borrowings.

“An initial public offering (IPO), referred to simply as an "offering" or "flotation", is when a company (called the issuer) issues common stock or shares to the public for the first time.”

IPOs are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately owned companies looking to become publicly traded. When a company lists its securities on a public exchange, the money paid by
investors for the newly-issued shares goes directly to the company (in contrast to a later trade of shares on the exchange, where the money passes between investors). An IPO, therefore, allows a company to tap a wide pool of investors to provide it with capital for future growth, repayment of debt or working capital. IPO can be used as both a financing strategy and an exit strategy. In a financing strategy the main purpose of the IPO is to raise funds for the company. In an exit strategy for existing investors, IPOs may be used to offload equity holdings to the public through a public issue. A company selling common shares is never required to repay the capital to investors. Once a company is listed, it is able to issue additional common shares via a secondary offering, thereby again providing itself with capital for expansion without incurring any debt. This ability to quickly raise large amounts of capital from the market is a key reason many companies seek to go public.

There are several benefits for being a public company, namely:

- Bolstering and diversifying equity base
- Enabling cheaper access to capital
- Exposure, prestige and public image
- Attracting and retaining better management and employees through liquid equity participation
- Facilitating acquisitions
- Creating multiple financing opportunities: equity, convertible debt, cheaper bank loans, etc.
- Increased liquidity for equity holder
Fig 1.1: Resources Mobilized from the Primary Market (\text{\textdollar} in crores).

### Table 1.1: Industry-wise Classification of Capital Raised

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1.4. Different kinds of issues in primary market

Primarily, issues made by an Indian company in primary market 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 as illustrated below:

(a) Public issue
   (i) Initial Public offer (IPO)
   (ii) Further public offer (FPO)
(b) Rights issue
(c) Bonus issue
(d) Private placement
   (i) Preferential issue
   (ii) Qualified institutional placement

(i) Public issue: When an issue / offer of securities is made to new investors for becoming part of shareholders’ family of the issuer it is called a public issue. Public issue can be further classified into Initial public offer (IPO) and Further public offer (FPO). The significant features of each type of public issue are illustrated below:

(ii) Initial public offer (IPO): When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO. This paves way for listing and trading of the issuer’s securities in the Stock Exchanges.

(iii) Further public offer (FPO) or Follow on offer: When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a follow on offer (FPO).
(iv) **Rights issue (RI):** When an issue of securities is made by an issuer to its shareholders existing as on a particular date fixed by the issuer (i.e. record date), it is called a rights issue. The rights are offered in a particular ratio to the number of securities held as on the record date.

(v) **Bonus issue:** When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued out of the Company’s free reserve or share premium account in a particular ratio to the number of securities held on a record date.

(vi) **Private placement:** When an issuer makes an issue of securities to a selected group of persons not exceeding 49, and which is neither a rights issue nor a public
issue, it is called a private placement. Private placement of shares or convertible securities by listed issuer can be of two types:

(1) Preferential Allotment: When a listed issuer issues shares or convertible securities, to a selected group of persons in terms of provisions of Chapter XIII of SEBI (DIP) guidelines, 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.

(2) Qualified Institutions Placement (QIP): When a listed issuer issues equity shares or securities convertible into equity shares to qualified institutions buyers only in terms of provisions of Chapter XIII A of SEBI (DIP) guidelines, it is called a QIP.

1.5. Offer Documents (ODs)

‘Offer document’ is a document which contains all the relevant information about the company, the 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 or offer for sale and “Letter of Offer” in case of a rights issue.

Terms used for offer documents vary depending upon the stage or type of the issue where the document is used. The terms used for offer documents are defined below:

Draft offer document: It 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 SEBI website, for enabling public to give comments, if any, on the draft offer document.

Red herring prospectus: It 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 Registrar of Companies before the issue opens.

Prospectus: It is an offer document in case of a public issue, which has all relevant details including price and number of shares being offered. This document is registered with Registrar of Companies 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.
**Letter of offer:** It is an offer document in case of a Rights issue and is filed with Stock exchanges before the issue opens.

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

**Shelf prospectus:** It 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/Public Financial Institutions.

**Placement document:** It is an offer document for the purpose of Qualified Institutional Placement and contains all the relevant and material disclosures.

**1.6. 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.

(i) An unlisted issuer making a public issue i.e. (making an IPO) is required to satisfy the following provisions:

**Entry Norm I (Profitability Route):** The Issuer Company shall meet the following requirements:

(a) Net Tangible Assets of at least `three crores in each of the preceding three full years.

(b) Distributable profits in atleast three of the immediately preceding five years.

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

(d) If the company has changed its name within the last one year, at least fifty percent revenue for the preceding one year should be from the activity suggested by the new name.
(e) The issue size does not exceed five times the pre-issue net worth as per the audited balance sheet of the last financial year.

To provide sufficient flexibility and also to ensure that genuine companies do not suffer on account of rigidity of the parameters, SEBI has provided two other alternative routes to the companies not satisfying any of the above conditions, for accessing the primary market, as under:

**Entry Norm II (QIB Route)**

(a) Issue shall be through book building route, with at least fifty percent to be mandatory allotted to the Qualified Institutional Buyers (QIBs).

(b) The minimum post-issue face value capital shall be `ten crores or there shall be a compulsory market-making for at least two years.

**Entry Norm III (Appraisal Route)**

(a) The “project” is appraised and participated to the extent of 15 percent by Financial Institutions / Scheduled Commercial Banks of which at least 10 percent comes from the appraiser(s).

(b) The minimum post-issue face value capital shall be `10 crores or there shall be a compulsory market-making for at least 2 years.

In addition to satisfying the aforesaid entry norms, the Issuer Company shall also satisfy the criteria of having at least 1000 prospective allottees in its issue.

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

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

(b) The issue size does not exceed five times the pre-issue net worth as per the audited balance sheet of the last financial year.
Any listed company not fulfilling these conditions shall be eligible to make a public issue by complying with QIB Route or Appraisal Route as specified for IPOs.

