CHAPTER III

SCENE OF MERCHANT BANKING ACTIVITIES AND CORPORATE SECURITIES PATTERN

SECTION I: MERCHANT BANKING ACTIVITIES

Merchant Banking activities especially those covering issue and underwriting of shares and debentures are regulated by the Merchant Bankers Regulations of Securities and Exchange Board of India (SEBI). Merchant banking activities are, of course, organized and undertaken in several forms. Commercial banks, Indian and foreign and Development Finance Institutions (DFIs) have organized them through formation of divisions; nationalised banks have formed subsidiary companies; and share brokers and consultancies constituted themselves into public limited companies or registered themselves as private limited companies or firms, partnerships or proprietary concerns. Most of the outfits have several branches. Table 1 presents the merchant bankers registered with SEBI classified according to sectors and category and Table 2 presents according to zones.

* DATA AND INFORMATIONS PRESENTED IN THIS CHAPTER ARE SECONDARY SOURCES COLLECTED BY THE RESEARCHER FROM THE PUBLIC SECTOR BANKS, INTERNATIONAL BANKS, PRIVATE SECTOR MERCHANT BANKS, AND INVESTMENT MERCHANT BANKERS OFFICIAL RECORDS
**TABLE 1**

REGISTERED MERCHANT BANKERS BY SECTOR

<table>
<thead>
<tr>
<th>MERCHANT BANKERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Commercial Banks (24)</td>
</tr>
<tr>
<td>Financial Institutions (6)</td>
</tr>
<tr>
<td>State Institutions (4)</td>
</tr>
<tr>
<td>Subsidiaries (7)</td>
</tr>
<tr>
<td>Divisions</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>International Banks (10)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Private Sector</td>
</tr>
<tr>
<td>Financial &amp; Investments</td>
</tr>
<tr>
<td>Leasing</td>
</tr>
<tr>
<td>231</td>
</tr>
</tbody>
</table>

* * WITH TABLE SHOWS ARE SECONDARY SOURCE OF INFORMATION COLLECTED BY THE RESEARCHER DURING THE FIELD VISIT FROM THE OFFICIALS RECORDS OF MERCHANT BANKERS.
<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>NO.</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category I</td>
<td>164</td>
<td>56.2</td>
</tr>
<tr>
<td>Category II</td>
<td>19</td>
<td>6.5</td>
</tr>
<tr>
<td>Category III</td>
<td>21</td>
<td>7.1</td>
</tr>
<tr>
<td>Category IV</td>
<td>88</td>
<td>30.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>292</td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>
### Table 2 *

**DISTRIBUTION OF MERCHANT BANKERS ZONE-WISE**

<table>
<thead>
<tr>
<th>ZONE</th>
<th>CATEGORY</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I</td>
<td>%</td>
<td>II</td>
<td>%</td>
<td>III</td>
<td>%</td>
<td>IV</td>
<td>%</td>
<td>TOTAL</td>
<td>PERCENT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>WEST</td>
<td>77</td>
<td>46.9</td>
<td>14</td>
<td>73.6</td>
<td>10</td>
<td>47.6</td>
<td>61</td>
<td>69.3</td>
<td>162</td>
<td>55.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NORTH</td>
<td>38</td>
<td>23.3</td>
<td>2</td>
<td>10.5</td>
<td>7</td>
<td>33.3</td>
<td>15</td>
<td>17.1</td>
<td>62</td>
<td>21.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOUTH</td>
<td>35</td>
<td>21.3</td>
<td>2</td>
<td>10.5</td>
<td>3</td>
<td>14.2</td>
<td>8</td>
<td>9.0</td>
<td>48</td>
<td>16.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EAST</td>
<td>14</td>
<td>8.5</td>
<td>1</td>
<td>5.3</td>
<td>1</td>
<td>4.8</td>
<td>4</td>
<td>4.6</td>
<td>20</td>
<td>6.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>164</td>
<td>100.0</td>
<td>19</td>
<td>100.0</td>
<td>21</td>
<td>100.0</td>
<td>88</td>
<td>100.0</td>
<td>292</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The head offices of merchant banks are concerned in west zone. West zone accounts for 55.6 per cent of 292 merchant bankers registered at end July 1993. Among the four categories, Category I merchant bankers account for 56.2 per cent of total merchant bankers. Next in importance is Category IV who account for 30.2 per cent of total registration. The products/services covered include, project counselling and pre-investment activities, feasibility studies, project reports, design of capital structure, issue management and underwriting, loan syndication, non-resident Indians, foreign currency finance, mergers, amalgamation and takeovers, venture capital and public deposits. Some of the merchant bank outfits have offices coverings the entire country. A few have entered into collaboration with merchant bankers abroad.  

Merchant bankers, irrespective of the form in which they are organised are governed by the Merchant Bankers Rules (M.B.Rules) issued by Ministry of Finance, and Merchant Bankers Regulations (M.B.Regulations) issued by SEBI (22.12.1992).


2 Government of India, Department of Company Affairs, Authorization for Merchant Bankers, by SEBI, F.No.1.3.91 CL.V., Cir.No.7/91, 22.2.1991.
For orderly growth and development of the securities market investor confidence is a prerequisite. In the primary market investor confidence depends in a large measure on the efficiency of the issue management function which covers drafting and issue of prospectus or letter of offer after vetting by SEBI to timely despatch of share certificates or refund orders. To ensure proper disclosure and to bring about transparency in the primary market with a view to protect investors interests SEBI has issued M.B. Regulations.

