INTRODUCTION
INTRODUCTION

Main Headings:

- Indian Financial system: An Overview
- Securities Markets in India: an Overview
- Capital Markets: Role
- Need for Regulations and Reforms
- Section - I : Capital Market Regulations
- Section - II : Provisions of Securities Laws
- Section - III : Policies and Programmes
- Section - IV : Primary Securities Market
- Section - V : Disclosure Requirements
- Section - VI : Principal Steps of a Public Issue

- References:
- Annexures:
INTRODUCTION

The recent thrust towards liberalizing economic and financial policies have brought about a phenomenal growth in the securities industry in India. Their importance in the economy is expected grow even further in the coming years with an increasing proportion of household savings getting invested in corporate and other securities. In fact, securities markets in India have grown exponentially in the past fifteen years, as judged by the number of issues, capital raised, market capitalization, trading volumes as well as price indices. The number of investors, intermediaries, and stock exchanges have also seen a significant increase. As economy grows, securities markets are being increasingly relied upon by the private corporate sector, by public sector units and by banks for raising funds. While the investor profile continues to be dominated by middle class individuals, trends towards institutionalization in the securities markets are becoming evident. With the opening of the Mutual Fund Industry to the private sector and the advent of foreign portfolio investment, Indian securities industry is set to continue their rapid growth. The healthy development of securities markets with appropriate degree and manner of regulation will be an immense importance in the coming years on account of their role in meeting the need for greater investment.¹

INDIAN FINANCIAL SYSTEM: AN OVER VIEW

The Indian financial system is a vast universe. This universe is regulated and supervised by two Government agencies under ministry of finance viz., RBI, SEBI. All parts of the system are interconnected with one another, and the jurisdictions of the central bank and the capital market regulator overlap in some fields of Indian financial activities.² The organized part of Indian financial system broadly classified from the point of view of regulators as:
Commercial Banks include the Public Sector banks, Private Banks and Foreign Banks. The RBI under the Banking Regulation Act and Negotiable Instruments Act regulates the Commercial Banks. Financial Institutions may be of all India level like IDBI, IFCI, ICICI, NABARD or sectoral financial institutions like EXIM, TFCIL etc. Term loan financing received a boost after the merger of Refinance Corporation of India limited with IDBI. IFCI was the first term lending institution to be set up. IDBI is the apex development financial institution set up to provide funds for the rapid industrialization in India.

The participants in the Foreign Exchange markets include banks, financial institutions and are regulated by the RBI. Primary Dealers are the registered participants of the wholesale debt market. They bid at auctions for Government Debt, Treasury Bills, which are then retailed to banks and financial institutions who invest in these papers to maintain their Statutory Liquidity Ratio (SLR).
SEBI was set up as an autonomous regulatory authority by the Government of India in 1988 "to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto." It is empowered by two acts namely the SEBI Act, 1992 and the Securities Contract (Regulation) Act, 1956 to perform the function of protecting investors rights and regulating the capital markets.

SECURITIES MARKETS IN INDIA: AN OVERVIEW

The process of economic reforms and liberalization was set in motion in the mid eighties and its pace was accelerated in 1991 when the economy suffered severely from a precariously low foreign exchange reserve, burgeoning imbalance on the external account, declining industrial production, galloping inflation and a rising fiscal deficit. The economic reforms, being an integrated process, included deregulation of industry, liberalization on foreign investment, regime, restructuring and liberalization of trade, exchange rate, and tax policies, partial disinvestment of Government holding in public sector companies and financial sector reforms. The reforms in the real sectors such as trade, industry and fiscal policy were initiated first in order to create the necessary macroeconomic stability for launching financial sector reforms, which sought to improve the functioning of banking and financial institutions (FIs) and strengthen money and capital markets including securities market. The securities market reforms were based on the recommendations of the Pherwani, Dave, Nadkarni and Narasimham Committees and the Standing High Level Committee on capital markets, and included measures for its liberalization, regulation and development. Specifically these included: repeal of the Capital Issues (Control) Act, 1947 through which Government used to expropriate and allocate resources from capital market for favoured uses; enactment of the Securities and Exchange Board of India (SEBI) to regulate and promote development of securities
market; setting up of NSE in 1993, passing of the Depositories Act, 1996 to provide for the
maintenance and transfer of ownership of securities in book entry form; amendments to the
Securities Contracts (Regulation) Act 1956 (SCRA) in 1999 provide for the introduction of futures
and option. Other measures included free pricing of securities, investor protection measures, use
of information technology, dematerialization of securities, improvement trading practices, evolution
of inefficient and transparent regulatory framework, emergency of several innovative financial
products and services etc. These reforms are aimed at creating efficient and competitive securities
market subject to effective regulation by SEBI, which would ensure investor protection.3

The corporate securities market in India dates back to the 18th century when the securities of the
East India Company were traded in Mumbai and Kolkotta. The brokers used to gather under a
Banyantree in Mumbai and under a neem tree in Kolkotta for the purpose however the beginning
came in the 1850s with the introduction of joint stock companies with limited liability. The 1860s
witnessed feverish dealings in securities and reckless speculation. This brought brokers in
Bombay together in July 1875 to form the first formally organized stock exchange in the country
viz., The Stock Exchange, Mumbai. Ahmedabad Stock Exchange in 1894 and 22 others followed
in the 20th Century.

BACKGROUND:4

Securities markets in India have a long history. The Bombay Stock Exchange (BSE) has its roots
in brokers coming together in the 1860’s to trade in shares issued by various companies. Other
groups also emerged in different parts of the country. These informal groups gradually grew into
stock exchanges of which the BSE, established in 1875, is the oldest. The stock exchanges were
brought under the central Government's regulation through the enactment of the Securities Contracts (Regulation) Act (SCRA), 1956.

The raising of capital from the securities markets was free from controls until the Second World War, when the Defense of India Rules were introduced, which imposed the first restrictions on the issue of capital. After independence, controls on capital issues continued and were formally incorporated in the Capital Issues (Control) Act, 1947. The office of the Controller of Capital Issues (CCI) administered the Act.

After 1947, the Government followed the policy of giving predominance to public sector enterprises in the economy. As part of this policy, various industries were nationalized and certain sectors of the economy were reserved for the public sector. As a consequence of this predominance of the public sector, enterprises in sectors such as coal, petroleum, power, banking, insurance, and transportation which provide some of the highest capitalized firms in other markets, did not access the securities markets in any significant way. Private sector corporations were restricted from investing in response to market forces by a system of industrial licensing. Their access to equity was restricted through the institution of the CCI and their debt requirements were met through loans from nationalized commercial banks and from public sector development banks. The regime of administered interest rates did not offer much incentive to access the securities markets for debt.

The process of reforms have led to a pace of growth almost unparalleled in the history of any country. Securities market in India has grown exponential as measured in terms of amount raised from the market, number of stock exchanges and other intermediaries, the number of listed stocks, market capitalization, trading volumes, turnover on stock exchanges, investor population and price
indices. Along with this, the profiles of the investors, issuers and intermediaries have changed significantly. The market has witnessed fundamental institutional changes resulting in drastic reduction in transaction costs and significant improvements in efficient, transparency and safety, thanks to the National Stock Exchange. Indian market is now comparable to many developed markets in terms of a number of parameters, as is seen from Table No. 5.

TABLE I

INTERNATIONAL COMPARISON: END MARCH 1995

<table>
<thead>
<tr>
<th>Particulars</th>
<th>USA</th>
<th>UK</th>
<th>JAPAN</th>
<th>GERMANY</th>
<th>INDIA</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of listed Companies</td>
<td>8450</td>
<td>2399</td>
<td>2416</td>
<td>741</td>
<td>9833</td>
</tr>
<tr>
<td>Market Cap ($MN)</td>
<td>13451352</td>
<td>2374273</td>
<td>2495757</td>
<td>1093962</td>
<td>147454</td>
</tr>
<tr>
<td>Market Cap Ratio (%)</td>
<td>173</td>
<td>193</td>
<td>52</td>
<td>47</td>
<td>38</td>
</tr>
<tr>
<td>Turnover ($MN)</td>
<td>13148480</td>
<td>1167382</td>
<td>948522</td>
<td>1390798</td>
<td>227171</td>
</tr>
<tr>
<td>Turnover Ratio (%)</td>
<td>106</td>
<td>53</td>
<td>40</td>
<td>145</td>
<td>154</td>
</tr>
</tbody>
</table>


There are very few countries that have higher turnover ratio than India. Market capitalization as a percentage of GNP compares favourably even with advanced countries and much better than emerging markets. In terms of number of companies listed on stock exchanges, India is second to none.

Major part of the liberalization process was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. With this Government's control over issues of capital, pricing of the issues, fixing of prime and rates of interest on debentures etc., ceased, and the office which administered the Act was abolished, the market was allowed to allocate resources to competing uses. However, to ensure effective regulation of the market, SEBI ACT 1992 was enacted to empower SEBI with statutory powers for (a) protecting the interests of investors in securities (b) promoting the development of the securities market and (c) regulating the securities market. Its regulatory jurisdiction extends over corporate in the issuance of capital and transfer of securities, in addition
to all intermediaries and persons associated with securities market. SEBI can specify the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues; can issue directions to all intermediaries and other persons associated with the securities market in the interest of investors for orderly development of the securities market; and can conduct enquiry, audits and inspection of all concerned and adjudicate offences under the Act. In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market. All the intermediaries in the market, such as Brokers and Sub-brokers, Underwriters, Merchant Bankers, Bankers to the Issue, Share Transfer Agents and Registrars to the Issue, are now required to register with SEBI and are governed by its regulations. A code of conduct for each intermediary has been prescribed in the regulations; capital adequacy and other norms have been specified; a system of monitoring and inspecting their operation has been institute to enforce compliance; and disciplinary actions are being taken against the intermediaries violating any regulation.

As noted above, there were several statutes regulating different aspects of the securities market and jurisdiction over the securities market was split among various agencies, whose roles overlapped and which at times worked at cross-purposes. As a result, there was no coherent policy direction for market participants to follow and no single supervisory agency had an overview of the securities business. Enactment of SEBI Act was the first such attempt towards integrated regulation of the securities market. SEBI was given full authority and jurisdiction over the securities market under the Act, and was given concurrent / delegated powers for various provisions under the Companies Act and the SCRA. The Depositories Act, 1996 is also administered by SEBI. A high level committee on capital markets has been set up to ensure coordination among the regulator agencies in financial markets.
CAPITAL MARKETS: ROLE

- The Capital Market is the indicator of the inherent health of the economy.
- The Capital Market is the largest source of funds with long or indefinite maturity for companies and thereby enhances capital formation in the economy.
- The Capital Market offers a number of investment avenues to investors.
- It helps in channeling the savings pool in the economy towards investments, which are more efficient and give a better rate of return thereby helping in optimum allocation of capital in the country.

The Capital Market may be, broadly, classified into three segments viz., Primary Market, Secondary Market and Derivatives Market.

PRIMARY MARKET

The Primary Market is the place where the new offerings by Companies are made either as an Initial Public Offering (IPO) or Right Issue. IPOs are offerings made by the Company for the first time while rights are offerings made to the existing shareholders.

SECONDARY MARKET

Secondary Markets consists of the Stock Exchanges where the buy-orders and sell orders are matched in an organized manner. There are at present 24 recognized stock exchanges in the country and are governed by the Securities Contracts (Regulation) Act (SCRA). The functions of the stock exchange are:
• It ensures a measure of safety and fair dealing.
• It translates short-term and medium term investments into long term funds for companies.
• It directs the flow of capital to the area of maximum returns and ensures ample investment options for the investors depending on their risk preference and
• It induces the companies to raise their standards of performance.

DERIVATIVES MARKET

Derivatives Market is the market for financial instruments whose value is derived from an underlying stock, commodity or currency. Derivatives trading is expected to start with index futures followed by index options and security options as per the recommendations of the SEBI appointed L.C Gupta Committee.

Derivatives market has the following roles:

• Derivatives allow hedging of market risk.
• It allows for a separate market to be developed for lending of funds and securities to the market.
• It helps in making the underlying cash market more liquid.
• It helps in innovations and the creation of new financial products.