(iii) Certain category of entities which are exempted from the aforesaid entry norms, are as under:

(a) Private Sector Banks
(b) Public sector banks
(c) An infrastructure company whose project has been appraised by a Public Financial Institution or IDFC or IL&FS or a bank which was earlier a PFI and not less than five percent of the project cost is financed by any of these institutions.

There is no entry norm for a listed company making a rights issue. An issuer making a public issue is required to inter-alia comply with the following provisions mentioned in the guidelines:

Minimum Promoter’s contribution and lock in: In a public issue by an unlisted issuer, the promoters shall contribute not less than 20 percent of the post issue capital which should be locked in for a period of three years. “Lock-in” indicates a freeze on the shares. The remaining pre issue capital should also be locked in for a period of one year from the date of listing. In case of public issue by a listed issuer [i.e. FPO], the promoters shall contribute not less than 20 percent of the post issue capital or 20 percent of the issue size. This provision ensures that promoters of the company have some minimum stake in the company for a minimum period after the issue or after the project for which funds have been raised from the public is commenced.
Table 1.2: Listing Criteria for Companies on the CM Segment of NSE

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<td>PUEC = <code>10 cr. and MC = </code>25 cr.</td>
<td>PUEC = <code>10 cr. and MC = </code>25 cr. OR PUEC = <code>25 cr. OR MC = </code>50 cr. OR The company shall have a net worth of not less than `50 crores in each of the preceding financial years.</td>
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<tr>
<td>Company/ Promoter's Track Record</td>
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<td>a) the applicant seeking listing, OR</td>
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<td></td>
<td>b) the promoters/promoting company incorporated in or outside India OR</td>
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<tr>
<td></td>
<td>c) Partnership firm and subsequently converted into Company not in existence as a Company for three years and approaches the Exchange for listing. The Company subsequently formed would be considered for listing only on fulfillment of conditions stipulated by SEBI in this regard.</td>
<td>b) the promoters/promoting company, incorporated in or outside India.</td>
</tr>
<tr>
<td>Dividend Record /</td>
<td>Dividend paid in at least 2 out of</td>
<td></td>
</tr>
<tr>
<td><strong>Net worth / Distributable Profits</strong></td>
<td></td>
<td>the last 3 financial years immediately preceding the year in which the application has been made OR The networth of the applicants atleast ` 50 crores OR The applicant has distributable profits in at least two out of the last three financial years.</td>
</tr>
<tr>
<td><strong>Listing</strong></td>
<td></td>
<td>Listed on any other recognized stock exchange for at least last three years OR listed on the exchange having nationwide trading terminals for at least one year.</td>
</tr>
<tr>
<td><strong>Other Requirements</strong></td>
<td>(a) No disciplinary action by other stock exchanges/regulatory authority in past 3 yrs.</td>
<td>(a) No disciplinary action by other stock exchanges/regulatory authority in past 3 yrs.</td>
</tr>
<tr>
<td></td>
<td>(b) Satisfactory redressal mechanism for investor grievances,</td>
<td>(b) Satisfactory redressal mechanism for investor grievances,</td>
</tr>
<tr>
<td></td>
<td>(c) distribution of shareholding and</td>
<td>(c) distribution of shareholding, and</td>
</tr>
<tr>
<td></td>
<td>(d) details of litigation record in past 3 years</td>
<td>(d) details of litigation record in past 3 years.</td>
</tr>
<tr>
<td></td>
<td>(e) Track record of Directors of the Company</td>
<td>(e) Track record of Directors of the Company</td>
</tr>
<tr>
<td></td>
<td>(f) Change in control of a Company/ Utilisation of funds raised from public</td>
<td></td>
</tr>
</tbody>
</table>
1.7. Pricing of an Issue (IPO)

Indian primary market ushered in an era of free pricing in 1992. SEBI does not play any role in price fixation. The issuer in consultation with the merchant banker on the basis of market demand decides the price. The offer document contains full disclosures of the parameters which are taken into account by merchant Banker and the issuer for deciding the price. The parameters include EPS, PE multiple, return on net worth and comparison of these parameters with peer group companies. On the basis of pricing, an issue can be further classified into fixed price issue or book building issue. In case of a fixed price issue the issuer at the outset decides the issue price and mentions it in the Offer Document, whereas in case on a book built issue the price of an issue is discovered on the basis of demand received from the prospective investors at various price levels.

The book building method is more efficient as it solves the "leakage" of value often seen with fixed priced IPOs. Here the issuer sets a price range within which the investor is allowed to bid for shares. The range is based on where comparable companies are trading and an estimate of the value of the company that the market will bear. The investors then bid to purchase an agreed number of shares for a price which they feel reflects fair value. By compiling a book of investors, the issuer can ascertain what price range the shares should be valued at, based on the demand of the people who are going to buy them, the investors. In this process supply and demand are matched.

Globally, the book building method is favoured for its mutually beneficial nature: investors get the shares at a fair price that typically has potential upside, and the issuing company receives fair compensation.

However regionally it is likely to take some time to adapt to this method. Issuers clearly have a vested interest in moving to an approach that is more likely to lead to a better price for their companies. This upsets some investors in the short term, who are used to making a lot of money from these fixed price IPOs.

In the longer-term, however, efficient pricing should be seen as a sign of the growing maturity of the capital markets in the region.
1.8. Book Building Process

Book building is a process of price discovery. The issuer discloses a price band or floor price before opening of the issue of the securities offered. On the basis of the demands received at various price levels within the price band specified by the issuer, Book Running Lead Manager (BRLM) in close consultation with the issuer arrives at a price at which the security offered by the issuer, can be issued. The price band is a band of price within which investors can bid. The spread between the floor and the cap of the price band cannot be more than 20 percent. The price band can be revised. If revised, the bidding period is extended for a further period of three days, subject to the total bidding period not exceeding thirteen days.