The M.B. Regulations which seek to regulate the raising of funds in the primary market would assure for the issuer a market for raising resources at low cost, effectively and easily, ensure a high degree of protection of the interests of the investors and provide for the merchant banker a dynamic and competitive market with high standard of professional competence, honesty, integrity and solvency. The regulations would promote a primary market which is fair, efficient, flexible and inspires confidence.

The Regulations stipulate that any person or body proposing to engage in the business of merchant banking or presently engaged as managers, consultants or advisors to issue would need authorization by securities and exchange board of India.
The Notification of the Ministry of Finance defines a merchant banker as, "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management."

The authorised activities would include issue management which consists of preparation of prospectus and other information relating to the issue, determining financing structure, tie-up of finances and final allotment and/or refund of subscription, corporate advisors to the issue, managers, consultants or advisors to issue and underwriting. Other authorised activities would be portfolio management services.

The criteria for authorization take into account (a) professional qualification in finance, law or business management, (b) infrastructure like adequate office space, equipment and manpower, (c) employment of two persons who have the experience to conduct the business of merchant bankers, (d) capital adequacy and (e) past track record, experience, general reputation and fairness in all their transactions.
In regard to existing merchant banking outfits, SEBI fixed 3 months ceiling within which the authorisation has to be obtained.

Terms of authorisation are:

Merchant banks for the first three categories must have a minimum net worth of Rs.1 crore/Rs.50 lakhs/Rs.20 lakhs respectively. For fourth category no net worth is prescribed.

Authorisation is valid for an initial period of 3 years.

An initial authorisation fee, an annual fee and renewal fee may be collected by SEBI.

All issues should be managed by atleast one authorised merchant banker, functioning as the sole manager or lead manager. The number of lead merchant managers for issues upto Rs.50 crores is restricted to two. For larger issues of Rs.400 crores and above the number could go up to five. Lead merchant banker is not essential where the issue does not exceed Rs.50 lakhs.

The specific responsibilities of each lead manager must be submitted to SEBI prior to the issue.
Merchant bankers are expected to exercise due diligence independently. They should verify the contents of the prospectus and reasonableness of the views expressed therein. Merchant bankers of the issue shall certify to this effect to SEBI.

The M.B.Regulations integrate issue management with underwriting in order to ensure, a stake of merchant bankers in the issue managed by them. Lead managers to the issue are required to accept a minimum of 5 per cent underwriting obligation or Rs.25 lakhs in the issue subject to a ceiling.

The M.B.Regulations ensure involvement of merchant bankers in post issue management even where those activities are handled by other intermediaries. They would be responsible for ensuring timely refunds and allotment of securities to the investors and listing of the instrument on the stock exchange.

Merchant bankers have to submit to SEBI whatever information, documents, returns and reports as may be prescribed and called for.

Merchant bankers have to adhere to a code of conduct prescribed by SEBI.
The authorisation of merchant bankers may be suspended or cancelled for suitable duration in case of violation of the guidelines. A procedure for appeal to Government of India has also been prescribed against the orders of SEBI.¹

The Registrar of Companies (ROC) has also been advised that prospectus for public issue can only be filed by merchant bankers who are authorised by SEBI and given a code number. Further the Registrar of Companies is required not to register a prospectus where he has been informed by SEBI that the contents of the prospectus are in contravention of provisions of any law or statutory rules and regulations.

Merchant bankers are classified into four categories having regard to their nature and range of activities and their responsibilities to SEBI, investors and issuers of securities. The minimum net worth and initial authorisation fee depend on the category. The first category consists of merchant bankers who carry on any activity of issue management, which will inter alia consist of preparation of prospectus and other information relating to the issue, determining financial structure, tie-up of financiers and final allotment and refund of the subscrip-

¹ Securities and Exchange Board of India, Guidelines for Merchant Bankers, 7.11.1990.
tion and to act in the capacity of managers, advisor or consultant to an issue, portfolio manager and underwriter. The second category consists of those authorised to act in the capacity of co-manager, advisor, consultant, underwriter to an issue or portfolio manager. The third category consists of those authorised to act as underwriter, advisor or consultant to an issue. The fourth category consists of merchant bankers who act as advisor or consultant to an issue.

**Net worth**

Minimum net worth for first category is Rs. 1 crore, second category Rs. 50 lakhs, third category Rs. 20 lakhs and fourth category nil.

**Registration fee**

Registration fees for first category is Rs. 2.5 lakhs annually in the first two years, Rs. 1 lakh in third year, second category Rs. 1.5 lakhs annually for first two years and Rs. 50000 in third year, third category Rs. 1 lakh annually for the first two years and in third year Rs. 25000; and fourth category Rs. 5000 annually for first two years and Rs. 1000k in third year.
Renewal Fees

Category I, Rs.1 lakh to be paid annually in first two years and thereafter Rs.20000; Category II Rs.75000 for first two years and Rs.10000 from third year; Category III Rs.50000 first two years and Rs.5,000 third year and Category IV Rs.5000 annually first two years and Rs.2500 from third year.

