CHAPTER - 1 (1)

Financial Markets.

Primary Market

The primary market is an important part of Capital market, which deals with issuance of new securities. It enables corporate, Public Sector institutions as well as the government to raise resources [Through issuance of debt or equity based securities] to meet their capital requirements.

Features of Primary Markets.

① The primary market is the market where the securities [both capital market and money market] are sold for the first time. Therefore it is also called New Issue market (NIM)

② In primary market securities are issued by Companies as well as government [Through RBI]

③ In a primary market, the securities are issued by the Company / issuer directly to investors.

④ The primary market is used by companies as a Primary source of funding for the purpose of setting up new ventures / business or for expanding or modernizing the existing business.

⑤ In India, Primary market is regulated by both SEBI and RBI

⑥ The successful functioning of Primary market indicates the efficiency of the financial system of the country.

(7) Efficient primary market is crucial for facilitating capital formation in the economy.

Services of Primary market

(1) The Transfer :- An important function rendered by Primary market is to allow the Transfer of resources from investor to entrepreneurs who establish new Companies/ventures. It is also called the function of origination.

(2) Investigative Services :- The merchant bankers and other agencies involved in primary market Provide the investigative services. These include, economic analysis, Technical analysis financial analysis of the Companies where an investor wants to invest.

(3) Advisory and information services :- Various advisory Services are available in Primary market with a view to improving the quality of Capital issues in Primary market. The relevant Services include determining the Type, The mix, The price, The time, The Size and the Terms and Conditions of Issue of Securities, etc.

(4) The Guarantee :- If The Company entering Capital market is not sure of raising full amount of funds from The market, there are Certain mechanism there by Sucess of Such issue will be guaranteed. It is The function of "underwriting". Underwriting aims at

guaranteeing the subscription of public issue. Underwriters ensure successful subscription of the issue by undertaking to take up the securities in the event of the public failing to subscribe the same.

(5). The Distribution :- The function that facilitates the sale of securities from company to investors is called 'distribution'. The function of distribution is rendered by the specialized. agencies like brokers and dealers in securities They maintain a constant and a close link with the issuers and the ultimate investors on the one hand, and issuers and other.

Advantages

1. Mobilization of Savings.
2. Channelizing savings for productive use.
3. Source of large supply of funds.
4. Rapid Industrial growth due to increase in Production and Productivity in economy.

Disadvantages

1. Possibility of deceiving investors.
2. No fixed norms for project appraisal.
3. Lack of Post issue Seriousness.
4. Ineffective role of merchant bankers.
5. Delay in allotment process.

Players of Primary Market.

The important players in primary market are:-

1. Companies issuing shares and debentures.
2. SEBI [as a regulator]
3. RBI [as a regulator as well as issuer of money market instruments on behalf of central government]
4. Commercial Banks.
5. Stock Exchanges.
6. Different categories of merchant Bankers such as:
   - Lead manager.
   - Co-manager/ Advisers to the issue.
   - Underwriters to the issue
   - Brokers to the issue
   - Bankers to the issue and refund Banker.
   - Registrar to the issue.
7. Credit rating agencies.
8. Insurance Companies.
9. Depositories.
10. Depository participants
11. Investors.
    - Individual Investors.
    - Domestic institutional investors.
    - Foreign institutional investors.

The Primary Market Instruments.

Some of the important primary market instruments [which are part of both Capital and money market] are given below:-

1. Equity shares.
   - IPO
   - Subsequent Issue
   - Right issue
   - Private placement
   - Preferencial Allotment.
2. Preference shares
3. Debentures/bonds
4. Foreign currency convertible bonds.
5. Participatory Notes
6. Global depository/American depository receipts.
7. Commercial papers
8. Certificate of deposit
9. Treasury bills
10. Repo and reverse Repo.

