B.Com. Program in Accounting
Semester-IV
CC-8: Capital Market
Unit 2: New Issue market

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Definition of New Issue Market:

A new issue is a stock or bond that is being sold to investors for the first time. This new issue can be an Initial Public Offering (IPO) of a company or it can be a new issue floated by an organization that has floated many such issues in the past. The market that deals with these new issues is called the primary market, as opposed to the secondary market that deals with existing shares and bonds.

A new issue is a reference to a security that has been registered and issued and is being sold on a market to the public for the first time. The term does not necessarily refer to newly issued stocks, although initial public offerings (IPOs) are the most commonly known new issues.

Functions of New Issue Market

The main function of the New Issue Market is to facilitate the 'transfer of resources' from savers to users. Conceptually, however, the New Issue Market should not be conceived as a platform only for the purpose of raising finance for new capital expenditure.

In fact, the facilities of the market are also utilised for selling existing concerns to the public as going concerns through conversions of existing proprietary enterprises or private companies into public companies.

Now, the main function of the New Issue Market, i.e. channelling of investible funds, can be divided, from the operational stand-point, into a triple-service function:

(a) Origination
(b) Underwriting
(c) Distribution

The institutional setup dealing with these can be said to constitute the New Issue Market organisation. Let us elucidate a little on all of these.

(a) Origination :

Origination refers to the work of investigation and analysis and processing of new proposals. This in turn may be:

(i) A preliminary investigation undertaken by the sponsors (specialised agencies) of the issue. This involves a/careful study of the technical, economic, financial and/legal aspects of the issuing companies to ensure that/it warrants the backing of the issue house.

(ii) Services of an advisory nature which go to improve the quality of capital issues. These services include/advice on such aspects of capital issues as: determination of the class of security to be/issued and price of the issue in terms of market conditions; the timing and magnitude of issues; method of flotation; and technique of selling and so on.

The importance of the specialised services provided by the New Issue Market organisation in this respect can hardly be over-emphasized. On the thoroughness of investigation and soundness of judgement of the sponsoring institution depends, to a large extent, the allocative efficiency of the market. The origination, however, thoroughly done, will not by itself guarantee success of an issue. A second specialised service i.e. "Underwriting" is often required.

(b) Underwriting:
The idea of underwriting originated on account of uncertainties prevailing in the capital market as a result of which the success of the issue becomes unpredictable. If the issue remains undersubscribed, the directors cannot proceed to allot the shares, and have to return money to the applicants if the subscription is below a minimum amount fixed under the Companies Act. Consequently, the issue and hence the project will fail.
Underwriting entails an agreement whereby a person/organisation agrees to take a specified number of shares or debentures or a specified amount of stock offered to the public in the event of the public not subscribing to it, in consideration of a commission the underwriting commission.
If the issue is fully subscribed by the public, there is no liability attaching to the underwriters; else they have to come forth to meet the shortfall to the extent of the under- subscription. The underwriters in India may broadly be classified into the following two types:
(i) Institutional Underwriters;
(ii) Non-Institutional Underwriting.
Institutional Underwriting in our country has been development oriented. It stands as a major support to those projects which often fail to catch the eye of investing public. These projects rank high from the points of view of national importance e.g. steel, fertilizer, and generally receive higher priority by such underwriters.
Thus institutional underwriting may be broadly recognised, in the context of development credit, as playing a decisive role in directing the economic resources of the country towards desired activities.
This does not mean that they are barred entrance in the issue market from so called glamorous issues to which public can be expected to readily subscribe. They may be underwriting in such cases, but what is expected of them is their support to projects in the priority sector.
One of the principal advantages they offer is that resource-wise they are undoubted. They are in a position to fulfill their underwriting commitments even in the worst foreseeable situations.
The public financial institutions namely IDBI, IFCI, ICICI, LIC and UTI, underwrite a portion of the issued capital. Usually, the underwriting is done in addition to granting term finance by way of loans on debentures. These institutions are usually approached when one or more of the following situations prevail:
(i) The issue is so large that broker-underwriting may not be able to cover the entire issue.
(ii) The gestation period is long enough to act as distinctive
(iii) The project is weak, inasmuch as it is being located in a backward area.
(iv) The project is in the priority sector which may not be able to provide an attractive return on investment.
(v) The project is promoted by technicians.
(vi) The project is new to the market.
The quantum of underwriting assistance varies from institution to institution according to the commitments of each of them for a particular industry.
However, institutional underwriting suffers from the following two drawbacks:

1. The institutional handling involves procedural delays which sometimes dampen the initiative of the corporate managers or promoters.
2. The other disadvantage is that the institutions prefer to wait and watch the results to fulfill their obligations only where they are called upon to meet the deficit caused by under subscription.