Number of Lead Managers

The number of lead managers depends on the size of the public issue. The guidelines stipulate that for an issue up to Rs.50 crores, the number of lead managers should not exceed two, for issues between Rs.50-100 crores maximum of three, for issues between Rs.100-200 crores, four, for issues above Rs.200 crores but less than Rs.400 crores, five, and for issues above Rs.400 crores, five or as may be agreed by SEBI.¹

The code of conduct stipulates the performance of duties as merchant banker, act in an ethical manner, inform the client that he is obliged to comply with the code of conduct, render high standard of service and exercise due diligence, not to indulge in unfair practices, not to make

misrepresentations, give best advice, not to divulge confidential information about the clients, endeavour to ensure that true and adequate information is provided to investors and to abide by all rules, regulations, guidelines, resolutions issued by the Government of India and SEBI from time to time.

Maintenance of books of accounts, records and documents; merchant bankers have to keep and maintain a copy of the balance sheet, a copy of the auditor's report and a statement of financial position. Merchant bankers should inform SEBI where the accounts, records and documents are maintained.

Merchant bankers have to furnish annually to SEBI copies of balance sheet, profit and loss account and such other documents for any other preceding five accounting years as required.

Merchant bankers are required to submit SEBI half yearly working results with a view to monitor their capital adequacy. Books, records and documents should be preserved for five years. Auditor's report should be acted upon within two months. Merchant bankers should execute an agreement with the issuing company setting out their mutual
rights, liabilities and obligations relating to such issue and in particular to disclosures, allotment and refund.

Lead managers should not agree to manage any issue unless his responsibilities relating to the issue mainly disclosures, allotment and refund are clearly defined. A statement specifying such responsibilities should be furnished to SEBI.

Underwriting Obligations

Lead merchant banker in Category I should accept a minimum underwriting obligation of five per cent of the total underwriting commitment or Rs.25 lakhs whichever is less.

Submission of Due Diligence Certificate

A due diligence certificate about verification of contents of prospectus or the letter of an offer in respect of an issue and the reasonableness of the views expressed therein should be submitted to SEBI at least two weeks prior to the opening of an issue by the lead merchant banker.

Documents to be submitted to SEBI by Lead Manager

The lead manager should submit to SEBI, (a) particulars of the issue, draft prospectus or letter of offer,
(b) any other literature intended to be circulated to the investors including the shareholders and (c) such other documents relating to prospectus or letter of offer as the case may be. These documents should be furnished at least two weeks before filling the draft prospectus or letter of offer with ROC or with Regional Stock Exchange. The lead manager has to ensure that modifications suggested by SEBI are incorporated. The lead manager undertaking the responsibility for refunds or allotment of securities in respect of any issue should continue to be associated with the issue till the subscribers have received share certificate or refund of excess application money.

Merchant bankers either directly or indirectly are prohibited from entering into any transaction in securities on the basis of unpublished price sensitive information.

**Acquisition of shares**

Merchant Bankers should submit to SEBI particulars of any transaction for acquisition of securities of a company whose issue is managed by them within 15 days from the date of entering into such transaction.

As and when required by SEBI, merchant banker has to disclose his, (a) responsibilities with regard to the management of the issue, (b) any change in information
furnished which have a bearing on the certificate granted, 
(c) the names of the companies whose issue he has managed, 
(d) breach of capital adequacy and (e) his activities as a 
manager, underwriter, consultant or adviser to an issue.

Inspection

SEBI may inspect books of accounts, records and documents of merchant bankers to ensure that the books of account are maintained in the required manner, that the provisions of the Act, rules, regulations are being complied with, to investigate complaints against the merchant banker and to investigate suo moto in the interest of securities business or investors interest into the affairs of the merchant banker. SEBI may either give reasonable notice or undertake inspection without notice in the interest of investor.

The findings of inspection report are communicated to merchant banker. SEBI may appoint a qualified auditor to investigate into the books of account or the affairs of merchant banker.

Penalties for non-compliance of conditions for registration and contravention of the provisions of the MB regulations include suspension or cancellation of registration.
SEBI categorised defaults as under penalty points

<table>
<thead>
<tr>
<th>Penalty points</th>
<th>General defaults</th>
<th>Minor defaults</th>
<th>Major defaults</th>
<th>Serious defaults</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td></td>
</tr>
</tbody>
</table>

For the purpose of penalty point, the following activities are categories under general defaults and attract one Penalty point.

Non receipt of draft prospectus/letter of offer from the lead manager by SEBI, before filing with Registrar of Companies/Stock exchanges.

Non receipt of inter-se allocation of responsibilities of lead managers in an issue by SEBI prior to the opening of issue.

Non receipt of due diligence certificate in prescribed manner by SEBI, before opening of the issue.

Failure to ensure submission of certificate of minimum 90 per cent subscription to the issue as required under-Government of India, press note No.F2/14/cc1/90 dated 6th April 1990.
Failure to ensure publicising of despatch of refund orders, shares/debentures certificates, filing of listing application by the issuer as required under Government of India press notification No.2/6/ccil89 dated 10.1.1990.

The following activities are categorised under minor defaults and attract two penalty points.

Advertisement, circular, brochure, press release and other issue related materials not being in conformity with contents of the prospectus.

Exaggerated information or information extraneous to the prospectus is given by issuer or associated merchant banker in any press conference, investor conference, brokers conference or other such conference/meet prior to the issue for marketing of the issue arranged/participated by the merchant banker.

Failure to substantial matters contained in highlights to the issue in the prospectus.

Failure to exercise due diligence in verifying contents of prospectus/letter of offer.

Failure to provide adequate and fair disclosure to investors and objective information about risk factors in the prospectus and other issue literature.

Delay in refund/allotment of securities.

Non handling of investors grievances promptly.