The Indian Capital Market change amazingly quickly. People in the securities industry attribute the lack of comprehensive information material about the market to the rapid and incessant changing rules and regulations.
NEED FOR REGULATIONS AND REFORMS:

Patel IG  in his lecture on "some reflections on Financial Liberalization" stressed the need for reforms and argues on the task of rehabilitation of weak banks and creating conditions of effective and free competition. The speech raises many basic questions and provides suitable solutions for the same. The portion of his speech on "Nature of Financial Markets" reproduced here for better understanding the significance of finance sector reforms.

He, further, said that, it must also be mentioned that the very nature of financial markets is such that it is neither possible nor desirable to march forward full throttle in any one direction. One has to maintain a fine balance all the time between conflicting or divergent considerations. Nothing would be gained by shutting one's eyes to the inherent problems of financial liberalization. Financial markets hang on the slender thread of confidence, which can be maintained only by a fine blend of transparency as well as a certain sense of mystery and even secrecy. One cannot afford to sink the ship of confidence with every whiff of suspicion. How soon should the Bank of England have blown the whistle on the Bank for Credit and Commerce International? The same factor of confidence encourages a degree of oligopoly in financial markets with a few large institutions accounting for a decisive share of the market and the rest occupied by a large number of small ones. It may be that the technological revolution in computing and communication reduces the advantage of large financial firms and access to foreign markets certainly does so, which is why such access is so essential to effective competition. But a certain degree of overt or covert collusion in financial markets is only to be expected and policy must take account of it.
Again, financial markets trade in a peculiar commodity called risk, which is, by its very nature, difficult to evaluate precisely, particularly in respect of the assets of depository institutions. The risk factor has now greatly increased beyond the traditional credit risk and extends to the risk inherent in frequent and large changes in interest and exchange rates which become unavoidable as all markets tend to be closely linked across national boundaries. Financial risks, thus, tend to spread and become systematic. It is not easy to adopt the loser shoot himself in the forehead’, in financial matters. The loser is often not just the financial intermediary but the vast number of savers and investors involved. All this makes the question of regulating financial markets inherently a complex one. It is easy to say, as is often done, that financial markets should not be over-regulated but better supervised. But extreme cases of interference apart, what does it actually mean? Supervision is not possible without a set of transparent regulations and guidelines with reference to which it should be undertaken. Otherwise, it would soon degenerate into the most intensive and subjective inquisition. The fact of the matter is that it would always be a matter of opinion as well as concern whether regulations and guidelines are overdone and supervision becomes too like nitpicking. What needs to change fundamentally is the kind set of both regulators and supervisors who have to shed the control mentality and to act decisively in select and significant cases. In all probability countries will oscillate between too much and too little in one or the other area or in both. One can only hope that the swings are not too large.

Consider for instance a few practices which are a part of the international financial scene and which are certainly not compatible with the functioning of a fully competitive market as understood by most economists. Even Germany has comprehensive deposit insurance. But surely such insurance is not compatible with the rules of competition unless it is voluntarily provided by competing private insurance. And yet, how many practical bankers would recommend the abolition
of deposit insurance, as we know it? In a country where there is so much illiteracy and lack of information, deposit insurance builds up confidence and becomes a prerequisite for the growth of financial savings.

The Government started liberalizing economic policy in the early 1980s, and in this period securities markets activity increased several fold, as we have just seen. As a result of the increasing importance of securities markets and of the widening investor base, there was a need for setting up of a separate and independent regulatory body to take over the regulation of the stock exchanges and to ensure investor protection. Government departments under the provisions of certain Acts, which regulated securities transactions and company affairs, were previously carrying out these functions. As mentioned earlier, SEBI was set up in April 1988 under an administrative arrangement to regulate and further develop securities markets. The most recent phase of economic reform began in 1991, and the need for an independent agency for the regulation and development of securities markets became even more pressing. SEBI was given statutory powers in January 1992 through the enactment of the SEBI Act, which is mainly based on the concept of investor protection and regulation of intermediaries. Recently, SEBI has also been empowered to exercise powers under certain sections of the Companies Act, 1956 and of the SCRA.

In April 1992, irregularities were discovered in Indian securities markets. A Joint Parliamentary Committee was set up to look into the causes of the irregularities and to suggest remedial measures. The Committee found that large amounts of funds had been diverted from banks and into the hands of brokers through the use of various devices such as fake bankers' receipts and through the misuse of ready forward transactions. The Joint Parliamentary Committee made
various recommendations, suggesting inter-alia that SEBI should examine trading practices and systems in the stock exchanges and should effect the necessary changes. This episode highlighted the urgency for further reforms in Indian securities markets.

SECTION – I
CAPITAL MARKET REGULATIONS

A. LEGAL FRAME WORK:

Nearly two hundred years of British rule resulted a comprehensive legal system in India. However, today’s capital markets in India cannot live only on the British legacy. New wine needs new bottles. After she initiated economic reforms in 1991, India quickly repealed or revised old laws, Rules and regulations, and legislated new ones in order to align herself with global capital market standards.

The Indian securities laws, rules and regulations that were amended or newly enacted for the development of the reform capital markets include:

- The Companies Act, 1956
- The Securities and Exchange Board of India Act, 1992
- The Securities Contracts (Regulation) Act, 1956
- Delegation of Powers to SEBI under Securities Contracts (Regulation) Act, 1956
- The Securities Contracts (Regulation) Rules, 1957
- Depositories Act, 1996
- The SEBI (Depositories and Participants) Regulations, 1996
• The SEBI (Bankers to an Issue) Rules, 1994
• The SEBI (Bankers to an Issue) Regulations, 1994
• The SEBI (Custodian) Regulations, 1996
• The SEBI (Debenture Trustees) Rules, 1993
• The SEBI (Debenture Trustees) Regulations, 1993
• The SEBI (Foreign Institutional Investors) Regulations, 1995
• The SEBI (Insider Trading) Regulations, 1992
• The SEBI (Merchant Bankers) Rules, 1992
• The SEBI (Merchant Bankers) Regulations, 1992
• The SEBI (Mutual Funds) Regulations, 1996
• The SEBI (Prohibition of Fraudulent and Unfair Trading Practices relating to securities market) Regulations, 1995
• The SEBI (Portfolio Managers) Rules, 1993
• The SEBI (Portfolio Managers) Regulations, 1993
• The SEBI (Registrars to Issue and Share Transfer Agents) Rules, 1993
• The SEBI (Registrars to Issue and Share Transfer Agents) Regulations, 1993
• The SEBI (Stock Brokers and Sub-Brokers) Rules, 1992
• The SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992
• The SEBI (Substantial Acquisition of Shares and Take Over) Regulations, 1994
• The SEBI (Underwriters) Rules, 1993
• The SEBI (Underwriters) Regulations, 1993
• The SEBI (Venture Capital Funds) Regulations, 1996
• The SEBI (Appeal to Central Government) Rules, 1993
- The SEBI Appellate Tribunal (Procedure) Rules, 1994
- The SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997

The texts of these laws, rules and regulations, except for the company Act, 1956, are readily available at the SEBI's web site, http://www.sebi.com.

B. SECURITIES ACTS:

The Companies Act, 1956, the Securities and Exchange Board of India Act, 1992 and The Securities Contracts (Regulations) Act, 1956, are statutory laws.

C. RULES AND REGULATIONS:

Rules are made by the Central Government and regulations by the SEBI, under the provisions of the relevant act for carrying out the purposes of that act. These are required to be laid before the Parliament for a total period of thirty days for possible modification or amendment. Such rules have the force of the act.

D. GUIDELINES AND CLARIFICATIONS:

The SEBI issues guidelines and their clarifications on specific and technical subjects, such as "disclosure and Investor Protection", "Development Financial Institutions", "Flexibility on Pricing of the Issue", "Bonus Issue", "Preferential Issue", "Outstanding Financial Instruments", and "Firm Allotments, Transfer". For example, seventeen clarifications have been issued on "Disclosure and Investor Protection" since 1992 in response to inquiries, complaints, comments from market participants, as at the end of March 1997.
They are no doubt practical and effectual, but there may be some confusion in their legal enforceability. Their authority is based on Section 11 (1) of the Securities and Exchange Board of India Act, 1992. They are not required to be laid before the Parliament, because they are neither rules nor regulations. However, the SEBI once claimed that any violation of the guidelines will be punishable by prosecution by SEBI under the SEBI Act, 1992. The provisions of Section 11 (1) only say, "... it shall be the duty of the Board to protect the interests of investors in securities to promote the development of, and to regulate the securities market, by such measure as it thinks fit." Non-compliance of the guidelines may well give SEBI reasonable grounds for disqualifying an issue of securities or taking necessary administrative actions. Yet, it is questionable whether such non-compliance of guidelines would be punishable directly under the Act.

E. BYE- LAWS OF STOCK EXCHANGES:

These set forth details of the administration of stock exchanges. They cover the hours of trade, clearing house operations, the collection and publication of market data, trading rules, listing rules, the scale of brokerage and other matters. SEBI has the authority under the SEBI Act, 1992 to approve, make or amend the bye-laws of recognized stock exchanges. In fact, SEBI exercised its power to amend the bye-laws of the Bombay, Delhi, Hyderabad, Madras and Cochin Stock Exchanges in implementing the segregation between clients accounts and member broker's accounts between November 1994 and January 1995 after the exchanges had failed to comply with the SEBI's direction issued in November 1993. Bye-laws have to be published in the Gazette of India, and also in the official Gazette of the State, before these can take effect.
F. THE COMPANIES ACT 1956:

This Act governs public offerings of shares and debentures, in addition to subjects generally common in company laws of other countries such as the incorporation of a company, share capital and debentures, the registration of charges, the management and administration, and winding up, etc. Part III of the Act, which pertains to public offerings of shares and debentures provides, in particular, for the prospectus, allotment, commission on discounts, issue of shares at a premium and discount, issue and redemption of preference shares, and further issue of capital. Recently, a revamp of the entire Companies Act has been proposed. While the provision of the current Act have been amended from time to time to accommodate the needs of the changing corporate and economic world, as a result of the economic liberalization programme started in 1991, however, the new India has not been able to function effectively within planned economy. In August 1996, a working group was constituted to drastically restructure and streamline the act. The working group published its recommendations on 3 March, 1997 for discussion and debate, and subsequently completed the codification of the new Companies Bill, 1997.13

The recommended amendments are conceptually characterized by:

- A remodeling of companies to today’s economic realities,
- The explicit incorporation of existing or desirable corporate practices,
- The shifting of some company law powers to SEBI,
- More freedom and flexibility to corporate governance,
- User-friendly and more disclosures of corporate activities, and
- A simplification of the company law procedures.
They specifically include, among other things, the new classification of companies, freedom to
transfer and acquire shares, the SEBI's sole authority for listed companies, the introduction of a
shelf prospectus (shelf registration), book building, hybrids, derivatives and options, Indian
depository receipts, employee stock options, the buyback of shares (Section 5.3), the chief
financial officer (CFO), the establishment of a company law tribunal, optional consolidation of group
accounts, disclosures of interest by directors, loans to directors, segment information, foreign
exchange information, and the time-bound winding up of companies.

The Companies (Second Amendment) Bill 1999 introduced in Parliament on 23rd December 1999
proposes to entrust SEBI with powers with regard to public issues, transfer of securities, payment
of dividend, maintenance of books of accounts, form and contents of balance sheet and profit and
loss account in respect of listed companies and in respect of those public companies which purport
to be listed.

In the interest of investors, SEBI issues Disclosure and Investor Protection (DIP) guidelines.
Issuers are now required to comply with guidelines and then access the market. The guidelines
contain a substantial body of requirements for issues / intermediaries, the broad intention being to
ensure that all concerned observe high standards integrity and fair dealing, comply with all the
requirements with due skill, diligence and care, and disclose the truth, the whole truth and nothing
but truth. The guidelines aim to secure fuller disclosure of relevant information about the issuer
and the nature of the securities to be issued so that investor can take an informed decision. For
example, issuers are required to disclose any material 'risk factors' in their prospectus and the
justification for the pricing of the securities to be given. SEBI placed a responsibility on the Lead
Managers to give a due diligence certification, stating that they have examined the prospectus, they find it in order and that it brings out all the facts and does not contain anything wrong or misleading. Though the requirement of voting has now been dispensed with, SEBI has raised standards of disclosures in public issues to enhance the level of investor protection.