(c) Distribution :
The sale of securities to the ultimate investors is referred to as distribution; it is another specialised job, which can be performed by brokers and dealers in securities who maintain regular and direct contact with the ultimate investors. The ability of the New Issue Market to cope with the growing requirements of the expanding corporate sector would depend on this triple-service function.

Methods of Floating New Issues in the Primary Market
Methods of Floating New Issues in the Primary Market are discussed below:

Capital Market

Method 1. Public Issue:

A public issue is an issue where anybody and everybody can subscribe for the securities. When an issue or offer of securities is made to new investors for becoming part of shareholders' family of the issuer it is called a public issue.

Public issue can be further classified into:

(a) Initial Public Offer (IPO) and

(b) Further Public Offer (FPO).

Both IPO and FPO can be either a fresh issue or an offer for sale. In terms of companies Act 1956, an issue becomes public if it results in allotment to more than 50 persons.

(a) Initial Public Offer (IPO): IPO means an offer of specified securities (i.e. equity shares and convertible securities) by an unlisted issuer to the public for subscription (including an offer for sale of its existing securities) for the first time. It is the first sale of stock by a company to the public. The Initial Public Offering can be made through the fixed price method, book building method or a combination of both. IPO enables listing and trading of the issuers securities in the securities market.

(b) Further Public Offer (FPO): When a listed company makes either a fresh issue of securities to the public or in offer for sale to the public, it is called a FPO. It is also called Follow on Public Offer.

It is the subsequent public offer of securities of a listed company. FPO is also known as Seasoned or Subsequent Public offer.

The methods of offering a public issue (IPO/FPO) can be of two:

(i) Offer through Prospectus

(ii) Offer of Sale.

(i) Offer through Prospectus:

Public issue through prospectus is the most popular method of distribution of shares of a company. Prospectus is an offer document containing the details of the company. The name of the company, address, location of the industry, authorized, paid up and subscribed capital, date of opening and closing of subscription list, names of lead merchant banker, brokers and underwriters, name of the board of directors, activities of the company and other important data must be included in the prospectus. After going through these details, the public can decide either to subscribe or not to subscribe the shares. The draft of the prospectus must be approved by the board of directors, financial institutions, designated stock exchange etc. An abridged prospectus is being annexed to every share application form.

The final prospectus with all the details including the final issue price and issue size should be filed with Registrar of Companies (RoC).

Advantages of Issue through Prospectus:

Following are the advantages of issue through prospectus:

i. Large number of investors could be contacted through prospectus.

ii. Services of intermediaries are not necessary for this.

iii. Concentration of shares in few hands is avoided as the shares are dispersed over a number of people.

Disadvantages of Issue through Prospectus:

Following are the disadvantages of issue through prospectus.

They are:

It is suitable only for large issues. The company has to incur additional expenses on advertisement, bank's commission, underwriting commission, listing fee, legal charges etc.

(ii) Offer of Sale:

This is outright sale of shares through intermediaries like issue houses, brokers etc. Shares are not offered to the public directly. The intermediaries, after buying the entire shares, resell them to the investing public. Then it can be called offer for sale. In this case the issue houses act as agents of the company. The advantage of this method is that the company need not be bothered about the printing and advertisement of prospectus, allotment of shares etc. Foreign companies who want to participate in the share market and Indian investors and promoters who want to sell their shares usually adopt this method.

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Method 2. Private Placement:

Shares can be distributed through outright sale by companies to select group of persons (u/s 80 of the Companies Act 1956). This is known as placement or private placement. In other words, when an issuer makes an issue of securities to a select group of persons not exceeding 49, and which is neither a rights issue nor a public issue, it is called a private placement.