A floor price or price band within which the bids can move is disclosed at least two working days before opening of the issue in case of an IPO and at least one day before opening of the issue in case of an FPO. The applicants bid for the shares quoting the price and the quantity that they would like to bid at. After the bidding process is complete, the ‘cut-off’ price is arrived at based on the demand of securities. The basis of allotment is then finalized and allotment/refund is undertaken. The final prospectus with all the details including the final issue price and the issue size is filed with Registrar of Companies (ROC), thus completing the issue process. Only the retail investors have the option of bidding at ‘cut-off’. Cut-off” option is available for only retail individual investors i.e. investors who are applying for securities worth up to ` 1,00,000/- only. Such investors are required to tick the cut-off option which indicates their willingness to subscribe to shares at any price discovered within the price band. Unlike price bids (where a specific price is indicated) which can be invalid, if price indicated by applicant is lower than the price discovered, the cut-off bids always remain valid for the purpose of allotment.

The investor can change or revise the quantity or price in the bid using the form for changing/revising the bid that is available along with the application form. However, the entire process of changing or revising the bids is to be completed within the date of closure of the issue. The investor can also cancel the bid anytime before the finalization of the basis of allotment by approaching/ writing/ making an application to the registrar of the issue. The syndicate member returns the counterfoil with the signature, date and stamp of the syndicate member. Investor can retain this as a
sufficient proof that the bids have been accepted by the trading / syndicate member for uploading on the terminal.

Table 1.3 Difference between Book Building Issue and Fixed Price Issue

<table>
<thead>
<tr>
<th>Features</th>
<th>Fixed Price Process</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pricing</strong></td>
<td>Price at which the securities are offered/ allotted is known in advance to the investor.</td>
</tr>
<tr>
<td><strong>Demand</strong></td>
<td>Demand for the securities offered is known only after the closure of the issue.</td>
</tr>
<tr>
<td><strong>Payment</strong></td>
<td>Payment if made at the time of subscription wherein refund is given after allocation.</td>
</tr>
<tr>
<td></td>
<td>Price at which securities will be offered/ allotted is not known in advance to the investor. Only an indicative price range is known.</td>
</tr>
<tr>
<td></td>
<td>Demand for the securities offered can be known everyday as the book is built.</td>
</tr>
<tr>
<td></td>
<td>Payment only after allocation</td>
</tr>
</tbody>
</table>

Source: www.chitorgarh.com

1.9. Categories of Investors

Investors are broadly classified under following categories-:

(i) Retail Individual Investor (RIIs)
(ii) Non-Institutional Investors (NIIs)
(iii) Qualified Institutional Buyers (QIBs)

In retail individual investor category, investors can not apply for more than two lakh (₹ 2,00,000) in an IPO. Retail Individual investors have an allocation of 35% of shares of the total issue size in Book Build IPO's.

A “Qualified Institutional Buyer” shall mean:

(a) a public financial institution as defined in section 4A of the Companies Act, 1956;
(b) a scheduled commercial bank;
(c) a mutual fund registered with the Board;
(d) a foreign institutional investor and sub-account registered with SEBI, other than a sub account which is a foreign corporate or foreign individual;
(e) a multilateral and bilateral development financial institution;
(f) a venture capital fund registered with SEBI;
(g) a foreign venture capital investor registered with SEBI;
(h) a state industrial development corporation;
(i) an insurance company registered with the Insurance Regulatory and Development Authority (IRDA);
(j) a provident fund with minimum corpus of ` 25 crores;
(k) a pension fund with minimum corpus of ` 25 crores;

Investors who do not fall within the definition of the above two categories are categorized as “Non-Institutional Investors”

Allotment to various investor categories is provided in the guidelines and is detailed below:

**In case of Book Built issue**

1. In case an issuer company makes an issue of 100 percent of the net offer to public through 100 percent book building process—

   (a) Not less than 35 percent of the net offer to the public shall be available for allocation to retail individual investors;

   (b) Not less than 15 percent of the net offer to the public shall be available for allocation to non-institutional investors i.e. investors other than retail individual investors and Qualified Institutional Buyers;

   (c) Not more than 50 percent of the net offer to the public shall be available for allocation to Qualified Institutional Buyers:
2. In case of compulsory Book-Built Issues at least 50 percent of net offer to public being allotted to the Qualified Institutional Buyers (QIBs), failing which the full subscription monies shall be refunded.

3. In case the book built issues are made pursuant to the requirement of mandatory allocation of 60 percent to QIBs in terms of Rule 19 (2) (b) of Securities Contract (Regulation) Rules, 1957, the respective figures are 30 percent for RIIs and 10 percent for NII.

In case of fixed price issue the proportionate allotment of securities to the different investor categories in a fixed price issue is as described below:

1. A minimum 50 percent of the net offer of securities to the public shall initially be made available for allotment to retail individual investors, as the case may be.

2. The balance net offer of securities to the public shall be made available for allotment to:

   a. Individual applicants other than retail individual investors, and

   b. Other investors including corporate bodies/ institutions irrespective of the number of securities applied for.

SEBI (DIP) guidelines provide that an issuer making an issue to public can allot shares on firm basis to some categories as specified below:

(i) Indian and Multilateral Development Financial Institutions,

(ii) Indian Mutual Funds,

(iii) Foreign Institutional Investors including Non-Resident Indians and Overseas Corporate Bodies and

(iv) Permanent/regular employees of the issuer company.

(v) Scheduled Banks

(vi) It may be noted that OCBs are prohibited by RBI to make investment.
Reservation on Competitive Basis is when allotment of shares is made in proportion to the shares applied for by the concerned reserved categories. Reservation on competitive basis can be made in a public issue to the following categories:

(i) Employees of the company

(ii) Shareholders of the promoting companies in the case of a new company and shareholders of group companies in the case of an existing company

(iii) Indian Mutual Funds

(iv) Foreign Institutional Investors (including non resident Indians and overseas corporate bodies)

(v) Indian and Multilateral development Institutions

(vi) Scheduled Banks

In a public issue by a listed company, the reservation on competitive basis can be made for retail individual shareholders and in such cases the allotment to such shareholders shall be on proportionate basis.