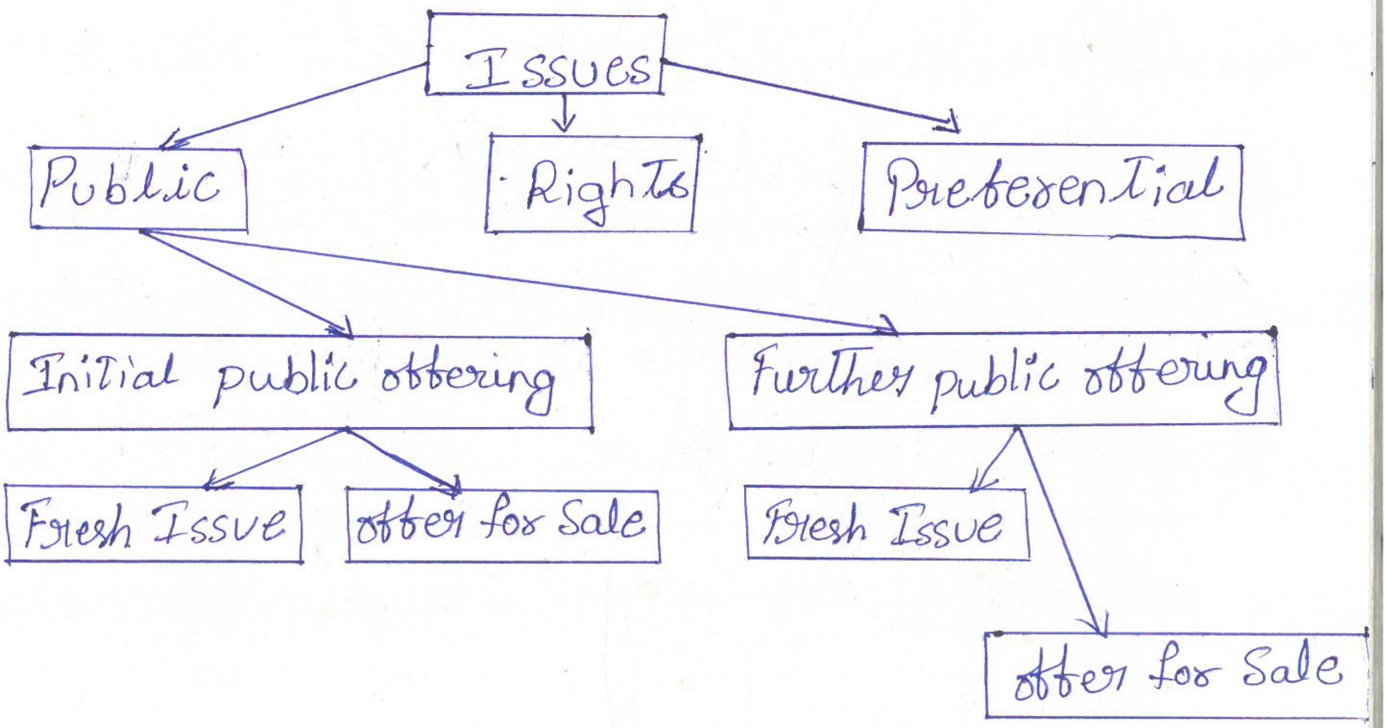
TYPES AND PROCEDURE FOR ISSUE OF EQUITY.

Different Types of Issue of Equity shares in Primary market (Issue mechanism).

A Company can raise finance by issuing equity shares in different forms like:-

-> IPO
-> Subsequent issue / FPO
-> Right issue
-> Private placement
-> Preferential allotment
-> Bought out deals [offer for sale]

Classification of Issue of Equity shares in Primary market.



-> **Initial Public offer of Equity shares [IPO]**

If the firm is issuing the shares for the first time, it is referred to as initial public offer. Initial public offer will be followed by listing of the equity shares in the stock exchange.

Parties Involved in IPO

A. Managers To The Issue / Lead Manager :- lead managers are appointed by the Company to manage the initial public offering Compaign.