The following activities are categorised under major defaults and attract three penalty points.

Mandatory underwriting not taken up by lead manager.

Excess number of lead managers than permissible under SEBI press release of 28th February, 1991.

Association of unauthorised merchant banker in an issue.

The following activities are categorised under serious defaults and attract four penalty points.

Unethical practice by merchant banker and/or violation of code of conduct.
Non co-operation with SEBI in furnishing desired information, documents, evidence as may be called for.

A merchant banker on reaching cumulative penalty points of eight (8) attracts action from SEBI in terms of suspension/cancellation of authorisation.

To enable a merchant banker to take corrective action, maximum penalty points awarded in a single issue managed by a merchant banker are restricted to four.

In the event of joint responsibility, same penalty point is awarded to all lead managers jointly responsible for the activity. In the absence of receipt of inter se allocation of responsibilities, all lead managers to the issue are awarded the penalty point.

If highlights are provided, the following deficiencies will attract negative points.

Absence of risk factors in highlights.

Absence of listing in highlights.

Extraneous contents to prospectus, if stated in highlights.

The maximum grading points of prospectus will be 10 and prospectuses scoring greater than or equal to 8
points are categorised as $A^+$ those with 6 or less than 8 points as $A$, with 4 or less than 6 points as $B$ and with score of less than 4 points, the prospectus falls in category $C$.

\[
\begin{array}{ccc}
\geq & 8 & A^+ \\
< & 8 \geq 6 & A \\
< & 6 \geq 4 & B \\
< & 4 & C
\end{array}
\]

Merchant bankers are advised to take note of the above system of prospectus grading, and should endeavour to give fair and adequate disclosures in prospectus for the benefit of investors.

If at all "Highlights" are provided in an issue:

Risk factors, should form part of Highlights, otherwise it will attract negative point of $-1$.

Listing details, should form part of "Highlights", otherwise it will attract negative point of $-0.5$.

Any matter extraneous to the contents of the prospectus, if stated in highlights, will attract negative point of $-0.5$. 
SECTION II: CORPORATE SECURITIES PATTERN

"Securities represent claims on a stream of income and/or particular assets". Debentures are debt securities. Market loans are raised by Government of India, State Government and public sector institutions through issue of debt securities. Equity shares in corporate sector or privatised public sector undertakings are ownership securities. Preference share is a hybrid security that entails a mixture of both ownership and creditorship privileges.

The issue of debentures by public limited companies is regulated by Companies Act 1956. Debenture is a document which either creates a debt or acknowledges it and any document which fulfills either of these conditions is a debenture. Debenture are issued through a prospectus. A debenture is issued by a company and is usually in the form of a certificate which is an acknowledgement of indebtedness. They are issued under the company's seal. Debentures are one of a series issued to a number of lenders. The date of repayment is invariably specified in the debenture. A company can however issue perpetual or

---

irredeemable debentures. Generally debentures are issued against a charge on the assets of the company. Debentures may, however, be issued without any such charge. Debenture holders have no right to vote in the meetings of the company. Section 117 of the Companies Act prohibits issue of debentures with voting rights. Debentures can be issued at discount. Particulars of discount are to be filed with Registrar of companies.

Bearer Debentures

They are registered and are payable to its bearer. They are negotiable instruments and are transferable by delivery.

Registered Debentures

They are payable to the registered holder whose name appears both on debenture and in the register of debenture holders maintained by the company. Registered debentures can be transferred but have to be registered again. Registered debentures are not negotiable instruments. A registered debenture contains a commitment to pay the principal sum, interest, description of the charge and a statement that it is issued subject to the conditions endorsed therein.
Debentures which create a charge on the assets of the company which may be fixed or floating are known as secured debentures.

Debentures which are issued without any change on assets are unsecured or naked debentures. The holders are like unsecured creditors and may sue the company for recovery of debt.

Normally debentures are issued on the condition that they shall be redeemed after a certain period. They can, however, be reissued after redemption under Section 121 of Companies Act 1956.

When debentures are irredeemable they are called perpetual.

If an option is given to convert debentures into equity shares at stated rate of exchange after a specified period, they are called convertible debentures. In our country the convertible debentures are very popular. On conversion, the holders cease to be lenders and become owners.

Debentures are usually issued in a series with a pari passu (at the same rate) clause which entitles them to
be discharged rateably though issued at different times. New series of debentures cannot rank pari passu with old series unless the old series provide so.

New debt instruments issued by public limited companies are participating debentures, convertible debentures with options, third party convertible debentures, convertible debentures redeemable at premium, debt equity swaps, zero coupon convertible notes, secured premium notes (SPNs) with detachable warrants, non-convertible debentures (NCDs) with detachable equity warrants, zero interest fully convertible debentures (FCDs) secured zero interest partly convertible debentures (PCDs) with detachable and separately tradeable warrants and fully convertible debentures (FCDs) with interest (optional).

They are unsecured corporate debt securities which participate in the profits of a company. They might find investors if issued by existing dividend paying companies.

They are a derivative of convertible debentures with an embedded option, providing flexibility to the issuer as well as the investor to exit from the terms of the issue. The coupon rate is specified at the time of issue.
They are debt with a warrant allowing the investor to subscribe to the equity of a third firm at a preferential price vis-a-vis the market price. Interest rate on third party convertible debentures is lower than pure debt on account of the conversion option.

Convertible debentures are issued at face value with a put option entitling investors to later sell the bond to the issuer at a premium. They are basically similar to convertible debentures but embody less risk.