There is no discretion while doing the allotment amongst various investor categories as per the permissible allocations in the allotment process. All allottees are allotted shares on a proportionate basis within their respective investor categories.

Applications Supported By Blocked Amount (ASBA): Application forms for applying/bidding for shares are available with all syndicate members, collection centers, the brokers to the issue and the bankers to the issue. In case applicant intend to apply through new process introduced by SEBI i.e. Applications supported by blocked amount (ASBA), applicant may get the ASBA application forms form the Self Certified Syndicate Banks.

The document is prepared by Merchant Banker(s), registered with SEBI. They are required to do the due diligence while preparing an offer document. The draft offer document submitted to SEBI is put on website for public comments.

As per the requirement, all the public issues of size in excess of 10 crore, are to made compulsorily in demat mode. Thus, The investors are required to have a demat
account and also have the responsibility to put the correct DP ID and Client ID details in the bid/application forms if he intend to apply for an issue that is being made in a compulsory demat mode.

It is compulsory for the investor to have Permanent Account Number (PAN). Any investor who wants to invest in an issue should have a PAN which is required to be mentioned in the application form. It is to be distinctly understood that the photocopy of the PAN is not required to be attached along with the application form at the time of making an application.

The period for which an issue is required to be kept open is:

- **For Fixed price public issues**: Three to Ten working days
- **For Book built public issues**: Three to seven working days extendable by three days in case of a revision in the price band
- **For Rights issues**: Fifteen to thirty days.

The investor get the allotment/ refund of shares within thirty days of the closure of the issue in case of Fixed price public issues and within fifteen days of the closure of the issue For Book built public issues.

The status of bidding in a book built issue is available on the website of BSE/NSE on a consolidated basis. The data regarding bids is also available, investor category wise. After the price has been determined on the basis of bidding, the public advertisement containing, inter alia, the price as well as a table showing the number of securities and the amount payable by an investor, based on the price determined, is issued.

However, in case of a fixed price issue, information is available only after the closure of the issue through a public advertisement, issued within ten days of dispatch of the certificates of allotment/ refund orders.

The investor will gets the refund in an issue through various modes viz. registered/ordinary post, Direct Credit, RTGS (Real Time Gross Settlement), ECS (Electronic Clearing Service) and NEFT (National Electronic Funds Transfer).
In book built public issue the listing of shares is done within three weeks after the closure of the issue. In case of fixed price public issue, it is done within thirty seven days after closure of the issue.

The information about the forthcoming issues may be obtained from the websites of Stock Exchanges. Further the issuer coming with an issue is required to give issue advertisements in an English national Daily with wide circulation, one Hindi national newspaper and a regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.

1.10. Intermediaries involved in the Issue Process

Intermediaries which are registered with SEBI are Merchant Bankers to the issue (known as Book Running Lead Managers (BRLM) in case of book built public issues), Registrars to the issue, Bankers to the issue and Underwriters to the issue who are associated with the issue for different activities. Their addresses, telephone/fax numbers, registration number, and contact person and email addresses are disclosed in the offer documents.

(i) Merchant Banker: The merchant banker are those financial intermediary involved with the activity of transferring capital funds to those borrowers who are interested in borrowing. Merchant banker does the due diligence to prepare the offer document which contains all the details about the company. They are also responsible for ensuring compliance with the legal formalities in the entire issue process and for marketing of the issue.

The activities of the merchant banking in India is very vast in nature of which includes the following:

a) The management of the customers securities

b) The management of the portfolio,

c) The management of projects and counseling as well as appraisal

d) The management of underwriting of shares and debentures

e) The circumvention of the syndication of loans
f) Management of the interest and dividend etc

(ii) **Registrars to the Issue:** They are involved in finalizing the basis of allotment in an issue and for sending refunds, allotment etc. 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.

(iii) **Bankers to the Issue:** “Banker to an issue” means a scheduled bank carrying on all or any of the following activities, namely acceptance of application and application monies, acceptance of allotment or call monies, refund of application monies and payment of dividend or interest warrants. The Bankers to the Issue enable the movement of funds in the issue process and therefore enable the registrars to finalize the basis of allotment by making clear funds status available to the Registrars.

(iv) **Underwriters:** An underwriter is a company or other entity that administers the public issuance and distribution of securities from a corporation or other issuing body. An underwriter works closely with the issuing body to determine the offering price of the securities buys them from the issuer and sells them to investors via the underwriter's distribution network. Underwriters are intermediaries who undertake to subscribe to the securities offered by the company in case these are not fully subscribed by the public, in case of an underwritten issue. Underwriters generally receive underwriting fees from their issuing clients, but they also usually earn profits when selling the underwritten shares to investors. However, underwriters assume the responsibility of distributing a securities issue to the public. If they can't sell all of the securities at the specified offering price, they may be forced to sell the securities for less than they paid for them, or retain the securities themselves.
1.11. The Offer Document

This sub-section attempts to inform the structure of presentation of the content in an offer document. The basic objective is to help the reader to navigate through the content of an offer document.

(a) **Cover Page**: Under this head full contact details of the Issuer Company, lead managers and registrars, the nature, number, price and amount of instruments offered and issue size, and the particulars regarding listing are mentioned. Other details such as Credit Rating, IPO Grading, risks in relation to the first issue, etc are also disclosed if applicable.

(b) **Risk Factors**: Under this head the management of the issuer company gives its view on the internal and external risks envisaged by the company and the proposals, if any, to address such risks. The company also makes a note on the forward looking statements. This information is disclosed in the initial pages of the document and also in the abridged prospectus. It is generally advised that the investors should go through all the risk factors of the company before making an investment decision.