In order to enhance liquidity in shares and help corporate in capital restructuring with a view to enhancing the wealth of shareholders, companies have been allowed to buy back their own shares subject to the condition that the volume of buy back does not exceed 25% of the capital of the buying company.

G. THE SECURITIES CONTRACTS (REGULATION) ACT, 1956:

This Act is meant to prevent undesirable transactions in securities by regulating the business of dealing in securities, and by providing for certain other matters connected with securities dealing. The Act governs mainly the following areas:

- Recognized stock exchanges;
- Contracts and options in securities; and
- Listing of securities by public companies.

It is this Act which defines ‘securities’ in the Indian context. The SEBI Act, 1992 refers to this Act for the definition of ‘securities’. Section 2 (h) of this act stipulates that ‘securities’ include:

- Shares, scrips, stocks, bonds, debentures, debenture stock or marketable securities of a like nature in or of any incorporated company or other body corporate;
- Government securities;
- Such other instrument as may be declared by the Central Government to be securities; and

...
- Rights or interest in securities.

The Indian definition of a security is narrower and less specific than that of the Securities Act of 1933 of the United States. The Indian scope of a security is roughly the same as that under the Japanese securities law. Like the Japanese securities laws, the Indian act does not categorically include investment contracts in its definition of a security. Without some remedy, the narrow definition would become a drag both on the development of investment activities in India and on their future regulation. Nonetheless, the definition of securities has not been modified, nor has it been explicitly expanded. Instead, "registering and regulating the working of .......collective investment schemes.....' was added to the list of the items that the SEBI may take 'to protect the interests of investors in securities and .....". This approach nevertheless is somewhat illogical, but is a practical solution to the problem for the time being.

The Act earlier prohibited options. Section 20. (1) of the act provided that "all options in securities entered into after the commencement of this Act shall be illegal." This section, together with its sub-section (2), was omitted by the Securities Laws (Amendment) Act, 1995, to accommodate the introduction of futures and options contracts of NSE-50, a National Stock Exchange index (Section 4.4.7). This Act is also being reviewed for further amendments to keep up with the changing Indian capital market. The SEBI, in March 1997, appointed the D.R.Dhanuka Committee to review the Act, together with the SEBI Act, the Depositories Act and relevant provisions of the Companies Act."
H. THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992:

This Act is pivotal to the regulatory framework of the Indian capital markets today. It was enacted in 1992 in line with the economic reforms initiated in 1991.

This administrative law provides for the establishment of the Securities and Exchange Board of India, commonly known as SEBI, to protect the interests of investors in securities and to promote the development of and to regulate the securities market and for matters connected with or incidental to them. It delegates to SEBI the rule-making power, the licensing power, the investigating power and the directing power. It prescribes the powers and functions of the Board, and the registration of capital market participants such as stock brokers, sub-brokers, share transfer agents, etc. It also empowers the Central Government to make rules and SEBI to make regulations for carrying out the purposes of the Act. This Act will be considerably affected by the proposed Companies Bill, 1997. Consequently, the Dhanuka Committee appointed by SEBI has reviewed it for necessary amendments.

I. MARKET PARTICIPANTS:

In accordance with the wording of the law, most participants in the Indian capital markets are supposed to register with SEBI in order to carry out their businesses. Such participants are:

- Stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deed, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment
advisers and other such intermediaries who may be associated with securities markets in any manner.

- Depositories, Participants, Custodians of securities, Foreign Institutional Investors, Credit Rating Agencies, and other such intermediaries who may be associated with securities markets in any manner; and,

- Venture capital funds and collective investment schemes including Mutual Funds.¹⁸

However, the ambitious registration system is far from complete. For some professional categories such as sub-brokers, the registration system is nominally in place, but the lack of SEBI’s enforcement power permits hundreds of thousands of unregistered sub-brokers to conduct their securities businesses, while registered sub-brokers are not effectively regulated (Section 3.2.2).

There is also no registration system at all for investment advisers. Getting all the existing market participants registered with SEBI and regulating them tightly cannot be the Indian regulator’s single policy goal. As expressed in the preamble of the SEBI Act, 1992, the regulator’s policy goals are:

- To protect the interests of investors in securities;

- To promote the development of the securities market; and

- To regulate the securities market.

The development of the securities market will be another important key to protect the interests of investors in securities (and to ultimately mobilize and allocate domestic as well as foreign capital for the development of the Indian economy).
SECTION – II

PROVISIONS OF SECURITIES LAWS

Since the capital markets are a major source of funds for the corporate sectors therefore some of provisions of the Companies Act, SCRA, SCRR indirectly and directly affects the capital markets. The significant provisions of the Companies Act, SCRA and SCRR are,

A. PROVISIONS OF COMPANIES ACT:

• Debentures carrying voting rights cannot be issued (Sec-117).

• Dividends are payable only out of profits after setting aside a certain percentage towards reserves. Such dividend declared has to be paid within 42 days from the date of declaration (Sec-207) and the amount remaining unpaid after the expiry of this period has to be transferred to the Unpaid Dividend Account within 7 days. If it still remains unpaid for a period of 7 years has to be transferred to investor Education and Protection Fund (Sec – 205).

• The Board of Directors of the company shall at every Annual General Meeting lay before the company a Balance Sheet and Profit & Loss account. (Sec – 210)

• A bonus issue is to be made out of genuine profits, free reserves and share premium collected in cash only excluding revaluation reserve if any.

• Every company shall within three months after the allotment of any of its shares/debentures and within 2 months after the application for the registration of the transfer of any such shares / debentures deliver the certificates of all shares / debentures to the shareholders / debenture holders,(Sec – 113)
The company can close the register of members for a maximum period of 45 days in a year and 30 days at any one time (Sec – 154). As per listing agreement the minimum time gap between two book closures must be 90 days. Book Closures refers to the period in which all share transfer activity is suspended for the purpose of updating the Register of Members of the company and ascertaining the shareholder's entitlement to corporate benefits. In certain cases, the companies instead of closing the register of members announce the record date for the purpose of ascertaining the shareholders entitlement to corporate benefits.

The Company has to give intimation of Book Closure /Record Date, at least 42 days in advance (30 days in respect of securities which are announced by SEBI to be compulsorily delivered in demat form by all investors) to the stock exchanges where the shares are listed. (Listing Agreement).

A Company has to inform the stock exchange where its shares are listed immediately after the meeting of Board of Directors to consider quarterly results, dividend, rights/bonus issues about decisions taken at the board meeting and within 48 hours has to be published in an English daily (Listing Agreement).

A Company, which has issued physical share certificates, has to file a distribution schedule giving the details of the shareholding, its categories, details of lock-in etc with the Stock Exchanges where the shares are listed after its Annual General Meeting. (Listing Agreement)

A listed company is required to furnish to the Stock Exchanges where its shares are listed and to publish ---the quarterly un-audited financial results within one month from the expiry of the quarter—quarterly audited results within two months from the expiry of the quarter and companies have to explain the reasons for discrepancy of more than 20% between the
audited and un-audited results (Clause 41 of the 'Listing Agreement'). Announcement of quarterly results is also a requirement under the SEBI Rules for listed Companies.

- A Director, who is required by the 'Articles of Association' if the company to hold qualification shares, shall obtain such shares within two months from the date of appointment as a Director. The nominal value of the qualification shares shall not exceed Rs. 5000/- or the nominal value one share where it exceeds Rs. 5000/- (Sec – 270)

- Books of Accounts and other details have to be preserved by the company for a minimum period of eight years. (Sec – 209 (4 – A))

- The minimum number of Board Meetings held during the year shall be four (Sec – 285). The absence by a director for three consecutive Board Meetings without obtaining a leave of absence is a ground for vacating the office as a Director (Sec – 283). A person can be a director in a maximum of 20 companies (Sec – 275). Every company having a paid-up capital of more than Rs.5 Crores shall have a Managing or a Whole-time Director or a Manager (Sec – 269 read with Schedule XIII)

- The maximum amount of shares that can be bought back under the buyback scheme is 25% of the total paid-up capital and free reserves.

- In case where the average annual turnover of a private company is more than Rs.25 crores then the private company shall become a 'deemed public' company (Sec – 43A).

B. PROVISIONS OF SCR ACT, 1956:

- All contracts of securities (other than the spot delivery contracts) which are not entered into through, with or between members of the recognized stock exchanges shall be illegal and punishable with fine or imprisonment.
• A contract that violates the bye-laws specified in that behalf shall be void.

• Members of recognized stock exchanges are permitted to act as both brokers and dealers. No member is allowed to enter into a transaction as a principal with any other person unless the other person is a member of the recognized stock exchange.

• The Central Government can require listing of securities of any public company if it is deemed necessary in the interest of the trade or in the interest of the public.

C. PROVISIONS OF SCR RULES, 1957:

According to Rule 8 of the SCRR, 1957, the eligibility criteria for becoming a member of a recognized stock exchange inter-alia includes

• He should be an Indian citizen and at least 21 years of age,

• He should not have been declared insolvent, bankrupt or declared a defaulter by any other stock exchange,

• He should not be involved in fund-based activity, which is not incidental to the securities business.

FURTHER REFORMS IN SECURITIES MARKET:

The Subject Group on Capital Markets and Financial Services Initiatives of Prime Minister's Council on Trade and Industry in their report submitted in November 1998 have recommended various measures to improve the working of the capital market. These recommendations would most likely form the basis for second generation reforms in the securities market. These recommendations are shown below:
A. Debt Markets

- Widen investor base through broad banding of pension / provident fund and insurance industries.
- Liberalize investment norms and encourage active management of contractual funds.
- Initiate steps to entail GOI securities through primary dealers, NBFC and bank networks.
- Provide hedging opportunities to facilitate market making by primary dealers.
- Facilitate introduction of interest rate swaps and bond utters.
- Allow short selling / borrowing of securities.
- Make repos applicable across wider range of securities.
- Make the trading and settlement process efficient through the setting up of depository for fixed income securities.
- Establish nationwide access to trading infrastructure at affordable costs.
- Encourage Debt Securitization.
- Introduce tax incentives like indexation benefits on long-term capital gains in fixed income securities.
- Encourage Foreign Institutional Investors in debt market.
- Rationalize tax and regulatory norms across players / instruments.
- Mandate registration of all market intermediaries.
- Mandate compliance with uniform valuation procedures by all players.
- Introduce standard disclosure and reporting norms for all trades.
• Make listing and credit rating of private placement compulsory as per public issues and introduce guidelines for issue documentation, post issue reporting and disclosure.

B. Equity Markets
• Encourage book building (involves close dialogue with prospective institutional investors) and auctions (which can be done over computer systems to thousands of market participants) whereby the IPO does not come to the market with a stated offer price.
• Give a strong thrust to the Government divestment programmeme.
• Divest PSU stocks at marked down prices
• Improve disclosure norms.
• Mandate market making
• Introduce rolling settlements and compulsory dematerialization of securities.
• Amend the SCRA to allow for derivatives trading.
• Encourage individual investment accounts for high income / high net worth individuals / corporate.
• Ease entry for FIIs / Foreign venture capital funds.
• Amend taxation norms on capital losses.
• Remove restrictions on lending against shares by the banks.
• Amend taxation norms on borrowing against shares.
• Encourage retail investment in the market through Mutual Funds.