In this case, the issue houses or brokers can buy the securities from the company and sell them to his own clients. The brokers here act as wholesalers. They may resell them at a margin. In private placement the promoters may sell a portion of issue to the friends and well-wishers. The promoters have to make a minimum contribution before the issue goes to the public. Financial institutions, mutual funds, investment bank etc. subscribe to placement orders.

Private placement of securities by listed issuer can be of two types:

(a) Preferential Issue/Allotment

(b) Qualified Institutions Placement

(a) Preferential Issue/Allotment:

(a) Preferential Issue means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis. An issuer can make preferential issue of specified securities only if, a special resolution by the shareholders has been passed.

The price of issue should be a price higher of the average of the weekly high and low of the closing price of the related shares quoted on the stock exchange during the (a) 6 months and (b) 2 weeks preceding the relevant date.

(b) Qualified Institutions Placement (QIP):

When a listed issuer issues/allots equity shares or securities convertible in to equity shares to Qualified Institutions Buyers on private placement basis, it is called a QIP.

An issuer can make a QIP only if a special resolution approving the qualified institutions placement has been passed by its shareholders.

The QIP should be managed by a merchant banker. The qualified institutions placement shall be made on the basis of a placement document which shall contain all material information.

Method 3. Rights Issue:

Shares offered to the existing shareholders of a company are called rights issues. The shares are offered in a particular proportion to the existing share ownership. The proportion may be decided on the basis of capital requirement of the company. Such shares are marketable in the market by the owners. Successful companies adopt this method for fund raising.

Procedures for Rights Issue:

(i) According to section 81 of the Companies Act 1956, a company can make a rights issue after the expiry of two years from the date of formation or at any time after the expiry of one year from the date of allotment of shares for the first time after its formation, whichever is earlier.

(ii) An issuer making a rights issue shall announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue.

(iii) The issue price should be decided before determining the record date.

(iv) The company should send a circular to all existing shareholders stating the fact of rights issue. The circular should include information on how the additional fund collected is going to be used.

(v) The company should normally give a time limit of at least 15 days to one month to shareholders to raise their right before it is offered to the public.

(vi) If the rights are not fully taken up- the balance is to be equitably distributed among the applicants for additional shares.

No company shall make a rights issue of equity shares if it has outstanding fully or partly Convertible debt instruments at the time of making rights issue.

Advantages:

Rights issue is advantageous to the company as the cost of issue is minimum. Underwriting, advertising and brokerage expenses could be avoided in this case. The control of the company is undisturbed as the shareholders get shares according to the proportion of existing number of shares held.

Method 4. Bonus Issue:

Bonus issue is the issue of shares to the existing shareholders out of the free reserves of the company. The existing shareholders get this as a bonus without payment of any money. Companies usually adopt this method to bring up the value of shares with market value. As the free reserves are capitalized there is an increase of equity capital.

A listed company can issue bonus shares if:

(a) It is authorized by its articles of association for issue of bonus shares

(b) It has not defaulted in payment of interest/ principal in respect of fixed deposits/debt securities issued by it.

(c) It has not defaulted in respect of the payment of statutory dues of the employees.

(d) It has made partly paid up shared fully paid up.

SEBI Regulations on Bonus Issue:

Chapter IX of SEBI ICDR Regulations 2009 discusses the conditions with respect to bonus issue.

They are given below:

(i) The articles of association should contain provision for issue of bonus shares.

(ii) It should be made out of free reserves built out of genuine profits/securities premium collected in cash only. Reserves created by revaluation of fixed assets are not capitalized.

(iii) The declaration of bonus issue, in lieu of dividend, is not to be made.

(iv) The bonus issue should be implemented within 15 days from the date of its approval by the Board of Directors (BoD) of the issuer.

(v) Bonus issue shall not dilute the value or rights of debenture holders.

(vi) A bonus issue once announced cannot be withdrawn.

Method 4. Book Built Issue:

In book built issue, the issuer stipulates only a price band consisting of a floor price and a cap price, and the final price will be decided on the basis of demand for the issue. On the basis of final price decided by market demand the bids are evaluated and successful bidders get allotment.