Their main duties are:

- Drafting of Prospectus.
- Preparing the budget ~~of~~ expenses related to the issue
- Suggesting the appropriate timings of the public issue
- Assisting in marketing the public issue Successfully
- Advising the Company in the appointment of registrars to the issue, underwriters, brokers, bankers to the issue, advertising agents etc.
- Directing the various agencies involved in the Public issue.

B. Registrar To The Issue :- After the appointment of the lead managers to the issue is appointed. The Registrars normally receive the share application from various Collection Centers. They arrange for the dispatching of the share certificates. They hand over the details of the share allocation and other related ~~g~~ registers to the Company.

C. Underwriters :- Underwriters is a contract by means of which a person gives an assurance to the issuer to the effect that the former would Subscribe to the securities offered in the event of non-Subscription by the person to whom

assures is called an Underwriter.
Underwriters are divided into Two Categories:-

- Financial Institutions and Banks.
- Brokers and approved investment Companies.

D. Bankers To The Issue:- Bankers to the issue have the responsibility of collecting the application money along with the application form. The bankers to the issue generally charge commission besides the brokerage, if any. Depending upon the size of the public issue more than one banker to the issue is appointed. when the size of the issue is large, 3 to 4 banks are appointed as bankers to the issue.

E. Advertising Agents:- Advertising plays a key role in promoting the public issue. The advertising agencies take the responsibility of giving publicity to the issue on the suitable media. The media may be newspapers/magazines/hoardings/Press release or a combination of all.

F. The Financial Institutions:- Financial Institutions generally underwrite the issue and lead term loans to the companies. Hence, normally they go through the draft of Prospectus, study the proposed program for public issue and approve them. IDBI, IFCI and ICIC, LIC, GIC and UTI are the some of the financial institutions that underwrite and give financial assistance.

G. Government and Statutory Agencies :-

The various regulatory bodies related with the Public issue are :

- Securities Exchange Board of India
- Registrar of Companies
- Reserve Bank of India [if the project involves foreign investment]
- Stock Exchange where the issue is going to be listed
- Industrial licensing authorities.

Issue Management Activities.

Merchant banker is the agency that plan, Coordinate and control the entire issue activity and direct different agencies to contribute to the Successfull marketing of securities. The procedure of the managing a public issue by a Merchant banker is divided into two Phases, viz;

- Pre-issue management
- Post-issue management.

Pre-issue Management Activities.

Steps required to be taken to manage pre-issue activity is as follows:-

1) Obtaining stock exchange approvals to memorandum and articles of associations.
2) Taking action as per SEBI guide lines
3) Finalizing the appointments of the following agencies:-
   - Co-manager/Advisers to the issue
   - Underwriters to the issue
   - Brokers to the issue
   - Bankers to the issue and refund Banker
   - Advertising agency
   - Printers and Registrar to the issue
4) Advise the Company to appoint auditors, legal advisers and broad base Board of Directors.
5) Drafting of Prospectus
6) Obtaining approvals of draft prospectus from the Company's legal advisers, underwriting financial institutions / Banks.
7) Obtaining Consent from parties and agencies acting for the issue to be enclosed with the Prospectus.
8) Approval of prospectus from Securities and Exchange Board of India.
9) Filing of the prospectus with Registrar of Companies.
10) Making an application for enlistment with stock Exchange along with copy of the prospectus.

11) Publicity of the issue with advertisement and Conferences.

Post-issue Management.

Steps involved in post-issue management are :-

1) To ~~P~~Verify and confirm that the issue is Subscribed
2) To Supervise and co-ordinate the allotment procedure of registrar to the issue as per prescribed stock Exchange guidelines
3) To ensure issue of refund order, allotment letters/Certificates within the prescribed time limit after the closure of Subscription list.
4) To report periodically to SEBI about the progress in the matters related to allotment and Refunds
5) To ensure the listing of securities at stock Exchanges
6) To attend the investors grievances regarding the Public issue.