C. Mutual Funds
• Empower Mutual Funds that meet defined criteria to manage retirement funds in the economy.
• Increase capital adequacy in proportion to the assets managed and reintroduce minimum
  corpus criteria formula fund entry.
• Prescribe stringent norms for intermediaries.
• Encourage development of fund supermarkets.
• Prescribe regulations on investing in unlisted companies including into group companies.
• Introduce “Funds of Funds” concept.
• Mandate active investor education and stringent disclosure norms.
• Make valuation norms uniform.
• Strengthen the role of trustees.
• Amend money market Mutual Fund regulations
• Impose strict penalties on sponsors not fulfilling their commitments.
• Appoint Ombudsmen
• Strengthen Unit Trust of India
SECTION – III

POLICIES AND PROGRAMMEMES

Various measures initiated by Government and regulators to have contributed to improvement of sentiments in the market. Measures initiated during the year 1998-99 include:¹⁹

A. REVISION OF ENTRY NORMS FOR INITIAL PUBLIC OFFER:

SEBI norms permit a new company to come out with an IPO if it has a dividend payment track record for three out of immediately proceeding five years. In order to ensure IPO’s, SEBI relaxed this requirement of the ‘actual payment of dividend’ to ‘ability to pay dividend’ in terms of Section 205 of the Companies ACT, 1956. That is the company making IPO must have distributable profits for at least three out of the preceding five years. It was made necessary for the company making an IPO to be able to pay dividend to have a minimum praise net worth (i.e. paid up capital and free reserves minus intangible assets and revaluation reserves) of net less than Rs. 1 crore in three out of the preceding five years, with a minimum net worth to be met during the immediately preceding two years. The banks were exempted from fulfilling eligibility norms for making public issues. They can make equity issues at a price approved by RBI. The requirement of 30 mandatory collection centers was reduced with a view to minimize the cost of public issues. The minimum number of collection centers for an issue of capital would now be:

a. the four metropolitan centers and

b. such centers where the stock exchanges are located in the region in which the registered office of the company is situated.
B. RELAXATION OF ENTRY NORMS FOR INFRASTRUCTURE COMPANIES:

With a view to channelize greater flow of funds to infrastructure companies, SEBI granted a number of relaxations to infrastructure companies. These include:

- Exemption from the requirement of making a minimum public offer of 25 percent of securities and also from the requirement of 5 shareholders per Rs. 1 lakh of offer made

- Exemption from the minimum subscription of 90% provided disclosure is made about the alternate source of funding considered by the company in the event of under subscription in the public issue.

- Permission to free price the offerings in the domestic market provided the promoter companies along with equipment suppliers and other strategic investors subscribe to 50% of the equity at the same prices as the price offered to the public or at a price higher than that offered to the public.

- Permission to keep the issues open for 21 days to enable the companies to mobilize funds.

- Exemption from requirement to create and maintain a debenture redemption reserve in case of debenture issues as provided in the SEBI Disclosure and Investor protection guidelines.

These concessions are available to them if a Development Financial Institution, Infrastructure Development Finance Corporation or Infrastructure Leasing and Financing Services Ltd. appraise these and there is a minimum financial participation by them. The minimum financial participation of the appraising agency, initially fixed at 10% of the project cost, was reduced to 5%. Further the minimum participation can be met by any of the appraising agencies, jointly or severally, irrespective of whether they appraise the project or not.
C. EMPLOYEE STOCK OPTION / EMPLOYEE STOCK PURCHASE PLANS:

SEBI had constituted a committee under the Chairmanship of Prof. J.R. Verma, member of SEBI, to formulate the guidelines for Employee Stock Option Plan (ESOPs) / Employee Stock Purchase Plans (ESOPs). The recommendations of the Committee were accepted by SEBI. The salient decisions in this regard are:

a. ESOPs

Issue of stock options at a discount to the market price would be regarded as another form of employee compensation and would be treated as such in the financial statements of the company regardless of the quantum of discount on the exercise price of the option. The pricing provisions of SEBI's preferential allotment guidelines would not cover ESOPs. The issue of ESOPs would be subject to approval by shareholders through a special resolution. There would be no restriction on the maximum number of shares to be issued to a single employee. However, in case of employees being offered more than 1% of the shares, a specific disclosure and approval would be necessary in the AGM. A minimum period of one year between grant of options and its vesting is required. After one year, the company would determine the period during which the option can be exercised. The pertain of ESOP would have to be under the superintendence and direction of a compensation committee of the Board of Directors in which there would be a majority of independent directors. ESOP would be open to all permanent employees (whether working in India or abroad) and the directors of the company but next to promoters and large shareholders. With specific approval of the shareholders, the scheme would be allowed to cover the employees of a subsidiary or a holding company. The disclosures required to be made in the Director's Report or in the annexure to the Director's Report regardless of whether the stock options are issued at a discount or not are: the total number of shares covered by the ESOP as approved by the
shareholders, the pricing formula, options granted, options vested, options exercised, options
forfeited, extinguishment of modification of options, money realized by exercise of options, total
number of options in force, employee wise details of options granted to senior managerial
personnel and to any other employee who receives a grant in an one year of options amounting to
5% or more of options granted during that year, fully diluted Earnings Per Share computed in
accordance with international accounting standards.

b. ESPPs
In respect of shares issued under an ESPP scheme during any accounting period, the accounting
value of the shares so issued shall be treated as another form of employee compensation in the
financial statements of the company. The pricing provisions of the SEBI's preferential allotment
guidelines would not cover ESPPS. Shares issued under an ESPP shall be locked in for a period
of one year. However, if the ESPP is a part of a public issue and the shares are issued to
employees at the same price as in the public issue, the share shall not be subject to any lock-in.

The companies would continue to have the alternative of issuing shares to employees in full
compliance with the SEBI guidelines on preferential allotment without subjecting themselves to the
ESOP / ESPP guidelines.

D. ABOLITION OF STANDARD DENomination FOR EQUITY SHARES:
The Central Government had issued various circulars over the years with regard to standard
denominations for corporate securities directing the companies to have uniform denomination of
Rs. 10 or Rs. 100 for equity shares. With a view to give flexibility to companies to fix a
denomination of its equity shares, these circulars were modified as under:
• The companies shall have the freedom to issue shares in any denomination to be determined by them in accordance with section 13(4) of the Companies Act, 1956. While doing so, the companies will have to ensure that shares are not issued in denomination of less than one rupee of decimal of one rupee.

• The companies, which seek to change the standard denomination, may do so after amending the Memorandum and Articles of Association, if required.

• The existing companies, which have issued shares at Rs.10 and Rs.100, may also change the standard denomination into any denomination not below Rs.1 by splitting or consolidating the existing shares after amending their Memorandum and Articles of Association. At any given time, a share shall be only one denomination for the shares of a company.

• Only those companies, whose shares are dematerialized, shall be eligible to use the 'standard denomination'.

• The Stock Exchanges may also make necessary changes in their existing trading and settlement software to give effect to this decision.

• With a view to enable the investors to take informed investment decision, the stock exchanges are also directed to reflect the denomination value of the shares as fixed by the company along with the market quotations.

• The companies desirous to avail of the facility would be required to adhere to disclosure and accounting norms as may be specified from time to time.

This measure would give freedom to companies to price their IPOs below Rs.10 and would thus be an extension of free pricing. This will also harmonize the existing separate disclosure and entry point norm for par and premium issues.
E. GUIDELINES FOR ISSUES TO BE MADE THROUGH 100% BOOK BUILDING ROUTE:

SEBI had issued guidelines in October 1997 for book building which were applicable for 100% of the issue size and for issues above Rs.100 crore. The guidelines were revised subsequently to reduce the limit to issues of Rs. 25 crore to encourage the use of this facility. However, no issuer used this facility. SEBI modified the framework for book building further in October 1999 to make it more attractive. The modified framework does not place the existing guidelines. The issuer would have option to issue securities using book building facility under the existing framework or the modified set up broadly as given below:

- The present requirement of graphical display of demand at bidding terminals to syndicate members as well as the investors has been made optional.
- The 15% reservation for individual investors bidding for lot 10 marketable lots might be merged with the 10% fixed price offer.
- Allotment so for the book built portions shall be made in demats form only.
- The issuer may be allowed to disclose the issue size or the number of securities to be offered to the public.
- Additional disclosure with respect to the scheme for making up the deficit in the sources of financing and the pattern of deployment of excess funds shall be made in the offer document.

F. ELIGIBILITY NORMS FOR PUBLIC ISSUES / OFFERS FOR SALE BY COMPANIES IN THE IT SECTOR:

Eligibility norms were modified to provide that a company in the IT sector going for IPO / offer for sale shall have track record of distributable profits as per Section 205 of the Companies Act in three out of five years in the IT business/from out of IT activities. It can also access the market
through the alternative route of appraisal and financing by a bank or financial institution. The same conditions would apply also to a listed company which has changed its name to reflect activities in IT sector.

G. MARKETING INITIAL PUBLIC OFFERS (IPOs) THROUGH THE SECONDARY MARKET:
SEBI approved a proposal of marketing IPOs through the secondary market. It proposes to use the existing infrastructure of stock exchanges (terminals, brokers and systems) presently being used for secondary market transactions, for marketing IPOs with a view to get rid of certain inherent disadvantages faced by issuers and investors like tremendous load on banking and postal system and huge costs in terms of money and time associated with the issue price. This system would confirm to all extant statutory requirements. The investor would approach broker for placing an order for buying shares of primary issues. The registrar in consultation with Merchant Banker and the regional stock exchange of the issue will finalize the basis of allotment and intimate the same to the exchanges who in turn shall inform the brokers. The brokers will advise the successful allotted to submit the application form and the amount payable towards the shares. The broker will deposit the amount received in a separate escrow account for the primary market issue. The clearinghouse of the exchange will debit the primary issue account of the broker and credit the issuer's account. Subsequently, the certificates would be delivered to the investors or the depository account of the investor would be credited. The securities can be listed in the stock exchange from the 15th day from the closure of the issue as against 45-60 days at present. As investors will have to part with their funds only on successful allotment, their funds are not unnecessarily blocked. This would also ensure that refunds are done away with. The system seeks to reduce the time taken presently for completion of the issue process, as well as the cost of the issue.
SECTION –IV

PRIMARY SECURITIES MARKET

An efficient primary market, which brings together the user and the investor of funds directly, provides the most effective and the cost-efficient source for mobilization of financial resources. Moreover, viability of a project is not decided by an individual but by the market through its response to the issue. In India, till recently the office of the Controller of Capital Issues not only used to prove to any issue of capital but also the price at which such an issue was to be offered to the investors. This was with avowed intention to avoid investors to be taken for a ride by smart operators. Following the abolition of Capital issues (Control) Act, 1947 in May, 1992, issuers are free to offer their issues at a price to be fixed by them in tune with the guidelines issued by the Securities and Exchange Board of India (SEBI) for the purpose. These guidelines allow almost all issuers except the new entrepreneurs without any track record to issue their securities at premium. This has enthused the corporate sector leading to a spate of public and rights issues in recent months.

Schedule II of the Companies Act as amended in October 1991 also provides for detailed disclosure of information in prospectus to an issue including management’s perception of the risk factor. Similarly, SEBI guidelines on new issues also have provisions to ensure availability of full and fair information to the investors to take their investment decision. These guidelines also provide that Merchant Bankers authorized by SEBI shall exercise due diligence independently verifying the contents of the prospectus and reasonableness of the views expressed therein. The
Merchant Bankers shall certify to this effect to SEBI. Nonetheless, a proper check on these disclosures is called for which stock exchanges and SEBI are expected to exercise.

All issuers, except brand new companies promoted by new entrepreneurs without any track record, are now given the freedom to price their issues subject to the requirement of disclosure about the net asset value and a justification for the price of the issue. This has no doubt bridged to a great extent the wide gap between what the market can bear and what the issuer could get with all problems attendant on heavy subscription. Apprehensions are, however, expressed in some quarters about the likely misuse of this freedom by unscrupulous operators. 20

The repeal of the capital issues (control) Act 1947 on May 13, 1992 was a major development for the securities market. With the repeal of the Act, the issues of securities could rise the capital from the market without seeking the prior consent of the central Government and to freely price such securities. 21 Subsequently SEBI issued guidelines, which generally cover the eligibility norms for making issues (both public and rights) at par and at premium by various types of companies.

Indian primary capital market experienced 'free pricing' regime, which is a new concept and the issuers and intermediaries, are gradually attuning themselves to it. Since 1991, SEBI has been vetting the offer documents before the companies make an issue of capital. During 1993-94, SEBI introduced certain disclosure requirements in offer documents with respect to the projects, so that certain disclosure requirements about the projects would be available to investors. 22 In order to counter the problems of multiple applications in issues and to increase the speed and lessor the costs of processing, SEBI introduced proportional allotment of shares in primary issues in October 1993. Another significant change in rule is minimum application money. SEBI increased minimum
application money from Rs. 1000 to Rs. 5000. To enable issues to price their issues closer to the issue date, SEBI allowed Merchant Bankers to indicate a price band in the draft offer submitted to SEBI instead of specifying the issue price with effect from December 1, 1993, issues have been allowed to reserve certain portion of the issues for institutional investors viz., Mutual Funds, Financial institutions and FIls registered with SEBI. Later SEBI has laid down the norms for minimum promoter's contribution for public and rights issues with certain relaxation. In order to ensure observance of fair and proper allotment procedures in oversubscribed public issues, SEBI nominated representatives who associate with the process of finalization of basis of allotment which in turn reduces malpractice in the allotment process. To bring about a greater discipline among issuers and Merchant Bankers and to discourage the practice of allotting shares at significant discount to financial institutions (in case of under-subscription), additional post issue reporting requirements were prescribed since March 1993 for the Merchant Bankers.