Debt-equity swaps are an offer an issuer of debt to swap it for equity. The instrument is quite risky for the investor because the anticipated capital appreciation may not materialise.

A zero coupon convertible note can be converted into shares. If choice is exercised investors forego all accrued and unpaid interest. The zero coupon convertible notes are quite sensitive to changes in interest rates.

SPN, which is issued along with a detachable warrant, is redeemable after a notified period, say, 4 to 7 years. The warrants attached to it ensure the holder the right to apply and get allotted equity shares, provided SPN is fully paid.
There is a lock-in-period for SPN during which no interest will be paid for the investment amount. The SPN holder has an option to sell back the SPN to the company at par value after the lock-in-period. If the holder exercises this option, no interest/premium will be paid on redemption. In case, the SPN holder holds it further, the holder will be repaid the principal amount along with additional amount of interest/premium on redemption in instalments, as decided by the company. The conversion of detachable warrant into equity shares will have to be done within the time limit notified by the company.

The holder of NCDs with detachable equity warrants is given an option to buy a specific number of shares from the company at a pre-determined price within a definite time frame.

The warrants attached to NCDs will be issued subject to full payment of NCDs value. There is a specific lock-in-period after which the detachable warrant holders have to exercise their option to apply for equities. If the option to apply for equities is not exercised, the unapplied portion of shares would be disposed off by the company at its liberty.
The investors in zero interest fully convertible debentures will not be paid any interest. However, there is a notified period after which fully paid FCDs will be automatically and compulsorily converted into shares.

There is a lock-in-period up to which no interest will be paid. Conversion is allowed only for fully paid FCDs. In the event of company going for rights issue prior to the allotment of equity resulting from the conversion of equity shares into FCDs, FCD holders shall be offered securities as may be determined by the company.

This instrument has two parts—part A is convertible into equity shares at a fixed amount on the date of allotment and part B non-convertible, to be redeemed at par at the end of a specific period from the date of allotment. Part B will carry a detachable and separately tradeable warrant which will provide an option to the warrant holder to receive equity share for every warrant held at a price as worked out by the company.

This instrument will not yield any interest for a short period, say 6 months, after this period, option is given to the holders of FCDs to apply for equities at premium for which no additional amount needs to be paid.
This option needs to be indicated in the application form itself. However, interest on FCDs is payable at a determined rate from the date of first conversion to second/final conversion and in lieu of it equity shares will be issued.

**Object of Issues**

Guidelines apply only to issue of secured debentures by public limited companies to public. The object of the issue could be to raise long term funds to finance expansion/diversification or augment funds for working capital.

**Quantum**

Amount depends, for project finance, on the approval of the scheme by financial institution. In the case of working capital the debenture issue should not exceed 20 per cent of the gross current assets, loans and advances.

**Debt-Equity Ratio**

Debt-equity ratio is stipulated at 2:1 except in the case of capital intensive industries like fertilizers, petrochemicals, cement, paper and shipping.
Interest Rate

Interest payable on debentures has been deregulated since 1991. In 1993, 17 per cent is being offered on nonconvertible and 15 per cent on convertible debentures.

Maturity

Debentures are not redeemable before the expiry of seven years.

Value

The face value of debentures is ordinarily is Rs.100.

Listing

The debentures should be listed on the Stock Exchange.

Listing and Par Value

The company proposing the issue of debentures should be listed and its equity shares should have been quoted at or above par during the six months prior to the date of application for issue of debentures.
Underwriting

All debentures issued to public should be underwritten.

Secured Debentures

These are permitted to be issued.

Trust Deed

To protect the interests of debenture holders, trustees are appointed, to whom the property charged is conveyed through a trust deed. The trust deed contains the terms and conditions endorsed in the debenture and defines the right of debenture holders and the company. Under the trust deed, trustees are empowered to appoint a receiver to protect the property charged if the company defaults in payment of principal and interest. The trust deed also covers matters such as meeting of the debenture holder, supervision of the assets charged and the maintenance of a register of debenture holders.

In the case of unsecured debenture holder, who is like an unsecured creditor, two remedies are available. He may sue for recovery of his principal and interest or petition under Section 439 of Companies Act for the winding up of the company on the ground that the company is unable to pay its debts specified in Section 433(e).
Sections 56(3), 292 and 293(1) D of the Companies Act regulate the issue of debentures. On the authority of the articles of the company to issue debentures a resolution should be passed for issue of debentures by the Board of Directors. Such an issue needs the approval of the general body if the borrowing under debenture (past and present) exceeds the total paid-up capital and reserves of the company. Paripassu charge should be filed with the Registrar within 30 days of executing the charge. Copy of the certificate of registration relating to the charge issued by Registrar is endorsed on every debenture certificate. The prospectus in the case of a new company or a statement in lieu of prospectus in the case of an existing company has to be filed within three days before allotment with the Registrar. Application for listing should be made before 10th day after the issue of prospectus.