(c) **Introduction**: Under this head a summary of the industry in which the issuer company operates, the business of the Issuer Company, offering details in brief, summary of consolidated financial statements and other data relating to general information about the company, the merchant bankers and their responsibilities, the details of brokers/syndicate members to the Issue, credit rating (in case of debt issue), debenture trustees (in case of debt issue), monitoring agency, book building process in brief, IPO grading in case of First Issue of Equity capital and details of underwriting Agreements are given. Important details of capital structure, objects of the offering, funds requirement, funding plan, schedule of implementation, funds deployed, sources of financing of funds already deployed, sources of financing for the balance fund requirement, interim use of funds, basic terms of issue, basis for issue price, tax benefits are also covered.

(d) **About us**: Under this head a review of the details of business of the company, business strategy, competitive strengths, insurance, industry-regulation (if applicable), history and corporate structure, main objects, subsidiary details, management and
board of directors, compensation, corporate governance, related party transactions, exchange rates, currency of presentation and dividend policy are given.

(e) Financial Statements: Under this head financial statement and restatement as per the requirement of the guidelines and differences between any other accounting policies and the Indian Accounting Policies (if the Company has presented its Financial Statements also as per either US GAAP/IFRS) are presented.

(f) Legal and other information: Under this head outstanding litigations and material developments, litigations involving the company, the promoters of the company, its subsidiaries, and group companies are disclosed. Also material developments since the last balance sheet date, government approvals/licensing arrangements, investment approvals (FIPB/RBI etc.), technical approvals, and indebtedness, etc. are disclosed.

(g) Other regulatory and statutory disclosures: Under this head, authority for the Issue, prohibition by SEBI, eligibility of the company to enter the capital market, disclaimer statement by the issuer and the lead manager, disclaimer in respect of jurisdiction, distribution of information to investors, disclaimer clause of the stock exchanges, listing, impersonation, minimum subscription, letters of allotment or refund orders, consents, expert opinion, changes in the auditors in the last three years, expenses of the issue, fees payable to the intermediaries involved in the issue process, details of all the previous issues, all outstanding instruments, commission and brokerage on, previous issues, capitalization of reserves or profits, option to subscribe in the issue, purchase of property, revaluation of assets, classes of shares, stock market data for equity shares of the company, promise vis-à-vis performance in the past issues and mechanism for redressal of investor grievances is disclosed.

(h) Offering information: Under this head Terms of the Issue, ranking of equity shares, mode of payment of dividend, face value and issue price, rights of the equity shareholder, market lot, nomination facility to investor, issue procedure, book building procedure in details along with the process of making an application, signing of underwriting agreement and filing of prospectus with SEBI/ROC, announcement of statutory advertisement, issuance of confirmation of allocation note(“can”) and allotment in the issue, designated date, general instructions, instructions for completing the bid form, payment instructions, submission of bid form, other
instructions, disposal of application and application moneys, interest on refund of excess bid amount, basis of allotment or allocation, method of proportionate allotment, dispatch of refund orders, communications, undertaking by the company, utilization of issue proceeds, restrictions on foreign ownership of Indian securities are disclosed.

(i) Other Information: This covers description of equity shares and terms of the Articles of Association, material contracts and documents for inspection, declaration, definitions and abbreviations, etc.

1.12. SEBI’s Role in an Issue

Any company making a public issue or a rights issue of securities of value more than ` fifty lakhs is required to file a draft offer document with SEBI for its observations. The validity period of SEBI’s observation letter is twelve months only i.e the company has to open its issue within the period of twelve months starting from the date of issuing the observation letter. There is no requirement of filing any offer document / notice to SEBI in case of preferential allotment and Qualified Institution Placement (QIP). In QIP, Merchant Banker handling the issue has to file the placement document with Stock Exchanges for making the same available on their websites.

Given below are few clarifications regarding the role played by SEBI:

(a) Till the early nineties, Controller of Capital Issues used to decide about entry of company in the market and also about the price at which securities should be offered to public.

However, following the introduction of disclosure based regime under the aegis of SEBI, companies can now determine issue price of securities freely without any regulatory interference, with the flexibility to take advantage of market forces.

(b) The primary issuances are governed by SEBI in terms of SEBI (Disclosures and Investor protection) guidelines. SEBI framed its DIP guidelines in 1992. The SEBI DIP Guidelines over the years have gone through many amendments in keeping pace with the dynamic market scenario. It provides a comprehensive framework for issuing of securities by the companies.
(c) Before a company approaches the primary market to raise money by the fresh issuance of securities it has to make sure that it is in compliance with all the requirements of SEBI (DIP) Guidelines, 2000. The Merchant Banker are those specialized intermediaries registered with SEBI, who perform the due diligence process and ensures compliance with DIP guidelines before the document is filed with SEBI.

(d) Officials of SEBI at various levels examine the compliance with DIP guidelines and ensure that all necessary material information is disclosed in the draft offer documents.

Still there are certain misconceptions prevailing in the mind of investors about the role of SEBI which are clarified here in under:

It should be distinctly understood that SEBI does not recommend any issue nor does it take any responsibility either for the financial soundness of any scheme or the project for which the issue is proposed to be made.

Submission of offer document to SEBI should not in any way be deemed or construed that the same has been cleared or approved by SEBI. The Lead manager certifies that the disclosures made in the offer document are generally adequate and are in conformity with SEBI guidelines for disclosures and investor protection in force for the time being. This requirement is to facilitate investors to take an informed decision for making investment in the proposed issue.

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.
Fig 1.3: Life cycle of an IPO.