-> ## Subsequent Issue / Follow on Public offer

An FPO is essentially a stock issue of supplementary shares made by a Company that is already publicly listed and has gone through the IPO process.

FPOs are popular methods for companies to raise additional equity capital in the Capital markets through a stock issue. Public Companies can also take advantage of an FPO issuing an offer for Sale to investo-rs, which is made through an offer doument. FPOs should not be confused with IPOs, as IPOs are the initial public offering of equity to the public while

FPOs are Supplemantary issues made after a Company has been established on an exchange.

The Company need to fulfill certain Conditions before going for Subsequent issue of equity shares like :

(a) Company should be listed in stock exchange for atleast 3 years.

(b) Company need to have a track record of payment of dividend for atleast 3 years immediately proceeding the year of issue.

· Procedure for issue of equity shares of a limited Company is similar to that of an IPO. The Company is having a freehand in fixing the prices of subsequent issue. The general practice in India is that 6 months average closing price is taken as Issue price.

→ Right Issue

Right issue involves selling equity/securities in the primary market to existing shareholders. This can be done after meeting some requirements specified by SEBI

When Company issues additional Capital, it has to be first offered to existing shareholders. The Shareholders however may forfeit this right partially or fully to enable the Company to issue additional Capital to public.

According To sec 81 of The Companies Act 1956, if a Public Company wants To increase its Subscribed Capital by allotment of further shares after Two years from the date of its formation or one year from the date of its first allotment, which ever is earlier should offer share at first to the existing share holders in proposition To the shares held by them at th Time of offer. The shareholders have no legal binding To accept The offer and They have The right To renoun The offer in favor of any person. Shares of This Type are Called right shares. Generally right shares are offered at an advantageous rate Compared with The market Rate.

Characteristics of Right Issue.

1) Number of rights That a shareholders gets is equal to t number of shares held by him.
2) The number of rights required To Subscribe an additiona shares is determined by issued Company.
3) Price per share is determined by The Company.
4) Existing shareholders Can exercise right and Can apply for The share.
5) Shareholders who renounce Their rights are not entitle for additional shares.
6) Rights Can be sold.
7) Rights Can be exercised only during a fixed Period [usually 1 month]

$$\text{Number of New shares} = \frac{\text{Desired funds}}{\text{Subscription / offer price}}$$

$$\text{Number of rights required to get an additional share} = \frac{\text{Existing shares}}{\text{New shares.}}$$

Merits of Rights Issue

1. Less expensive as compared to direct public issue
2. Management of applications and allotment is less cumbersome.

Limitations.

1. Can be used by only existing company
2. Cannot be used for large issues
3. Wider ownership base cannot be achieved.

→ Private Placements.

It involves allotment of shares by a company to few selected sophisticated investors like mutual funds, insurance companies, banks, etc. In this method the issue is placed with a small number of financial institutions, corporate bodies and high net worth individuals. The financial intermediaries purchase the shares and sell them to investors at a later date at a suitable price. The stock is placed with issue house client with the medium of placing letter & other documents which taken together contribute a prospectus, giving the information regarding the issue.

Advantages of Private Performance.

1. Cost-effective :- Private placement is a cost-effective method of raising funds. In a public issue underwriting, Printing, mailing and Promotion account for 8 to 10 percent of the issue cost. In the case of the private placement several statutory and non-statutory expenses are avoided.

2. Time Effective :- In the public issue the time required for completing the legal formalities and other formalities takes usually six months or more. But in the private placement the requirements to be fulfilled are less and hence, the time required to place the issue is less, mostly 2 to 3 months.

3. Structure Effectiveness :- It can be structured to meet the needs of the entrepreneurs. It is flexible to suit the entrepreneurs and the financial intermediaries. This is not possible with the public issue with stringent rules and regulations. In the case of debentures the interest ceiling cannot be breached in a public issue.