The total value of debentures listed on all stock exchanges in India amounted to Rs.16600 crores in 1990-91 constituting 53 per cent of the total capital issued, (debentures, preference and equity); and in terms of market value at Rs.16800 crores they showed very little appreciation. Market value of debentures as a proportion of total capital amounted only to 16.8 per cent (Table 3).
### TABLE 3

**PAID-UP VALUE AND MARKET VALUE OF LISTED STOCK ON ALL STOCK EXCHANGES IN INDIA**

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of listed companies</th>
<th>Paid-up Value (Rs. crores)</th>
<th>Market Value (Rs. crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Equity</td>
<td>Preference</td>
</tr>
<tr>
<td>1986-87</td>
<td>4744</td>
<td>7142</td>
<td>222</td>
</tr>
<tr>
<td>1987-88</td>
<td>5560</td>
<td>8941</td>
<td>191</td>
</tr>
<tr>
<td>1988-89</td>
<td>5841</td>
<td>10549</td>
<td>176</td>
</tr>
<tr>
<td>1989-90</td>
<td>5968</td>
<td>12681</td>
<td>197</td>
</tr>
<tr>
<td>1990-91</td>
<td>6100</td>
<td>14500</td>
<td>190</td>
</tr>
</tbody>
</table>

Source: The Bombay Stock Exchange
There is hardly any trading once the debentures are converted. It may be noted that debenture market became active only when convertible debentures arrived on the scene a decade ago. A major reason for the unpopularity was the fixed rate of interest. Since 1991 the rate payable on debentures has been left to market. At the end of 1993 about 70 debentures are being traded on the Bombay Stock Exchange. Of the 70 securities, only 42 have CRISIL/ICRA rating (credit rating has been mandatory since August 1991). Of the rated debentures being traded, only 18 have current yield of 18 per cent.

**Interest and Yield on Debentures**

No matter what happens, interest payments and repayment of principal at maturity have to be made to debenture holders. But they would be irrational if they ignore alternative investments which bring in a higher return. If the investor knows the price of a debenture and its characteristics, he can infer a rate of return called Yield to Maturity (YTM). Yield means the return on investment at current market price. It is expressed as

\[
\text{Rate of return} \times \frac{\text{Face Value}}{\text{Current market price}} = \text{Yield per cent}
\]
TABLE 4*

COMPARISON OF PAR, BOOK AND MARKET VALUE OF SHARES OF SELECT COMPANIES

<table>
<thead>
<tr>
<th>Company</th>
<th>Par per share</th>
<th>Cash dividend per share</th>
<th>Book Value per share</th>
<th>No. of Shares (000)</th>
<th>52 Wk H/L</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACC</td>
<td>100</td>
<td>30%</td>
<td>420</td>
<td>73</td>
<td>4000/1750</td>
</tr>
<tr>
<td>Bombay Dyeing</td>
<td>10</td>
<td>30%</td>
<td>73.69</td>
<td>59</td>
<td>597.50/217.5</td>
</tr>
<tr>
<td>Essar Gujarat</td>
<td>10</td>
<td>27.5%</td>
<td>42</td>
<td>549</td>
<td>180/42.50</td>
</tr>
<tr>
<td>Glaxo India</td>
<td>10</td>
<td>18%</td>
<td>40.5</td>
<td>82</td>
<td>323/140</td>
</tr>
<tr>
<td>Hindustan Lever</td>
<td>10</td>
<td>42%</td>
<td>20.75</td>
<td>143</td>
<td>415/285</td>
</tr>
<tr>
<td>ITC</td>
<td>10</td>
<td>50%</td>
<td>10.15</td>
<td>151</td>
<td>645/360</td>
</tr>
<tr>
<td>Larsen &amp; Toubro</td>
<td>10</td>
<td>35%</td>
<td>10.4</td>
<td>133</td>
<td>273/145</td>
</tr>
</tbody>
</table>
The yield works out more than the rate of interest if market price is below par value; and less than the rate of interest when the market price is higher than par value. Risky debentures have to pay higher yields to maturity to attract investors. Yield to maturity is more significant than the coupon rate to debenture investors. If the debenture is selling at a discount, its market price is below its face value. Its yield to maturity exceeds coupon rate. If it is selling at a premium the market price is above its face value and the coupon rate is higher than yield to maturity. Yield to maturity and average rate of return compounded annually to maturity refer to effective rate of return if held to maturity.

EQUITY SHARES

Nature

Equity shares represent proportionate ownership of a company. This right is expressed in the form of participating in the profits of a going company and sharing the assets of after winding-up. Equity shares have lowest priority claim on earnings and assets of all securities issued. But they have unlimited potential for dividend payments and price appreciation. In contrast, owners of
debentures and preferred shares enjoy an assured return in the form of interest and dividend. As a result of this risk, investors are unwilling to invest in equity shares unless they offer a rate of return sufficiently high to induce investors to assume the possible loss.

When investors buy equity shares either through subscription to a public issue or through stock exchange from an existing owner, they obtain a share certificate as proof of their part as owners of the firm. A share certificate states the number of shares registered in the name of the share owner and their paid-up value apart from certificate number and folio number. In the case of shares purchased through stock exchange, the new owner's name is entered on the rear of the certificate.

**Equity Share with Detachable Warrant**

A hybrid equity instrument introduced in 1992-93 is equity share with detachable warrants. Detachable warrants are issued along with fully paid equity shares which will entitle the warrant holder to apply for a specified number of shares at a determined price. Detachable warrants are separately registered with stock exchanges and traded separately. The terms and conditions
relating to issue of equity against warrants would be determined by the company.

Companies Act (Sections 87 to 89) deals with the voting rights of a share owner. An equity share owner has a right to vote on every resolution placed before the company. The voting rights are proportional to the share owner's share of paid-up capital of the company. All shares carry proportionate rights. No company can issue shares which carry voting rights disproportionate to the rights attached to the holders of other issues. Voting rights cannot, however, be exercised in respect of shares on which a call or any other sum due to the company has not been paid.