<table>
<thead>
<tr>
<th>1. Issuer Company - IPO Process Initialization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appoint lead manager as book runner</td>
</tr>
<tr>
<td>Appoint registrar of the issue</td>
</tr>
<tr>
<td>Appoint syndicate members</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2. Lead Manager’s - Pre Issue Role - Part 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepare draft offer prospectus document for IPO</td>
</tr>
<tr>
<td>File draft offer prospectus with SEBI</td>
</tr>
<tr>
<td>Road shows for the IPO</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3. SEBI – Prospectus Review</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEBI review draft offer prospectus</td>
</tr>
<tr>
<td>Revert it back to Lead Manager if need clarification or changes (Step 2)</td>
</tr>
<tr>
<td>EBI approve the draft offer prospectus, the draft offer prospectus is now become Offer Prospectus</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4. Lead Manager - Pre Issue Role - Part 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Submit the Offer Prospectus to Stock Exchanges, registrar of the issue and get it approved</td>
</tr>
<tr>
<td>Decide the issue date &amp; issue price band with the help of Issuer Company</td>
</tr>
<tr>
<td>Modify Offer Prospectus with date and price band. Document is now called Red Herring Prospectus</td>
</tr>
<tr>
<td>Red Herring Prospectus &amp; IPO Application Forms are printed and posted to syndicate members; through which they are distributed to investors</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>5. Investor – Bidding for the public issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Issue Open for investors bidding</td>
</tr>
<tr>
<td>Investors fill the application forms and place orders to the syndicate members (syndicate member list is published on the application form)</td>
</tr>
</tbody>
</table>
Syndicate members provide the bidding information to BSE/NSE electronically and bidding status gets updated on BSE/NSE websites

Syndicate members send all the physically filled forms and cheques to the registrar of the issue

Investor can revise the bidding by filling a form and submitting it to Syndicate member

Syndicate members keep updating stock exchange with the latest data

Public Issue Closes for investors bidding

6. **Lead Manager – Price Fixing**

Based on the bids received, lead managers evaluate the final issue price

Lead managers update the 'Red Herring Prospectus' with the final issue price and send it to SEBI and Stock Exchanges

7. **Registrar - Processing IPO Applications**

Registrar receives all application forms & cheques from Syndicate members

They feed applicant data & additional bidding information on computer systems

Send the cheques for clearance

Find all bogus application

Finalize the pattern for share allotment based on all valid bid received

Prepare 'Basis of Allotment'

Transfer shares in the demat account of investors

Refund the remaining money though ECS or Cheques

**Lead manager – Stock Listing**

Once all allocated shares are transferred in investors dp accounts, Lead Manager with the help of Stock Exchange decides Issue Listing Date

Finally share of the issuer company gets listed in Stock Market

Source: www.chittorgarh.com
1.13. IPO Grading in India

IPO grading is the grade assigned by a Credit Rating Agency registered with SEBI, to the initial public offering (IPO) of equity shares or other convertible securities. The grade represents a relative assessment of the fundamentals of the IPO in relation to the other listed equity securities. Disclosure of “IPO Grades”, so obtained is mandatory for companies coming out with an IPO.

The grade represents a relative assessment of the fundamentals of that issue in relation to the other listed equity securities in India. Such grading is generally assigned on a five-point point scale with a higher score indicating stronger fundamentals and vice versa 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

IPO grading has been introduced as an endeavor to make additional information available for the investors in order to facilitate their assessment of equity issues offered through an IPO. IPO grading can be done either before filing the draft offer documents with SEBI or thereafter. However, the Prospectus/Red Herring Prospectus, as the case may be, must contain the grade/s given to the IPO by all CRAs approached by the company for grading such IPO. The company desirous of making the IPO is required to bear the expenses incurred for grading such IPO. A company which has filed the draft offer document for its IPO with SEBI, on or after 1st May, 2007, is required to obtain a grade for the IPO from at least one CRA. Irrespective of whether the issuer finds the grade given by the rating agency acceptable or not, the grade has to be disclosed as required under the DIP Guidelines. However the issuer has the option of opting for another grading by a different agency. In such an event all grades...
obtained for the IPO will have to be disclosed in the offer documents, advertisements etc.

IPO grading is intended to run parallel to the filing of offer document with SEBI and the consequent issuance of observations. Since issuance of observation by SEBI and the grading process, function independently, IPO grading is not expected to delay the issue process.

The IPO grading process is expected to take into account the prospects of the industry in which the company operates, the competitive strengths of the company that would allow it to address the risks inherent in the business and capitalise on the opportunities available, as well as the company’s financial position.

While the actual factors considered for grading may not be identical or limited to the following, the areas listed below are generally looked into by the rating agencies, while arriving at an IPO grade

1. Business Prospects and Competitive Position
   i. Industry Prospects
   ii. Company Prospects
2. Financial Position
3. Management Quality
4. Corporate Governance Practices
5. Compliance and Litigation History
6. New Projects—Risks and Prospects

It may be noted that the above is only indicative of some of the factors considered in the IPO grading process and may vary on a case to case basis.

IPO grading does not consider the price at which the shares are offered in the issue. IPO grading is done without taking into account the price at which the security is offered in the IPO. Since IPO grading does not consider the issue price, the investor needs to make an independent judgment regarding the price at which to bid for/subscribe to the shares offered through the IPO.

All grades obtained for the IPO along with a description of the grades can be found in the Prospectus. Abridged Prospectus, issue advertisement or any other place where
the issuer company is making advertisement for its issue. Further the Grading letter of
the Credit Rating Agency which contains the detailed rationale for assigning the
particular grade will be included among the Material Documents available for
Inspection.

An IPO grade is NOT a suggestion or recommendation as to whether one should
subscribe to the IPO or not. IPO grade needs to be read together with the disclosures
made in the prospectus including the risk factors as well as the price at which the
shares are offered in the issue.

IPO Grading is intended to provide the investor with an informed and objective
opinion expressed by a professional rating agency after analyzing factors like business
and financial prospects, management quality and corporate governance practices etc.
However, irrespective of the grade obtained by the issuer, the investor needs to make
his/her own independent decision regarding investing in any issue after studying the
contents of the prospectus including risk factors carefully.

SEBI does not play any role in the assessment made by the grading agency. The
grading is intended to be an independent and unbiased opinion of that agency. The
grading is intended to be an independent and unbiased opinion of a rating agency.
SEBI does not pass any judgment on the quality of the issuer company. SEBI’s
observations on the IPO document are entirely independent of the IPO grading
process or the grades received by the company.