4. Access Effective :- Through private placement a public limited company listed or unlisted can mobi-lize capital. like-wise issue of all size can be accommodated through the private placement either small or big where as in the public issue market, the size of the issue cannot fall below a certain minimum size.

V. Preferential Allotment

It is an issue of equity by a listed Company to selected investors at a price which may or may not be related to prevailing market price. It is not a public issue of shares. This kind of preferential allotment is made mainly to promoter or their friends and relative.

Pricing :- Price of preferential allotment must not be lower than months average closing price. Pricing regulations of preferential allotment to FII's are more stringent.

Lock in period :- The shares allotted under preferential allotment process will attract a lock in period. If it is allotted a promoter, the lock in period will be 3 years and to others, it is 1 year.

Bought-out Deals (offer for Sale)

Here, the promoter places his shares with an investment banker who offers it to the public at a later date. In other works in a bought out deal, an existing Company off-loads a part of the promoter's Capital to a wholesaler instead of making a public issue. The wholesaler is invariably a merchant banker or some time just a Company with surplus cash. In addition to the main sponsor, there could be individuals and other smaller Companies participating in the Syndicate.

The sponsors hold on to these shares for a period and at an appropriate date they offer the same to the Public. The hold on period may be as low as 70 days or more than a year.

There are many advantages for the issuing company:-

1) Firstly :- a medium or small sized company, which is already facing working capital shortage, cannot afford to have long lead-time before the funds could be mobilized from the public. Bought out deal helps the promoters to realize the funds without any loss of time.

2) Secondly :- The cost of raising funds is reduced in bought out deals. For issuing share to the public the company incurs heavy expenses, which may invariably be as high as 10 percent of the cost of the Project, if not more.

3) Thirdly :- bought out deal helps the entrepreneurs who are not familiar with the capital market but have sound professional knowledge to raise funds. Sponsors of the deal are mostly concerned with the promoters background and government policies than about the past track record or financial Projections. This helps the new entrepreneur to raise adequate ~~capital~~ Capital from the market.

4) Fourthly :- For a Company with no Track record of projects, public issues at a premium may pose problems, as SEBI guidelines come in the way. The stipulations can be avoided by a bought out deal. Companies sell the shares at a premium to the sponsors and they can off-load the shares to the public at a higher premium.

5). Fifthly :- To the investors bought out deals possess low risk since the sponsors have already held the shares for a certain period and the projects might have been completed or may be in the verge of completion, the investors need not wait for returns.

DEBENTURES

Debentures is a debt instrument indicating that a company has borrowed certain sum of money and promises to repay it future under clearly defined terms.

Features.

(a) Interest :- Debentures carries a fixed rate of interest, which is a contractual payment by the company. Interest is allowed as deduction for tax purpose.

(b) Maturity :- Debentures have fixed maturity usually 7-10 years. They are redeemable after the maturity period.

(c). Redemption :- After the maturity debentures are redeemed. They may be redeemed at par or at premium.

(d) Sinking fund :- A sinking fund is created by the Company for the purpose of redemption of the bond. Every year a fixed sum is transferred to the fund and that money will be used to redeem the debentures.

(e). Buy back/Call provision :- Company may excercise call option, there by can redeem the debentures before the maturity wherever buy back is done the company has to redeem at a Premium.

(f). Trust :- When the debentures is issued by the Company a Trust is Created. It includes Trustees drawn from Company's directors, investors, bankers, etc. it is the duty of the Trust to protect the interest of the investors.

(g) Security :- Debentures are either secured or unsecured. If it is secured the debenture holders can exercise lien on Company's assets.

(h). Yield :- Debentures are either secured exchange there will be a market value of debenture holders can exercise lien on Company's assets.

(i). Claims on asset and income :- Before payment of dividend to shareholders interest on debentures are paid same way. Before payment of Capital to shareholders, Capital be paid to debenture holders, Therefore debentures holders are having preferential claim over shareholders.