SEBI²³ had issued several operational guidelines to bring about a greater transparency in the operations of Merchant Bankers especially in issue management. This was a part of SEBI’s efforts to regulate the primary market through Merchant Bankers, in the absence of direct power over issuers. The operational guidelines covered both disclosures in the offer document to be ensured by the Lead Managers and other obligations of Merchant Bankers. Some of the important aspects of these guidelines are given below.

♦ To improve the quality of disclosures, issuers were required to disclose in offer documents a comparison of performance and promises made by an issuer in the previous issues, the manner in which the issue proceeds would be invested in the short term pending utilization in proposed projects, high and low prices of the shares of the issuer company during the past
three years, monthly high and low prices and the volume of business transacted at those high and low prices in the six months prior to the date of filing offer documents with SEBI. Besides, in the issue advertisement highlights and risk factors of a project were required to be given equal treatment in all respects.

- The Lead Manager responsible for tying up underwriting agreements in an issue was also made responsible for invoking underwriting obligations and ensuring that underwriters pay the amount of devolvement. To monitor this process, the Lead Managers were also required to report to SEBI on non-acceptance of devolved liability by the underwriters.

- To help SEBI monitor public and rights issues effectively, Merchant Bankers were advised to report the details of subscription of issues in four categories — subscribed and unsubscribed public issues and subscribed and unsubscribed rights issues managed by them.

-Merchant Bankers were also required to actively associate themselves with post issue refund and allotment activities and regularly monitor investor grievances arising from the issue process.

- Lead Managers were required to ensure that mandatory collection centers for new issues invariably include the places where stock exchanges have been established.

- Further clarifications on the guidelines for disclosure and investor protection were issued covering the areas of issue of capital at a premium by a new company promoted by existing companies having a track record of profitability, manner of computations of promoters contribution, minimum subscription from friends and relatives, firm allotment and reservation to various categories out of the public offer, fraudulent encashment of refund orders, safety net or buyback arrangements, if any, and proportionate allotments in case of over subscription.
A detailed code of advertisement for capital issues was prescribed and Lead Managers were advised to ensure strict compliance thereof.

With the progress of economic reforms, the primary market has become an important source of mobilizing funds for Indian corporate. The quantitative growth of the market and the freedom to price the issues, had also raised questions about the quality of issues to entering the market. It is also felt that, there is a every need to raise the standards of disclosures in public issues, and enhance the transparency for improving the levels of investor protection.

The efficient performance of the primary market is handicapped by several procedural and other problems. First, the issue applications have to be collected at 57 mandatory centers spread throughout the length and breadth of the country for a minimum period of three days. Till recently, with regulated pricing, most of the issues were being offered at a heavy discount to their market value and with the immediate prospects of appreciation, there was heavy oversubscription. Banking and postal systems are not fully geared to cater to the increased workload in the primary market. The expected avalanche of issues in the coming months is going to further aggravate the situation. It is, therefore, necessary to revise the whole issue procedure so that investors are not adversely affected by the excessive time taken in allotment. In fact, quicker allotments and refunds will ensure greater resource mobilization in the primary market with the investors' funds being released quickly.
REFORMS IN PRIMARY CAPITAL MARKET

A. IMPROVING DISCLOSURE STANDARDS: \(^2\)

In 1994-95, SEBI had appointed an expert committee under the chairmanship of Shri Y.H. Malegam to suggest measures that could be adopted by SEBI in this area. The Committee submitted its report during the year 1995-96. SEBI accepted almost all the recommendations made by the committee and implemented them during the year. The main recommendations implemented by SEBI (some with modifications) are given below:

- Unlisted companies which have been in commercial operation for more than 2 years and whose post issue paid up capital is Rs. 3 crore or more, but less than Rs. 5 crore, are eligible for listing only on those stock exchanges where trading of securities is screen based. Besides, such issuers are required to put in place market making arrangements to ensure liquidity to investors. Market Makers appointed by such issuers are required to provide a continuous two-way quote for a minimum period of 18 months from the date of commencement of trading. A minimum quote depth, a maximum bid-ask spread that the Market Maker can quote and the minimum inventory of the securities which the Market Maker would have to maintain are also prescribe.

- Greater disclosure in the offer document regarding expenditure incurred on the project before filing the offer document with SEBI for vetting and proposed to be incurred at later stages is required to be made. The means and sources of financing such expenditure are required to be stated.
• Issuers are required to disclose details of 'bridge loans', which were to be repaid from the proceeds of the issue.

• Issuers are required to specify further details of 'turnover' report in their profit and loss statements, clearly to bring the contribution to the stated turnover figures from products manufactured by the issuer, products traded in by the issuer and from products not normally dealt in by the issuer. As a result, a more detailed break up of the activities of the issuer is expected to become available.

• In the asset and liability statement, issuers are required to deduct 'revaluation reserves' from 'fixed assets' and from 'reserves'; and the net worth is required to be arrived at after such deduction.

• Issuers are required to give details of the shareholding in the issuer company of promoters and directors of the promoter, where the promoter is a body corporate, as well as details of the transactions by promoters and directors of the promoter in the six months preceding the date of filing of the offer document with SEBI. Issuers are required to provide details of the prices at which the transactions took place and the relevant dates.

• Issuers are required to give details, inter alia, of technical or financial collaborators, buy back arrangements, largest shareholders, growth of companies, the basis for issuer price, financial information, accounting ratios and other income.

• Additional disclosures are required to be made in abridged prospectus as is required in full prospectus to improve disclosure standards in the abridged prospectus.

• Only prospectus for issues made by new companies and existing companies setting up new projects, or undertaking a major expansion programme, could incorporate future projections, provided the projections were based on the appraisal done by a financial institution
or a scheduled commercial bank which is either financing the project or is committed to finance
the project.

- The advertisement code for issue has been strengthened to prevent issuers and intermediaries
  from misleading investors. No corporate advertisement can now be issued between the date
  of issue of acknowledgement card by SEBI and closure of the issues and the announcement of
closure of issue can only be made after getting a certificate from the registrar to the issue that
at least 90% of the issue has been subscribed to.

- The Lead Manager to an issue required furnishing due diligence certificates at five different
  stages of the issue process.

- Issuers are required to furnish a list of the persons constituting the promoters or promoters'
group to SEBI.

- Such a separate company can now consider the track record of profitability of a division of a
  company, spinning off into a separate company, for the purpose of a public issue at premium.

- Issuers are also required to give information regarding unusual or infrequent events or
  transactions, significant economic changes that materially affected or are likely to affect the
  income from continuing operations; the distribution of turnover among each segment in which
  the issuer operates; the status of any publicity announced product or venture; the seasonal
  variations in the issuer's business; the concentration of business with a small number of
  suppliers or customers; and issuers; perceptions of competitive conditions, cost and
  technological conditions in their segment of industry.

- Management perception and analysis of the financial conditions and results of operations as
  reflected in the financial statements is now required to be given.
Wherever, statements of assets and liabilities, profit and loss or any other financial information is qualified by the notes of an auditor, all necessary adjustments, wherever quantification is possible, shall be made in the statement itself.

In addition, SEBI also took several measures to simplify the issue process.

B. INCREASING TRANSPARENCY IN ISSUES – PUBLIC ACCESS TO DRAFT PROSPECTUS:

In order to enhance the transparency in public issues, the offer document is now a public document even at the draft stage, as soon as it is filed with or submitted to SEBI that prospective investors and market participants have sufficient time to bring any adverse feature to the notice of SEBI, before the issue opens for subscription. Lead Managers and stock exchanges have been instructed to make copies of the draft prospectus available to the public. Such copies can be obtained from SEBI.

C. STRENGTHENING OF ELIGIBILITY NORM FOR PUBLIC ISSUES:

The eligibility norms for companies accessing the primary market have been strengthened to improve the quality of issues:

a) 3 years dividend paying track record has been made a requirement for a company making its first issue of capital to the public;

A manufacturing company, not satisfying the above criteria, can make the first issue of capital to the public provided its project has been appraised by a public financial institution or a scheduled commercial bank with participation of at least 5% of the project cost.
b) A listed company desirous of making further issue of capital to public and whose equity capital after the issue becomes more than five times the equity capital prior to such issue would have to satisfy the criteria at a) or at b) above.

D. SIMPLIFICATION OF THE ISSUE PROCESS:

- SEBI dispensed with the requirement of vetting of public issues of listed companies offering pure debt instruments having at least an 'adequately safe' credit rating. However, Merchant Bankers were required to ensure compliance with SEBI rules, regulations, guidelines and requirements of other laws.

- SEBI also dispensed with the requirement of vetting of rights issues (not accompanied by public issue three months prior or subsequent to the rights issue). Merchant Bankers are required to ensure compliance with SEBI rules, regulations, guidelines and requirements of other laws in this respect.

- For the first time, guidelines to introduce the book building procedure have been issued, which can be adopted for issues over Rs. 100 crore. Book building, which is widely used in other markets, has been found to be a fair, transparent and market driven way of pricing and allocation of issues.

- The number of mandatory collection centers has been reduced for issues of up to Rs. 10 crore. In such cases, in addition to the four metropolitan centers of Mumbai, Delhi, Calcutta and Madras, mandatory collection centers are required only at places where stock exchanges are located in the region in which the registered office of the company is situated.
E. REMOVAL OF LOCK IN PERIOD:

➢ The requirement of minimum promoters contribution and lock in has been dispensed with in case of a company whose shares are listed on a stock exchange for at least 3 years and which has a 3 year track record of dividend payment out of preceding 5 years.

➢ The SEBI guidelines for preferential allotment issued on August 4, 1994 address the concern regarding the lack of transparency and market unrelated pricing which accompanied several preferential issues which were made in the past. In addition to imposing a requirement for pricing these allotments at market related levels; the guidelines also imposed a lock in period of 5 years on allottees. The interests of shareholders could be adequately protected by the requirement for pricing preferential allotments in line with market prices; besides approval at a general meeting of shareholders was required for making preferential issues. Therefore, the requirement for lock in was removed except for preferential allotments to promoters.

F. EMPLOYEES QUOTE AND EMPLOYEE STOCK OPTION SCHEMES:

▪ The limit of 200 shares per employee to be allotted on firm basis to a permanent / regular employee of the issuer in a public issue has been removed. However, as earlier, reservation to employees in a public issue may not exceed 10% of the size of the issue.

▪ Listed companies are permitted to issue securities to employees under Employee Stock Option Scheme (ESOPs) subject to two main conditions:

a) issue of securities to employees under ESOPS should not exceed 5% of the paid up capital of the company in one year; and
b) pricing of securities should be in accordance with formula contained in SEBI preferential offer guidelines dated August 4, 1994. The companies were free to devise further details of the ESOPS including the terms of payment.

G. REVIEW OF POLICIES AND PROGRAMMES – 1997 – 98

- The SEBI has exempted infrastructure companies and municipal corporations from the requirements of Rule 19(2)(b) of Securities Contracts (Regulations) Rules 1957 allowing them to list their debt instruments on the stock exchanges without the pre-existing requirement of equity being listed first. These companies can come out with a public offer and list their NCDs / PCDs subject to the condition that such instruments carry an investment grade rating and are fully secured irrespective of their maturity. In case of FCDs / PCDs the equity issued prior to the issue of debt could be listed only at the time when the equity arising on conversion of such convertible instruments gets listed. This has been done so as to facilitate fund raising by infrastructure companies, which have long gestation periods and entities like municipal corporations, which can only raise funds through debt instruments.

- The existing SEBI guidelines restricted the facility of book building to 75% of the issue size. However, the constrained the benefits arising out of demand and price discovery. The facility of making an issue through book building has now been extended to entire issue size and shall be available to issuer companies which propose to make an issue of capital at and above Rs. 100 crores.