Green shoe Option: Green Shoe Option is a price stabilizing mechanism in which
shares are issued in excess of the issue size, by a maximum of 15 percent. 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 volatility.

Safety Net: In a safety net scheme or a buy back arrangement the issuer company in
consultation with the lead merchant banker discloses in the RHP that if the price of
the shares of the company post listing goes below a certain level the issuer will
purchase back a limited number of shares at a pre specified price from each allottee.
**Open book/closed book:** In an open book building system the merchant banker along with the issuer ensures that the demand for the securities is displayed online on the website of the Stock Exchanges. Here, the investor can be guided by the movements of the bids during the period in which the bid is kept open. Indian Book building process provides for an open book system. In the closed book building system, the book is not made public and the bidders will have to take a call on the price at which they intend to make a bid without having any information on the bids submitted by other bidders.

**Hard underwriting:** Hard underwriting is when an underwriter agrees to buy his commitment before the issue opens. The underwriter guarantees a fixed amount to the issuer from the issue. Thus, in case the shares are not subscribed by investors, the issue is devolved on underwriters and they have to bring in the amount by subscribing to the shares. The underwriter bears a risk which is much higher than soft underwriting.

**Soft underwriting:** Soft underwriting is when an underwriter agrees to buy the shares at stage after the issue the issue is closed. The risk faced by the underwriter as such is reduced to a small window of time.

**Differential pricing:** When one category of investors is offered shares at a price different from the other category it is called differential pricing. An issuer company can allot the shares to retail individual investors at a discount of maximum 10 percent to the price at which the shares are offered to other categories of public.

**1.15. Basis of Allocation/Basis of Allotment**

After the closure of the issue, for example, a book built public issue, the bids received are aggregated under different categories i.e., firm allotment, Qualified Institutional Buyers (QIBs), Non-Institutional Buyers (NIBs), Retail, etc. The oversubscription ratios are then calculated for each of the categories as against the shares reserved for each of the categories in the offer document. Within each of these categories, the bids are then segregated into different buckets based on the number of shares applied for. The oversubscription ratio is then applied to the number of shares applied for and the number of shares to be allotted for applicants in each of the buckets is determined. Then, the number of successful allottees is determined. This process is followed in
case of proportionate allotment. Thus allotment to each investor is done based on proportionate basis in both book built and fixed price public issue.

1.16. The Market Index (S&P CNX NIFTY)

S&P CNX Nifty (Nifty), the most popular and widely used indicator of the stock market in the country, is a 50-stock index comprising the largest and the most liquid stocks from about 25 sectors in India. These stocks have a MC of over 50% of the total MC of the Indian stock market. The index was introduced in 1995 by the National Stock Exchange (NSE) keeping in mind it would be used for modern applications such as index funds and index derivatives besides reflecting the stock market behavior. NSE maintained it till July 1998, after which the ownership and management rights were transferred to India Index Services & Products Ltd. (IISL), the only professional company in India which provides index services.

Choice of index set size:

While trying to construct Nifty, a number of calculations were done to arrive at the ideal number of stocks. A simple index construction algorithm was implemented which did not pre-specify the size of the index set, but added and deleted stocks based on criteria of MC and liquidity. Ten index time-series (from 1990 to 1995) were generated by using various thresholds for addition and deletion of stocks from/into the index set. These index sets turned out to range from 69 to 182 stocks as of end-1995 indicating that the ideal number of stocks for the index could be somewhere in the range 69 to 182. For each of these ten index time-series, the correlation between the index time-series and thousands of randomly chosen portfolios was calculated. This gave a quantitative sense of how increasing the index set size helps improve the extent to which the index reflects the behavior of the market. It was observed that the gain from increasing the number of stocks from 69 to 182 was quite insignificant. It was corroborated by the theory on portfolio diversification, which suggests that diversifying from 10 to 20 stocks results in considerable reductions in risk, while the gains from further diversification are smaller. An analysis of liquidity further suggested that the Indian market had comfortable liquidity of around 50 stocks. Beyond 50, the liquidity levels became increasingly lower. Hence the index set size of 50 stocks was chosen.
Selection of stocks

From early 1996 onwards, the eligibility criteria for inclusion of stocks in S&P CNX Nifty are based on the criteria of Market Capitalization (MC), liquidity and floating stock.

**Market capitalisation:** Stocks eligible for inclusion in Nifty must have a six monthly average market capitalisation of ₹ 500 crore or more during the last six months.

**Liquidity (Impact cost):** Liquidity can be measured in two ways: Traditionally liquidity is measured by volume and number of trades. The new international practice of measuring liquidity is in terms of impact cost. An ideal stock can be traded at its ruling market price. However practically, when one tries to buy a stock, one pays a price higher than the ruling price for purchase, or receives a price lower than the ruling price from sale, due to sufficient quantity not being available at the ruling price. This difference from the ruling price in percentage terms is the impact cost. It is defined as the percentage degradation suffered in the price for purchase or sale of a specified quantity of shares, when compared to the ideal price. It can be computed for each individual stock based on order book snapshots. It can also be computed for a market index based on the impact cost of constituent stocks, using their respective index weights. The impact cost of a market index is effectively the cost incurred when simultaneously placing market orders for all constituents of the index, in the proportion of their weights in the index. A highly liquid market index is one where the impact cost of buying or selling the entire index is low.

It is the percentage mark up suffered while buying / selling the desired quantity of a stock compared to its ideal price, that is, (best buy + best sell)/2. Impact cost for sell can also be worked out. The impact cost criterion requires that the stocks traded for 85 percent of the trading days at an impact cost of less than 0.75 percent can be included in the index.