It may be noted that the word capital in share capital is used to mean nominal, authorized or issued or paid-up capital.

Nominal or authorized Capital is the maximum capital the memorandum envisages for the company unless it is changed. The memorandum also specifies the division of authorized capital into shares of fixed amount.

Issued capital is the nominal value of shares offered for public subscription. In case all shares offered for public subscription are not taken up the position subscribed, is subscribed capital which is less than issued capital.
Paid-up capital is the share capital paid-up by share owners or which is credited as paid-up on the shares.

Par Value is the face value of a share. It does not tell anything about the value of shares.

Book value is determined by deducting total liabilities including preference shares from total assets and the difference which is equal to shareholder equity with the number of equity shares outstanding.

**Cash Dividends**

A stable cash dividend payment was believed to be the basis for the increase in company's share prices. Growth oriented firm retains as much capital as possible for internal financing. Capital appreciation rather than dividends is what an investor has to look for in their case. Old established firms tend to pay out large proportion of their earnings as dividends.

Bonus shares (or stock dividends): Bonus shares are dividends paid in shares instead of cash. Bonus shares are issued by capitalising reserve. While net worth remains the same in the balance sheet its distribution between shares and surplus is altered. The New York Stock Exchange, however, classifies distribution of shares under 25 per cent
per share (1 bonus for 4 shares held) as stock dividend and distribution over 25 per cent as stock splits.

**Alteration of Share Capital**

If the Articles of Association authorise, a limited company can (i) increase share capital by issue of new shares, (2) consolidate and divide all or any part of its share capital into shares of larger amount, (3) convert fully paid-up shares into stock or vice versa, (4) subdivide shares into shares of smaller amount and (5) cancel shares which have not been subscribed (does not constitute reduction of share capital). Under Section 95, notice of alteration of capital should be sent to Registrar of Companies (ROC) within 30 days.

**Increase of Subscribed Capital**

Increase in the subscribed capital of a company may occur by allotment of further shares and by conversion of debentures or loans into shares. Increase in subscribed capital by issue of new shares should be offered in proportion to existing shares held by shareholders.

**PREFERENCE SHARES**

Preference shares carry preferential rights in comparison with ordinary shares. As a rule, preference
share holders enjoy a preferential right to dividend. As regards capital, it carries on the winding up of a company a preferential right to be repaid the amount of capital paid-up on such shares.

Preference shares are of two types, cumulative and non-cumulative. In the case of cumulative preference share, if there is no profit in any year, the arrears of dividend are carried forward and paid in the following years out of profits before any dividend is paid on ordinary shares. No such carry forward provision exists for non-cumulative preference shares.

If the articles of association provide that a preference share holder will also have the right to participate in surplus profits or surplus assets on the liquidation of a company or in both, such preference share holders would be called participating preference shareholders.

Redeemable preference shares are paid back to the shareholders out of the profits or out of the proceeds of new issues of shares. But in the case of irredeemable preference shares the amount that is fully paid is never returned. The shares have to state clearly that they are redeemable. It should be noted that redeemable
preference shares are not shares in the strict sense of the term. Since they are repayable, they are similar to debentures. Only fully paid shares are redeemed. Where redemption is made out of profits, a Capital Redemption Reserve Account is opened to which a sum equal to the nominal amount of the shares redeemed is transferred. It is treated as paid-up share capital of the company.

Two innovative types of preference shares were introduced into the market in 1992-93. These are fully convertible cumulative preference shares (Equipref) and preference shares with warrants attached.

Equipref has two parts: A and B. Part A, is convertible into equity shares automatically and compulsorily on the date of allotment without any further act or application by the allottee and Part B will be redeemed at par/converted into equity shares after a lock-in-period at the option of the investors.

Conversion into equity shares after the lock-in-period will take place at a price which would be 30 per cent lower than the average market price. The average market price shall be the average to the monthly high and low price of the shares in a stock exchange for a period of six months.
to the date of conversion including the month in which the conversion would take place.

The dividend on fully convertible cumulative preference shares shall be fixed and shall be given only for the portion that represents part B shares. Upon conversion of each part of the equipref shares, the face value of it will stand reduced proportionately and the equipref shares shall be deemed to extent of each part on their respective dates of conversion.

Under this instrument, each preference share should carry certain number of warrants entitling the holder to apply for equity shares for cash at premium at any time in one or more stages between the third and fifth year from the date of allotment. If the warrant holder fails to exercise his option, the unsubscribed portion will lapse. The holders of warrants would be entitled to all rights/bonus shares that may be issued by the company. From the date of allotment, the preference shares will warrants attached would not be transferred/sold for a period of three years.

A transfer of shares is complete as soon as the name of the transferee is substituted in place of transferor
in the register of members. The procedure for transfer of share or debenture has been laid down in Sections 108, 110 and 111 of the Companies Act.

There are two kinds of transfer: (a) a transfer under a proper instrument of transfer duly stamped and executed by the transferor and transferee; and (b) transmission by operation of law. Shares may change hands either inter vivos or by operation of law. The first is called transfer and the second transmission. Transfer means a transaction by the act of the parties whereas transmission means a transaction by operation of law. Transmission occurs on death or bankruptcy of owner.

Another form of transfer of shares is blank transfer. It must be made in prescribed form and delivered to the company for registration within the prescribed time.