- Amendments to SEBI (Merchant Bankers) Regulations, 1992 were made. Only body corporate were allowed to function as Merchant Bankers

- Multiple categories of Merchant Banker’s viz. Category II, III and IV was abolished and henceforth there will be only one category of Merchant Bankers. The Merchant Banker would
now be required to seek separate registration if they wish to act as underwriter or portfolio manager.

- Also Merchant Bankers were prohibited from carrying on fund based activities other than those related exclusively to the capital market. In effect, the activities undertaken by NBFCs such as accepting deposits, leasing, bill-discounting etc. would not be allowed to be undertaken by a Merchant Banker.

- The SEBI (Registrars to issue and share transfer agents) Regulations 1993 were amended to provide for an arms length relationship between the issuer and the Registrar of the Issue. It has been stipulated that no registrar can act as a registrar to any issue of securities made by any body corporate, if the Registrar to the Issue and the Issuer are an associate.

- In order to monitor the movement of employees of Merchant Bankers category I, the SEBI directed all category I Merchant Bankers to submit specified information on their employees engaged in merchant banking activity. Thus a database of persons engaged in Merchant Banking industry has been created by the SEBI.

- In November 1997, the central Government decided that entities which issue instruments such as agro bonds, plantation bonds etc. and the schemes through which such instruments are issued would be treated as collective investment schemes coming under the provisions of the SEBI Act 1992 and would be regulated by the SEBI. In order to draft the Regulations, a committee was appointed by the SEBI under the chairmanship of Dr. S.A. Dave. Until the regulations were notified, the provisions of section 12(1)(B) of the SEBI act prohibited any new scheme to be sponsored or further fund to be raised. Meanwhile the SEBI also stipulated that all existing schemes could mobilize funds only through the existing schemes after obtaining a rating from any of the recognized credit rating agencies. The SEBI also imposed the condition
that all advertisements issued by the collective investment schemes should adhere to the advertisement code prescribed by the SEBI.

GROWTH OF PRIMARY MARKET:

The primary market witnessed an accelerated investment activity in February 2000 as during this month amount mobilized increased to Rs. 1,433.9 crores from a much lower amount of Rs. 132.36 crore in January, 2000. On financial year basis, the resource mobilization recorded an increase of 41.6 per cent from Rs.5,146.5 crore during April-February, 1998-1999 to Rs.7,288.99 crores during April-February, 1999-2000. The market received 42 IPOs for mobilizing Rs.2, 595.6 crore during April-February, 1999-2000 as compared to 17 issues made for mobilizing only Rs.400.4 crore during the same period in 1998-99. As a result the share of IPOs in total capital raised from the primary market increased to 35.6 per cent during April-February, 2000 from a meager 7.8 per cent during the same period in 1998-99. The surge in equity prices on secondary market and a recovery in the industrial sector are probably encouraging the pick up in primary market. During April-February, 1999-2000 the SEBI cleared 95 issues for raising Rs.11799.1 crore as compared to 54 issues for Rs. 1788 crore during the corresponding period in 1998-99. The exponential growth in the amounts cleared for issues is an indication of likelihood of higher level of resource mobilization by the corporate for meeting their financial requirements in improving the business activities in the immediate future.

The upsurge in amount mobilized enabled the pick up of mega issues to dominate the market which have contributed 77.3 per cent of the total resources mobilized from the market during April-February, 1999-2000. The equity issues amounted to Rs. 2883.6 crore or 51.2 per cent of total mega issues.
FII net investment in Indian capital market registered a strong rise as the net investment was recorded at US$ 708.2 million in February, 2000 as compared to a net of US$ 1362.6 million during the preceding 10 months (April-January, 1999-2000). The cumulative net investment rose to US$ 10963.2 million in February 2000 from US$10255.10 million in January 2000. The increase in net investment of FII had a boosting impact on equity prices.

As regards performance of Mutual Funds, the net mobilization aggregated to Rs.17, 965.5 crore during April-February, 1999-2000. While Mutual Funds under public sector continued to perform poorly with a net outflow (of the order of Rs.579.7 crore in the current financial year so far), the private sector Mutual Funds added a net amount of Rs.13725.8 crore and UTI another Rs.4819.4 crore.

On February 3, 2000, the SEBI issued 11B orders to 8 companies and 74 directors prohibiting them from entering into the capital market for a period of 5 years. With these orders the SEBI has so far issued 11b orders to 57 companies and 216 directors prohibiting them from associating in respect with capital market activities, not to deal in securities, not to access the capital market, and not be or be associated with any of the intermediaries in the capital market for a period of 5 years.

Department of Company Affairs has also initiated action in terms of the provisions of the Companies Act, 1956 against these companies. Prosecution for non-filing of information by companies, prosecution under Section 209 A of the Companies Act in respect of 54 companies. Further action by the Department of company Affairs in terms of the provisions of the Company Act, 1956 is in progress.
In addition to the joint action by SEBI and Department of Company Affairs, it has been decided to refer these cases to respective State Government also for action where cheating or fraud is observed. It maybe stated here that these penal actions for which the State Government s are being approached both by the SEBI and Department of Company Affairs, is in addition to the penal action taken / proposed to be initiated by the Department of Company Affairs. This was done because in the Coordination and Monitoring Committee comprising SEBI and Department of Company Affairs officials. It was felt that fraud and cheating are the offences under the Indian Penal Code and could have been dealt only by the police Authorities of the respective State Governments. Besides, punishment under the offences has to be more severe. The SEBI has sought information from the investors on vanishing companies. The SEBI has also issued public notice inviting information from the investors also.

The option of issuing bonds is becoming increasingly attractive to corporate and financial institutions for a variety of reasons.

- The lackluster equity market has ruled out the possibility of raising large funds even at nominal premiums. This makes bonds the only option for raising funds besides term loans.

- Many corporate have already raised substantial funds through the equity route and servicing them maintaining a high dividend level is proving to be difficult.

- The gearing ratio (total debt to net worth) in the case of many companies has become considerably skewed towards equity funding owing to the raising of upfront funds at a premium. While five years ago, a 2:1 debt-equity ratio was favoured, the norm today is more around 1:1. But some companies, which have tapped the capital markets, have kept this figure
at around 0.5:1 or even, lower. For profitable companies, from the taxation point of view this is hardly a balanced situation as dividend is taxed twice—once at the company level and again at the shareholder’s end. Also, low EPS figures affect market discounting.

- The market for bonds is opening up with the coupon rates now moving up to attractive levels to tempt the traditional equity investor to the bond market. Further, equity investors have lost considerably in the prolonged downtrend in the equity market and are getting impatient with waiting for the stock markets to pick up. Bonds are, therefore, definitely more attractive today than ever before and this has a direct bearing on the extent of subscription.

- There is a concerted effort to create a market for bonds and the NSE in this direction has made a significant move. ICICI Securities and Lazard Creditcapital have even evolved a bond index for the investors. While these have yet to become popular, with increased trading activity these indices may become more meaningful for the investor.

Finally, banks and financial institutions are strapped for funds and are not even enhancing working capital limits, let alone sanction generous term loans. It is reported that even big term-lending institutions have not been able to make their disbursements quickly on loans already sanctioned.

**PRIMARY MARKET – CHANGING SCENARIO:**

Firstly to encourage small investor, SEBI introduced a new system of allotment favouring investors applying for less than 1000 share. A committee was set up under Y.C. Malegam to suggest ways of strengthening the primary market. The recommendation was endorsed and guidelines pertaining to it were issued by SEBI, which open new vistas to this area. Mushrooming of issue were curtailed with new norms like mandatory 5 crores limit for listing and two year track record a must for any Issuer will eventually lead to a lesser number of companies tapping the market.
Merchant Bankers have become cautious regarding pricing their issue and demanding full information from the promoter's regarding themselves and their project.

In the coming days the primary market scenario will change dramatically and the future will be for the small investor's as there will be greater transparency and disclosures. Safety Net concept will also emerge in the days to come, as Merchant Banker's will take large exposure in the issue they will lead manage. Hence small investors will be benefitted.

However, development of primary market will depends upon the sound development of secondary market which most offer easy liquidity to the investors. In future primary market and secondary market will work in union and cannot operate themselves in isolation. Number of issues in primary sector will go down, quantum of funds raised will increase, and Issue with inherent quality will come. The entire gamut of this segment will only be activated if a sound secondary market extends its support in the form of transparency, better liquidity, faster settlement system, minimization of bad delivery etc. Future really shines for Indian capital market anything in the positive direction will definitely emerge both for primary as well as secondary market and ultimately the market is for the small investors, by the small investors and with the small investors.
SECTION – V

DISCLOSURE REQUIREMENTS

As is the case with companies in capital markets of the other countries, a company offering securities in the Indian capital markets is required to make a public disclosure of all relevant information through its offer documents. The offer documents for an issue of securities is:

- the prospectus, and
- the application form and the abridged prospectus in case of an issue to the public, or
- the letter of offer in the case of a rights issue to existing shareholders or debenture holders of a company with or without the right to renounce in favour of other persons.

A. PROSPECTUS:

An Indian company making a public issue is required to make a true, fair and adequate disclosure on the issue, the company and other relevant matters through a prospectus. The Lead Manager for a public issue, who is a Merchant Banker of category I is responsible for preparing the prospectus of the issue. The Lead Manager is required to submit a draft prospectus to SEBI and the relevant stock exchanges at least 21 days (three weeks) prior to the filing of the final offer documents with the Registrar of Companies (ROC) and the stock exchange for disclosure purposes. A draft prospectus without the issue price fixed shall be at first submitted to SEBI for its comments. SEBI then issues an Observation Letter to the Lead Manager. Once the issue is priced and the prospectus is completed, the Lead Manager files its copies with the stock exchange on which the issue is proposed to be listed and distributes its copies to the public as a public
The final prospectus with the pricing information included in it is filed with the ROC and the relevant stock exchange.

Unlike a prospectus of an issue in the United States and some other countries, a prospectus in India is not required to be furnished to every investor before he or she commits to investing in the issue. It is required to be furnished only upon his or her request. Instead, the abridged prospectus is furnished to every investor who applies for newly issued shares or debentures.

B. ABRIDGED PROSPECTUS:

The abridged prospectus is an offer document attached to an application form for shares or debentures. The Companies Act, 1956 requires the application to be accompanied by "a memorandum containing such salient features of a prospectus as may be prescribed". The memorandum is conventionally called an abridged prospectus. It carries less information than the prospectus. The application form is part of the abridged prospectus, being attached to it along a perforated line. This is meant so that to ensure prospective investor will miss out on an opportunity to study important information for his or her investment decision before he or she submits the application form, given the fact that the investor may fail to request of a copy of the prospectus.
C. LETTER OF OFFER:

The letter of offer is a disclosure document for a rights issue in lieu of the prospectus. Where a listed company issues shares whose value exceeds Rs. 5 million (approximately US $140,000) by way of rights, its Merchant Banker, acting as the Lead Manager, is required to file a letter of offer with SEBI two weeks before the issue opens for subscription. Before that, the Merchant Banker is required to file the draft letter of offer with SEBI for observation and comments six weeks before the issue opens for subscription. SEBI is to provide the Merchant Banker with its comments within three weeks. The Merchant Banker is required to incorporate SEBI’s comments into the final letter of offer, or comply with SEBI’s comments before filing the final letter of offer with SEBI.

The disclosure requirements for the offer documents are, at present, governed by the following:

- **Schedule II to the Companies Act, 1956 (Schedule II)**
  
  This schedule is stipulated under Sections 44 (2) (a) and 56 of the Companies Act, 1956, and highlights the matters to be specified in the prospectus and reports to be sent out therein.

- **Form No. 2A of the General Rules & Forms (Form No. 2A)**
  
  The salient features of the prospectus which must be incorporated in the abridged prospectus are prescribed in Form No. 2A annexed to the Companies (Central Government’s) General Rules and Forms, 1956. Under Section 4CC thereof.