**Floating Stock:** Companies eligible for inclusion in S&P CNX Nifty should have at least 12 percent floating stock. For this purpose, floating stock shall mean stocks which are not held by the promoters and associated entities (where identifiable) of such companies.
Base date and value

The base date selected for S&P CNX Nifty index is the close of prices on November 3, 1995, which marks the completion of one year of operations of NSE’s Capital Market segment. The base value of the index has been set at 1000. S&P CNX Nifty has a historical time series dating back to January 1990. It is worth explaining the manner of calculation of the series. On 1st July 1990, BSE (the Stock Exchange, Bombay) data for the preceding six months was analysed to shortlist a set of stocks which had adequate liquidity. The top fifty companies were included in the index set, and the index time series was calculated for three months from 1st July 1990 to 30th September 1990. The index set was re-calculated afresh at this point (i.e. by dropping some low liquidity or low MC stocks, and adding better alternatives), and this new index set was used for the next three months, and so on. This methodology avoided selection bias associated with the simple back-calculation, which generates higher returns in the back-calculated series than is really the case. This happens because the index set chosen today is likely to contain stocks, which have fared well in the recent past. Conversely, stocks that fared badly in the past are likely to have lower MC and hence not get included in today’s index set. The historical time-series of Nifty truly reflects the behavior of an index populated with the biggest 50 stocks, which have required levels of liquidity throughout.

Index maintenance

An index is required to be maintained professionally to ensure that it continues to remain a consistent benchmark of the equity markets. This involves transparent policies for inclusion and exclusion of stocks in the index and for day-to-day tracking and giving effect to corporate actions on individual stocks. At IISL, an Index Policy Committee comprising of eminent professionals from mutual funds, broking houses, financial institutions, academicians etc. formulates policy and guidelines for management of the Indices. An Index Maintenance Sub-Committee, comprising of representatives from NSE, CRISIL, S&P and IISL take all decisions on addition/deletion of stocks in any Index and the day to day index maintenance.
On-line computation and dissemination

The index is calculated afresh every time a trade takes place in an index stock. Hence, we often see days where there are more than 5,00,000 observations for Nifty. The index data base provides data relating to Open, High, Low, and Close values of index every day, the number of shares traded for each of the index stocks, the sum of value of the stocks traded of each of the index stocks, the sum of the MC of all the stocks in the index etc. Nifty is calculated on-line and disseminated over trading terminals across the country. This is also disseminated on real-time basis to information vendors such as Bloomberg, Reuters etc.

1.17. Statement of the problem

The Indian capital market has witnessed a drastic change in recent years as a result of economic liberalisation in the country. This includes abolishing the regulated regime under the Controller of Capital Issues (CCI) and establishing the Securities and Exchange Board of India (SEBI) as the market monitor in 1992. The technological advancements, regulatory controls, increased investor base has brought a new equity culture in India, which is still developing continuously. Indian capital market is perceived by investors, whether local or global, as a new opportunity to earn high returns. The research statistics have proven that in the Indian financial markets, equity instruments provide higher returns in long period as compared to other traditional forms of investments such as fixed deposits and gold. Thus there is a continuous increase in the tendency of investors to make investments in equity by taking more risk in order to earn huge returns from the stock market. Capital market is considered as the best opportunity to fulfill the dreams for retail investors since the Indian economy is considered as one of the most developing economy in the whole world. The sensitivity index as a barometer of the economy has been moving with amazing speed and has now reached at its historical heights. The whole world is astonished by the developments happening in the Indian economy and in its capital market. The money from different class of investors including foreign institutional investors, qualified institutional investors and retail investors is now flooding in to the stock market. Along with the secondary market, the primary market is also attracting the investor’s interest to invest their money in IPO’s as well as the corporate perceive it as a reasonably reliable source of raising of funds in a scenario of highly volatile
interest rates in the economy. At the end, both entities seem to be the winners of the
game. The maturity of the capital market increases with the age and no doubt it will
soon reach the dream heights in the future.

The gold and fixed deposit investment culture up to the early nineties in India has
changed and now we have seen the new equity culture in the Indian capital market.
Primary market in India has emerged as a most promising investment opportunity.
Similar to most developed countries, presently, the IPO process in India requires a
company to file its draft prospectus with SEBI through an eligible merchant banker
prior to filing it with the Registrar of Companies. However, unlike many developed
countries, where large numbers of companies do not get listed, the Indian primary
market witnessed a large number of listings in the mid-1990s. From 1993 to 1996
alone, more than 1,500 companies went public in India, from all sectors of the
economy and from different ownership groups (e.g., private stand-alone companies,
business groups, and government-owned companies). Changes in the listing
guidelines over the entire decade transformed the Indian primary market. Many of the
investors may perceive the primary market as a new bubble but others take it as
opportunities to make profits. Meanwhile the primary market has also suffered
through IPO scam in 2005, where a single investor has multiple demat accounts.
Although the PAN no is made compulsory in equity trading, still the craze of IPO
exists in India, given experience of MS shoe, CRB etc. But still the IPO market is on.
Investors perceive it as a comparatively safe avenue to make money as most of the
time investors have the experience of having higher returns on the listing day of the
security. Different researchers claim that the Indian IPO’s are under priced, and in
such a scenario we also have the experience when the closing price of a security
moves down to the extent that it now less than the issue price on the very first day of
listing. Even if the IPO is oversubscribed many times, the returns are not assured.
Here some questions normally arise in the mind of investors. These are:

- How is IPOs valuation done?
- What should be the time horizons on investments in IPOs?
- Which factors affects the IPO returns on the listing day and in the following
  period?
• How is an IPO investment analyzed and which theories / techniques are helpful in explaining the behavior of an IPO?
• What are the determinants of post issue returns of an IPO?

The above mentioned questions are answered in the coming chapters with the help of the results from analyzing the collected data.

If the market index is considered as the barometer of economy, the primary market is the barometer of business confidence. Finally, the problem of the study can be stated as:

“To analyze the initial (listing) returns provided by Initial Public Offerings (IPO’s) over and above the benchmark index S & P CNX Nifty after the issue on the listing day as well as in the following years (long term returns) using event study methodology and to identify the different factors that can explains the return behavior of Initial Public Offerings in Indian Stock Market”.