Table 5 presents the growth pattern of listed stock in selected years in all stock exchanges in India. Equity shares of 6480 companies were listed in 1992 on the 21 stock exchanges in India. The paid-up value of the equity shares in 1990-91 was Rs.14500 crores and market value Rs.82870 crores. Equity shares accounted for 46.3 per cent of listed capital on all stock exchanges in 1990-91;
TABLE 5

GROWTH PATTERN OF LISTED STOCK IN SELECTED YEARS (ALL STOCK EXCHANGES IN INDIA)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. No. of Stock exchanges</td>
<td>7</td>
<td>7</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>14</td>
<td>20</td>
<td>21</td>
</tr>
<tr>
<td>2. No. of listed companies</td>
<td>1125</td>
<td>1203</td>
<td>1599</td>
<td>1852</td>
<td>2265</td>
<td>4344</td>
<td>6229</td>
<td>6480</td>
</tr>
<tr>
<td>3. No. of Stock issues of listed companies</td>
<td>1506</td>
<td>2111</td>
<td>2838</td>
<td>3230</td>
<td>3697</td>
<td>6174</td>
<td>8967</td>
<td>9642</td>
</tr>
<tr>
<td>4. Capital of listed companies (Cr. Rs.)</td>
<td>2.70</td>
<td>7.53</td>
<td>18.12</td>
<td>26.14</td>
<td>39.73</td>
<td>97.23</td>
<td>320.41</td>
<td>407.96</td>
</tr>
<tr>
<td>5. Market value of capital of listed companies (Rs.cr)</td>
<td>9.71</td>
<td>12.92</td>
<td>26.75</td>
<td>32.73</td>
<td>67.50</td>
<td>253.02</td>
<td>1102.79</td>
<td>3541.06</td>
</tr>
<tr>
<td>6. Capital per listed company (Lakh Rs.)</td>
<td>24</td>
<td>63</td>
<td>113</td>
<td>141</td>
<td>175</td>
<td>224</td>
<td>357</td>
<td>423</td>
</tr>
<tr>
<td>7. Market Value of Capital per listed company (Lakh Rs.)</td>
<td>86</td>
<td>107</td>
<td>167</td>
<td>177</td>
<td>298</td>
<td>582</td>
<td>1230</td>
<td>3673</td>
</tr>
</tbody>
</table>

contd...
Table 5 contd..

<table>
<thead>
<tr>
<th>As on 31st December</th>
<th>% increase in 1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. No. of Stock Exchange</td>
<td>185</td>
</tr>
<tr>
<td>2. No. of listed companies</td>
<td>476</td>
</tr>
<tr>
<td>3. No. of stock issues of Listed Companies</td>
<td>540</td>
</tr>
<tr>
<td>4. Capital of listed companies (Cr. Rs.)</td>
<td>15009</td>
</tr>
<tr>
<td>5. Market value of capital of listed companies (Rs. Cr.)</td>
<td>36368</td>
</tr>
<tr>
<td>6. Capital per listed company (Lakh Rs.)</td>
<td>1663</td>
</tr>
<tr>
<td>7. Market value of capital per listed company (Lakh Rs.)</td>
<td>4170</td>
</tr>
</tbody>
</table>

and market value of equity accounted for 82.9 per cent of the market value of listed capital.

The listed value of preference shares listed on all stock exchanges was Rs.190 crores in 1990-91 and the market value was Rs.185 crores.

The debt issues of the Union and State Governments have increased enormously in absolute terms as well as on a per capita basis in the last decade. The growing imbalance between current revenues and expenditure has been financed by borrowing. Of the total outstanding debt of Rs.436160 crores at the end of 1993-94 of the Central Government, 42.3 per cent consists of non-marketable issues. Marketable issues (other than treasury bills) of Rs.85383 crores make up 19.6 per cent of total outstanding debt. Of the marketable debt, about 85 per cent is over 10 years, 6 per cent 5-10 years and 9 per cent below 5 years. The total outstanding marketable debt of the state governments at the end of March 1992 was Rs.18640 crores. The yield on government securities was 13 per cent on 15 year securities and 12 to 12.75 per cent on 10 year securities.

The market for central and state securities is a captive market. Government securities are purchased by banks to meet statutory liquidity requirements and provident
funds and insurance to adhere to the investment pattern stipulated. Commercial banks hold 58 per cent of central and state government securities; life insurance, 11.7 per cent; provident funds 1.4 per cent and Reserve Bank of India 18.7 per cent (Central securities).

The dealings in government securities markets are mainly in the nature of repurchase agreements or REPOS between money market desks of large commercial banks especially in public sector and brokerage houses. REPOS are instruments used by securities dealers to help finance part of their multi crore inventories of marketable securities for one or few days. In our country, repurchase options or ready forward transactions gained tremendous importance due to their short tenure and flexibility which suit both lender and borrower. Under these transactions the borrower places with lender certain acceptable security against funds received and agrees to reverse the transaction on a predetermined future date at agreed cost. The period in practice ranges from fortnight to one year. The interest is market determined and built into the REPO transaction. REPO transactions are undertaken between commercial banks, financial institutions, security brokers and Discount and Finance House of India (DHFI). The REPOS in other than
treasury bills have been banned after the security scam. The banks which did not have adequate securities to meet SLR requirements used fictitious bank receipts (BRs) and SGL notes (receipts issued by RBI evidencing ownership of securities) in their REPO transactions which led to irregularities and scam. Consequently, they have been banned.