- **Guidelines for Disclosure and Investor Protection issued by SEBI (SEBI Guidelines) and Clarifications thereto (SEBI Clarifications)**. These guidelines were initially issued in June 1992, and subsequently 10 additional guidelines and 21 clarifications of the guidelines had been issued, as at the end of July 1997. These guidelines and clarifications are also referred to as DIP Series.
RMB (GI Series) Circulars issued by the SEBI (GI Series Circulars). The general instructions that SEBI had issued to registered Merchant Bankers regarding issue management and other activities were consolidated and codified into RMB (GI Series) Circulars. 41

Observation letters issued by SEBI to Lead Managers while scrutinizing the offer documents in individual cases (Observations Letters).

SEBI examines the draft prospectus of an issue filed with it, with a view to ensuring that the important and necessary disclosures are made, and issues an observation letter to the Lead Manager, pointing out if there is anything which is prima facie misleading or incorrect. The observation letter is valid for a period of 365 days. 42 It is an Indian version of a “deficiency letter” or letter of comment under the US Securities Laws.

The items required to be disclosed in an abridged prospectus are stipulated in Section II of Clarification XIV of the SEBI Guidelines. Those required to be disclosed in a letter of offer are stipulated in Annexure - I to Clarification X, dated May 23, 1995, and in Section II of Clarification XIV of the SEBI Guidelines. The disclosure requirements for a rights issue are simpler than those for a public issue.

D. CONTINUING DISCLOSURE:

After a security is issued to the public and subsequently listed on a stock exchange, the stock exchange requires the issuing company to make continuing disclosures under the listing agreement. The issuing company is required to continue to disclose in a timely manner to the exchange, to the holders of the listed securities (the shareholders or the bondholders), and to the
public through the exchange or the media, any information necessary to enable the holders of the listed securities to appraise its position and to avoid the establishment of a false market in such listed securities. Such information include:

- The date of the meeting of the board of directors for corporate actions;
- The audited financial results on an annual basis and the unaudited ones on a semi-annual basis;
- Any proposed change in the general character or nature of the company's business;
- Any alterations of the company's capital;
- Any change of the company's directorate including managing directors and auditors, etc.

E. ACCOUNTING PRINCIPLES:

The financial statements of an issuing company in its disclosure documents are prepared in accordance with India's generally accepted accounting principles (Indian GAAP). The increasing exposure of Indian listed companies to international investment communities, through their securities issues outside the country or FII's investment in their stocks or debentures in the domestic markets has compelled them to adopt more internationally acceptable accounting principles. Institutes of Chartered Accountants of India issued a note to introduce new accounting standards in the fiscal year 1995-96. The new accounting principles include the following:

- Cash flow statement
- Classification between long-term and current investments
- Earnings per share
• Recognition of a forward exchange contract hedged against a long-term commitment at the historical rate, and of the translation gain or loss from the hedged transaction over the life of the contract in the profit and loss account except for fixed assets.
• Provision for such compensation for future absences of employees, wherever applicable.

Yet, Indian GAAP is considerably different from UK GAAPs and US. Table III below summarizes the significant differences of Indian GAAP from UK and US are summarized in Annexure – I.1.

SECTION – VI

PRINCIPAL STEPS OF A PUBLIC ISSUE

A. VETTING OF PROSPECTUS BY SEBI:

• A draft prospectus is prepared giving out details of the Company, promoters background, management, terms of the issue, project details, modes of financing, past financial performance, projected profitability and others. Additionally, a Venture Capital Firm has to file the details of the terms subject to which funds are to be raised in the proposed issue in a document called the 'placement memorandum.'

• Appointment of underwriters: The underwriters are appointed whom commit to shoulder the liability and subscribe to the shortfall in case the issue is under-subscribed. For this commitment, they are entitled to a maximum commission of 2.5% on the amount underwritten.

• Appointment of Bankers: Bankers along with their branch network act as the collecting agencies and process the funds procured during the public issue. The Banks provide temporary loans for the period between the issue date and the date the issue proceeds becomes available after allotment, which is referred to as a 'bridge loan.'
- Appointment of Registrars: Registrars process the application forms, tabulate the amounts collected during the issue and initiate the allotment procedures.

- Appointment of the brokers to the issue: Recognized members of the Stock exchanges are appointed as brokers to the issue for marketing the issue. They are eligible for a maximum brokerage of 1.5%.

- Filing of prospectus with the Registrar of Companies: The draft prospectus along with the copies of the agreements entered into with the Lead Manager, Underwriters, Bankers, registrars and Brokers to the issue is filed with the Registrar of Companies of the state where the registered office of the company is located.

- Printing and dispatched to all the Merchant Bankers, underwriters, brokers to the issue.

- Filing of the initial listing application: A letter is sent to the Stock exchanges where the issue is proposed to be listed giving the details and stating the intent of getting the shares listed on the Exchange. The initial listing application has to be sent with a fee of Rs. 7,500/-. 

- Statutory Announcement: An abridged version of the prospectus and the issue start and close dates are published in major English dailies and vernacular newspapers.

- Processing of Applications: After the close of the Public issue all the application forms are scrutinized, tabulated and then shares are allotted against these applications.

- Establishing the liability of the Underwriter: In case the Issue is not fully subscribed to, then the liability for the subscription falls on the underwriters who have to subscribe to the shortfall, in case they have not procured the amount committed by them as per the Underwriting agreement.

- Allotment of Shares: After the issue is subscribed to the minimum level, the allotment procedure as prescribed by SEBI is initiated.
- Listing of the Issue: The shares after having been allotted have to list compulsorily in the regional stock exchange and optionally at the other stock exchanges.

B. COST OF A PUBLIC ISSUE:

The cost of a public issue works out between 8% to 12% depending on the issue size but the maximum has been specified by SEBI as under:

<table>
<thead>
<tr>
<th>FOR EQUITY &amp; CONVERTIBLE DEBENTURES</th>
<th>FOR NON- CONVERTIBLE DEBENTURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>- When the issue size is up to 5 crores = Mandatory costs + 5%</td>
<td>- When the issue size is up to 5 crores = Mandatory costs + 2%</td>
</tr>
<tr>
<td>- When the issue size is greater than 5 crores: Mandatory costs + 2%</td>
<td>- When the issue size is greater than 5 crores: Mandatory costs + 1%</td>
</tr>
</tbody>
</table>

**Mandatory costs includes underwriting commission, brokerage, fees of the Lead Managers of the issue, expenses on statutory announcements, listing fees and stamp duty.

C. ELIGIBILITY FOR AN IPO:

A company is allowed to make an IPO if:

- The company has a track record of dividend paying capability for 3 out of the immediately preceding 5 years;
- A public financial institution or scheduled commercial banks has appraised the project to be financed through the proposed offer and the appraising agency participates in the financing of the project to the extent of at least 10% of the Project cost. Typically a new company has to compulsorily issue shares at par, while for companies with a track record the shares can be issued at a premium. Before the advent of SEBI the prices of shares were valued as per the Controller of Capital Issues (CCI).
D. RIGHTS ISSUE:

The rights issue involves selling of securities to the existing shareholders in proportion to their current holding. When a company issues additional equity capital it has to offered in the first instance to the existing shareholders on a pro-rata basis as per Section 81 of the Companies Act, 1956. The shareholders may be a special resolution forfeit this right, partially or fully be a special resolution to enable the company to issue additional capital to the public or alternatively by passing a simple resolution and taking the permission of the Central Government.

E. PRIVATE PLACEMENT:

A private placement results from the sale of securities by the company to one or few investors. The distinctive features of private placement is that:

- There is no need for a formal prospectus as well as underwriting arrangement
- The terms of the issue are negotiated between the company and the investors

The issuers are normally the listed public limited companies or closely held public or private limited companies which cannot access the primary market. The securities are placed normally with the institutional investors, Mutual Funds or other Financial Institutions.
F. SEBI GUIDELINES FOR IPO's:

- Allotment has to be made within 30 days of the closure of the Public Issue and 42 days in case of a Rights Issue.

- Net Offer to the General Public has to be at least 25% of the Total Issue Size for listing on a Stock Exchange. For listing an IPO on the NSE firstly, Paid up capital should be Rs. 20 Crores, secondly the issuer or the promoting company should have a track record of profitability and thirdly the project should be appraised by a financial Institution, banks or Category I Merchant Bank. For knowledge based companies like IT the paid up capital should be Rs. 5 Crores, but the market capitalization should be at least Rs.50 Crores. It is mandatory for a company gets its shares listed at the regional stock exchange where the registered office of the issuer is located.

- A venture Capital Fund shall not be entitled to get its securities listed on any stock exchange till the expiry of 3 years from the date of issuance of securities.

- In an Issue of more than Rs. 100 crores the issuer is allowed to place the whole issue by book building.

- Minimum of 50% of the Net offer to the Public has to be reserved for Investors applying for less than 1000 shares.

- All the listing formalities for a public Issue has to be completed within 70 days from the date of closure of the subscription list.

- There should at least 5 investors for every 1 lakh of equity offered.

- Quoting of permanent Account number or GIR No. in application for allotment of securities is compulsory where monetary value of Investment is Rs. 50,000/- or above.
• Firm Allotment to permanent and regular employees of the issuer is subject to a ceiling of 10% of the issue amount.

• Indian development financial institutions and Mutual Fund can be allotted securities up to 75% of the Issue Amount.

• Allotment to categories of FII's and NRI's is up to a maximum of 24% which can be further extended to 30% by an application to the RBI – supported by a resolution passed in the General Meeting.

• 10% individual ceiling for each category a) Permanent employee's b) Shareholding of the promoting companies.

• Securities issued to the promoter, his group companies by way of firm allotment and reservation have a lock-in period of 3 years. However, shares allotted to FII's and certain Indian and multilateral development financial institutions and Indian Mutual Funds are not subject to lock-in periods.

• The minimum period for which a public issue has to be kept open 3 working days and the maximum for which it can be kept open is 10 working days. The minimum period for a rights issue is 15 working days and the maximum is 60 working days.

• A public issue is effected if the issue is able to procure 90% of the total issue size within 60 days from the date of earliest closure of the public Issue. In case of over-subscription the company may have the right to retain the excess application money and allot shares more than the proposed issue which is referred to as the 'green-shoe' option.

• A rights issue has to procure 90% subscription in 60 days of the opening of the issue.

• 20% of the total issued capital, if the company is an unlisted one with a three year track record of consistent profitability or else in all cases the following slab rate apply:
<table>
<thead>
<tr>
<th>Size of Capital issued (Including Premium)</th>
<th>Contribution %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than Rs. 100 crores</td>
<td>50%</td>
</tr>
<tr>
<td>&gt; 100 crores upto 300 crores</td>
<td>40%</td>
</tr>
<tr>
<td>&gt; 300 crores upto 600 crores</td>
<td>30%</td>
</tr>
<tr>
<td>&gt; 600 crores</td>
<td>15%</td>
</tr>
</tbody>
</table>

Promoter's contribution is subject to a lock-in period of 3 years.

- Refund orders have to be dispatched within 30 days of the closure of the Public Issue.
- Refunds of excess application money i.e. for un-allotted shares have to be made within 30 days of the closure of the public Issue.

**F. GDR AND ITS FEATURES:**

"Global Depositary Receipts means any instrument in the form of a depositary receipt or certificate (by whatever name it is called) created by the Overseas Depositary Bank outside India and issued to non-resident investors against the issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company." A GDR issued in America is an American Depositary Receipt (ADR).

Among the Indian companies Reliance Industries limited was the first company to raise funds through a GDR issue.
Salient Features Of A GDR

- The holder of a GDR does not have voting rights
- The proceeds are collected in foreign currency thus enabling the issuer to utilize the same for meeting the foreign exchange component of project cost, repayment of foreign currency loans, meeting overseas commitments and for similar other purposes.

G. SPONSORED ADR:

Sponsored ADR is ADR created by a Non-US Company working directly with a depositary bank. An unsponsored ADR is usually the one created by a bank without the participation or consent of the non-US company. unsponsored ADR can trade only in over-the-counter market.

Levels Of ADRs

- For a Level I ADR programme the receipts issued in the US are registered with the SEC, but the underlying shares are held in the Depositary Bank are not registered with the SEC. They must partially adhere to Generally Accepted Accounting Principles (GAAP) used in the USA.
- Level II ADRs and the underlying shares (that already trade in the foreign company’s domestic market) are registered with the SEC. They must also partially adhere to the Generally Accepted Accounting Principles.
- Level III ADR’s must adhere fully to the GAAP and the underlying shares held at the Depositary Bank are typically new shares not those already trading in the foreign company’s domestic currency.