(j). Compulsory Credit rating :- The Company issuind debentures need to take Compulsory Credit rating from approved agencies.

SEBI Guidelines Towards The Issue of Equity shares.

SEBI, being a capital market regulator, has issued guidelines [Issue of Capital and Disclosure requirements Regulations - 2009] relating to issue of equity shares. The following are some of the important guidelines

1. Entry Norm :- The company issuing shares shall meet the following entry requirements:

(a). Net Tangible Assets of at least ₹ 3 crores in each of the preceding three full years.

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

(c) Net worth of at least ₹ 1 crore in each of the preceding three full years.

(d) If the company has changed its name within the last one year, at least 50% revenue for the preceding 1 year should be from the activity suggested by the new name.

(e). The issue size does not exceed 5 times the pre-issue net worth as per the audited balance sheet of the last financial year.

2. Registration of Intermediaries :- Following are the intermediaries who have to be registered with SEBI and must have valid certificate from SEBI to act as an intermediaries:

- Merchant Bankers
- Registrar & share Transfer Agents
- Bankers To the issue
- Underwriters.

- Stock Brokers and Sub-brokers
- Depositories.

3. Filing of prospectus.

- A Company cannot come out with public issue unless draft prospectus is filed with SEBI.
- A Company cannot fill prospectus directly with SEBI. It has to be filed through a merchant banker.
- Company / merchant banker can proceed with the issue only after the prospectus is approved by the SEBI

4. Guidelines on procedure of Issue / Allotment :-

As per the SEBI guidelines following has to be fulfilled by the Company. issuing the equity or merchant banker on behalf of the Company.

- Filing form 23 with ROC for passing special resolution for issuing of shares.
- obtaining in-principle approval approval from stock exchanges.
- File final prospectus with SEBI / stock exchanges / ROC
- Statutory Advertisements.
- Submission of 1% security deposit with the Regional stock exchanges
- Depositing promoter's contribution in the issue in a separate Bank Account.
- Collection of Application forms & processing the same at the Registrar & share Transfer Agent in consultation with merchant Banker.
- Separate Account be opened for the applications received from public.

- Submitting 3-day post issue monitoring report with SEBI from merchant Banker.
- Finalizing the basis of allotment in consultation with regional stock exchange.
- Post-issue advertisement.
- Dispatch of share Certificates / refund orders
- Entering into listing agreement.
- Obtaining permission from stock Exchanges for listing of Securities.
- Commencement of Trading of Securities.
- Redressal of Investors Grievances.
- Application to SEBI / stock Exchanges for refund of security deposit.

5. Minimum Promoter's Contribution and lockin :-

SEBI guidelines insists that in a public issue by an unlisted issuer, the promoters shall contribute not less than 20% of the post issue Capital which should be locked in for a period of 3years. "lock in" indicates a freeze on the shares. In case of public issue by a listed issuer, the promoters shall contribute not less than 20% of the post issue Capital ~~of~~ or 20% of the issue size.

6. IPO Grading :- SEBI guidelines makes it compulsory for IPO grading. IPO grading is the grade assigned by a Credit Agency registered with SEBI, to the Initial public offering of equity shares or other convertable Securities. Disclosure of "IPO Grades", So obtained is mandatory for companies coming out with an IPO.

7. Reservation and firm allotment :- public issue should be at least 25% of the post issue capital [in case of unlisted company) and public issue should be at least 25% of the issue size [in case of listed company).

- Permanent Employees including working directors and in case of new company the permanent employees of promoting company.
- Shareholders of the promoting company in case of new company and shareholders of group companies in case of existing company.
- Indian mutual Funds.
- FII's including NRI's and OCB.
- Indian and multilateral development institutions
- Scheduled Banks.

8. Compliance officer :-

Company is required to appoint compliance officer to directly liaise with SEBI / stock Exchange to comply with various laws and investors complaints related matters.