A bond offering in the US domestic market by a non-US entity is referred to as the Yankee Bonds while if it is made in the Japanese market by a non-Japanese company is called Samurai Bonds.
REFERENCES:

1. SEBI, Indian securities markets: Agenda for Development and Reform – A Discussing paper p.1
7. Section 31 of the SEBI Act, 1992
9. Section 24 of the SEBI Act, 1992, provides "Whoever contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made thereunder, shall be punishable with imprisonment for a term which extend to one year, or with fine, or with both." (Underscored by the author).
10. Sections 9 & 10 of the SC (R) Act, 1956.
15. "Government security" means a security created and issued by the Central Government or a State Government. Section 2. (b) of the SC (R) Act, 1956.
16. Section 2 (1) (c) of the SEBI Act, 1992. The Ministry of Finance decided to expand the definition of the term 'securities' to include collective investment schemes, and to regulate them under the SEBI's jurisdiction. ("Finance Ministry redefines securities to bring plantation companies under market regulator SEBI", Business Standard, November 19, 1997)
18. Sections 11. (2) (b), (ba) & (c), and 12 (1), (1A) & (1B) of the SEBI Act, 1992.
22. SEBI AR 1993-94
23. SEBI AR – 1993-94
25. SEBI AR - 1997 – 98 P 6-7
28. Sanjay Sinha, "Primary Marketing – Changing Scenario",
30. Section 4 (b) of Part C of SEBI Clarification No. XIV dated March 1, 1996.
31. Section 24 (1) and (2), SEBI (Merchant Bankers) Regulations, 1992.
32. Previously SEB vetted offer documents and issued an acknowledgment card for an issue it approved. The board stopped such a practice in December 1996. Part A.1 of SEBI Clarification No. XVII, December 10, 1996.
33. Section 5 of Clarification No. XII of the SEBI Guidelines, dated September 29, 1995.
34. Section B 14 of Clarification No. XIII of the SEBI Guidelines, dated October 12, 1995.
35. The proviso of Section 56 (3) of the Companies Act, 1956.
36. Section 56 (3) of the Companies Act, 1956.

39. Section 4 (b) & (c) of Clarification No. X of the SEBI Guidelines, dated May 23, 1995.

40. DIP = Disclosure and investor Protection.

41. RMB = Registered Merchant Bankers, and GI = General Instructions.


## ANNEXURE - I.1
### SIGNIFICANT DIFFERENCES AMONG INDIAN, US & UK GAAP

<table>
<thead>
<tr>
<th></th>
<th>INDIAN GAAP</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>88</td>
<td>Consolidation of subsidiaries is not required.</td>
<td>Consolidation of subsidiaries is required.</td>
<td>Consolidation of subsidiaries is required. (Applies to large and listed companies only).</td>
</tr>
<tr>
<td>2</td>
<td>Investments in associated companies are carried at cost.</td>
<td>Investments in associated companies are accounted for under the equity method.</td>
<td>Investments in associated companies are accounted for under the equity method. (Applies to large and listed companies only)</td>
</tr>
<tr>
<td>3</td>
<td>For the fiscal years prior to 1996, a cash flow statement was not required. However, with effect from fiscal 1996, companies listed on Indian stock exchanges are required to furnish cash flow statements as part of listing agreement with stock exchanges.</td>
<td>Cash flow statement is required. (Applies to large and listed companies only)</td>
<td>Cash flow statement is required. (Applies to large and listed companies only)</td>
</tr>
<tr>
<td>4</td>
<td>Unrealized and realized gains and losses arising on translation of foreign currency liabilities incurred to finance the purchase of fixed assets are adjusted against the carrying cost of the relevant assets and depreciation is provided thereon.</td>
<td>Unrealized and realized gains and losses arising on foreign currency liabilities must be taken to the Profit and Loss Account.</td>
<td>Unrealized and realized gains and losses arising on foreign currency liabilities must be taken to the Profit and Loss Account.</td>
</tr>
<tr>
<td>5</td>
<td>Effective from fiscal 1996, forward exchange contracts are required to be accounted for at the rates prevailing on the transaction dates and the resultant gain or loss arising out of a hedging transaction is to be recognized as income or expense over the life of the contract in the Profit and Loss Account except for fixed assets.</td>
<td>Forward exchange contracts to hedge future commitments or commitments or transactions are revalued at each balance sheet date and the gain or loss arising is dealt with in income for the period or deferred if identifiable to a specific foreign currency commitment. However, losses are not deferred if it is estimated that deferral would lead to recognizing losses in later periods.</td>
<td>Where forward exchange contracts are hedged against future commitments, the transactions are accounted for at such contracted rate.</td>
</tr>
<tr>
<td></td>
<td>Minimum depreciation rates are prescribed by the Companies Act. Where applicable, higher depreciation based on useful economic life is required to be provided.</td>
<td>Depreciation rates are derived on the basis of the useful economic life of the asset.</td>
<td>Depreciation rates are derived on the basis of the useful economic life of the asset.</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>7</td>
<td>Revaluation of fixed assets is permitted by creating a revaluation reserve, which is not available for distribution.</td>
<td>Revaluation of fixed assets is not permitted.</td>
<td>Revaluation of fixed assets is not permitted.</td>
</tr>
<tr>
<td>8</td>
<td>Additional depreciation on revaluation of fixed assets is permitted to be credited to the Profit and Loss Account from revaluation reserve.</td>
<td>Revaluation of fixed assets is not permitted.</td>
<td>Permitted to credit the amount equal to additional depreciation from revaluation reserve to retained profit.</td>
</tr>
<tr>
<td>9</td>
<td>The provision for taxation is based on the estimated tax liability currently payable. No distinction is made between timing differences and permanent differences and adjustments are not made for deferred tax liability or deferred tax credit.</td>
<td>Timing differences are identified and provided for using the liability method for the reversal of these differences to the extent that the tax payment or receipt is expected to arise.</td>
<td>Timing differences are identified and provision using the liability method is made for the reversal of these differences to the extent that a tax payment for receipt is expected to arise.</td>
</tr>
<tr>
<td>10</td>
<td>Effect from fiscal 1996, investments are required to be classified into long-term and current investments. While long-term investments must be carried at cost less provision for permanent diminution in value (such provisions are determined and made individually for each investment). Current investments must be carried at the lower of cost and fair value determined either on an individual investment basis or by category of investment by not on an overall or global basis.</td>
<td>Investments are segregated into (a) &quot;held to maturity securities&quot; carried at amortized cost and classified in accounts based on contractual maturity; (b) &quot;trading securities&quot; (carried at fair value, recognizing unrealized gains and losses and classified in account as current asset); (c) &quot;available for sale securities&quot; (carried at fair value, unrealized gains and losses excluded from earnings, reported in separate component of shareholders equity and classified in accounts as current or long-term based on management intentions).</td>
<td>Fixed asset investments are carried at cost (with provision for permanent diminution in value). Current asset investments are recorded at lower of cost and net realizable value.</td>
</tr>
<tr>
<td>11</td>
<td>Obligations for repayment of long-term debts, which fall due for repayment within one year, are not segregated but continue to from part of long-term debt.</td>
<td>Obligations for repayment of long-term debts, which fall due for repayment within one year, are included in current liabilities.</td>
<td>Obligations for repayment of long-term debts, which fall due for repayment within one year, are included in current liabilities.</td>
</tr>
<tr>
<td>12</td>
<td>Extraordinary items are disclosed separately or by way of note without adjustment for the tax effect thereof.</td>
<td>Extraordinary items are reported net of disclosed income tax effect thereon.</td>
<td>Extraordinary items (Which are now extremely rate) are separately disclosed with income tax effect thereon. Items previously considered as &quot;extraordinary&quot; are now charged to profit before tax as exceptional items.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Premium on redemption of debentures and bonds can be amortized over the period of the debentures or bonds or charged to the share premium account.</td>
<td>Premium on redemption of debentures and bonds can be amortized over the period of the debentures or bonds, using the effective interest method.</td>
<td>Premium on redemption of debentures and bonds can be amortized over the period of the debentures or bonds or charged to the share premium account.</td>
</tr>
<tr>
<td>14</td>
<td>Changes in accounting policies and prior period items are reported on a prospective, if material, in the year of change, with separate disclosure and with quantification of impact on profits and losses for the year and reserves as at the year end. Accounting effect of changes in accounting policies made from an earlier date is given in the year of change.</td>
<td>Prior period items are accounted for by restating prior years and adjustment to retained profits. Except changes in certain specified accounting principles made by retroactive restatement, changes in accounting policies are not accounted for by restating prior years but the effect of such changes is separately disclosed in the Profit and Loss Account. The cumulative effect of the changes is included in the Profit and Loss Account, net of income-tax effects. Correction of errors required prior period restatement.</td>
<td>Changes in accounting policies and prior period items are accounted for by restating prior years and adjustments to retained profits.</td>
</tr>
<tr>
<td>15</td>
<td>For fiscal years prior to 1996, information regarding earnings per share was not required to be disclosed. With effect from fiscal 1996, such figure is required to be disclosed. However, a standard method for determining earnings per share has not yet been prescribed.</td>
<td>Information regarding earnings per share is disclosed. Prescribed methods are used for determining earnings per share.</td>
<td>Information regarding earnings per share is disclosed. (Applies to large and listed companies only)</td>
</tr>
<tr>
<td>16</td>
<td>There is no requirement to disclose information for segments of business.</td>
<td>Segmental disclosure must be made of turnover, net assets and profits before interest and tax in respect of each class of business and geographical segment.</td>
<td>Segmental disclosure must be made of turnover, net assets, and profits before tax in respect of each class of business and geographical segment (Applies to large and listed companies only).</td>
</tr>
<tr>
<td>17</td>
<td>Share and debenture issue expenses can be written off when incurred or charged to the share premium account or can be accounted for as deferred revenue expenses and amortized.</td>
<td>Direct costs of issuing share capital are deducted from the related proceeds and the net amount is recorded in shareholders' equity. Debt issue costs are amortized over the life of the debt.</td>
<td>Share and debenture issue expenses can be written off when incurred or charged to the share premium account.</td>
</tr>
<tr>
<td>18</td>
<td>Proposed dividends are reflected in the financial statements of the year to which they relate even though proposed or declared after the year-end.</td>
<td>Dividends are a charge to retained earnings at the point of time they are formally declared by the Board of Directors.</td>
<td>Proposed dividends are reflected in the financial statements of the year to which they relate even though proposed or declared after the year-end.</td>
</tr>
<tr>
<td>Page</td>
<td>Description</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>-------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Generally lease rentals for both operating and finance leases are recognized in the Profit and Loss Account. In the case of a finance lease, a matching annual charge is made to the Profit and Loss Account representing recovery of the net investment / fair value of the leased asset over the lease term. Lease rentals for operating leases are recognized in the Profit and Loss Account. In respect of finance leases the present value of the minimum lease payments discounted at the interest rate implicit in the lease is capitalized and depreciated over the shorter of the lease term and its useful life. Lease rentals are apportioned between finance charges and outstanding obligations. Finance charges are recognized in the Profit and Loss Account.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Profit and loss arising from sale and leaseback transactions in respect of finance leases may be recognized in the financial statements in the year of the transaction, only if the sale and leaseback transaction is at fair value. Profit or loss arising from sale and leaseback transactions in respect of finance leases should be deferred and amortized in the financial statements of the seller / lessee over the shorter of the lease term and the useful life of the assets.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Effect from fiscal 1996, provision for compensation for future absences of employees to the extent earned by the employee during the period is required to be provided. Provision for compensation for future absences of employees is necessary if the absences are earned by the employees during the period and the unused rights eventually vest or accumulate and compensation therefor is probable and can be reasonably estimated. Compensation for future absences of employees is generally not provided for.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>Although related party transactions are not required to be disclosed, amounts due to / from specified related parties are disclosed separately as required by the Companies Act. All related party transactions are required to be disclosed. Where material, related party transactions are required to be disclosed.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: MTN Offer Document (August 1997) of the Industrial Credit & Investment Corporation of India Limited, audited by Messrs. N. M. Raiji & Co., Chartered Accountants (By courtesy of Messrs. N. M. Raiji & Co.)