<u>Rules & Norms for IPO</u>

Every company need funds to expand its business and the same can be raised either by issue of securities or by loan or borrowings. Companies can raise funds by issue of securities in any of the ways provided under section 23 of companies act, 2013. Section 23 makes a distinction between public and private company as far as raising funds is concerned.

Section 23 of Companies act, 2013 provides that:

- Public company my raise a fund or issue securities, by :
  1. Issue of prospectus to public either by Initial Public Offering (IPO) or Follow on Public Offer (FPO), or
  2. Private placement, or
  3. Right issue or bonus issue.
- Private companies may raise fund or issue securities, by:
  1. Right issue or bonus issue, or
  2. Private placement.

Section 23 has profoundly cleared that only a public company may raise a fund or issue securities from/to the public by way of either IPO or FPO.

As also section 2(68) (iii) prohibits the private company to make any invitation to public to subscribe for its securities.

In this article we will discuss about the eligibility norms and legal obligations for the public company to issue securities to the public by way of IPO.

Instruments of Issue:

A primary instrument is a financial investment whose price is based directly on its market value. A financial instrument can be any type of financial investment that is priced based on its own value. Examples of primary instruments include stocks, bonds and currency. By contrast, the price of derivative instruments, such as options and futures, are often based on the value of a primary instrument.

Primary instruments are standard financial investments. They often trade on mainstream exchanges with high levels of liquidity. Their market value is determined based on assumptions about their individual characteristics. Primary investments like stocks are what most beginning investors think of when they think about investing. This is because investing in primary instruments often requires only a general knowledge of markets and investment principles.

Understanding primary instruments provides the base knowledge for derivatives. Derivatives were created to hedge against some of the risks of primary instruments. Derivatives also provide products for alternative investing strategies that are based on the speculation of values of underlying primary instruments.

Players in the New Issues Market in India:

The important intermediaries/players in the new issue market are: 1. Merchant Bankers (Managers to the Issue) 2. Underwriters 3.Registrars to the Issue 4.Brokers to the Issue 5.Banker to the Issue 6. Syndicate Members.

1. Merchant Bankers (Managers to the Issue): Merchant banker means any person/institution who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager, consultant, advisor or rendering corporate advisory services in relation to such issue management.
2. Underwriters to the Issue: Underwriters are financial institutions who make a firm commitment that they will take up the shares up to a certain amount if the public does not subscribe to it. This is an agreement with one or more institutions and a guarantee of the marketability of shares. Under writing is mandatory for the Public Issue. Underwriters are appointed by the company in consultation with the managers to the issue. Financial institutions, bankers, members of stock exchanges, investment companies, trusts etc. can act as under writers.
3. Brokers to the Issue: Brokers are persons authorized to market the issues. Companies can engage any number of brokers to market the new issue. The brokers may engage sub-brokers and they send their own circulars, publicity materials and applications to the clients and follow up the work for canvassing the subscription. Brokers to the issue are not compulsory for public issues, but their expertise and contacts with investors could be used for marketing the issue.
4. Registrars to the Issue (Registrar and Share Transfer (R&T) Agents): R&T agent plays a significant role in a public issue along with the lead managers. Registrars are persons appointed in consultation with lead managers to assist the issue management functions. Their work relates to pre-issue management, management during the currency of issue, pre- allotment Work, allotment work and post allotment work. It is their duty to collect the application forms from bankers to the issue, process them for allotment and issue certificate of allotment.
5. Bankers to the Issue: Bankers to the issue collect the application forms and the money in cash, cheque or ASBA. Depending on the size of the issue there may be many collection centers and many bankers. They are appointed in consultation with lead manager. Infrastructure facilities available, manpower, past experience, location of branches, efficiency and cost effectiveness etc. are parameters for selection of bankers to the issue.
6. Syndicate Members: The Book Running Lead Managers to the issue appoint the Syndicate Members, who enter the bids of investors in the book building system. Syndicate Members are commercial or investment banks registered with SEBI who also carry on the activity of underwriting in IPO.

Recent Trends in New Issue Market:

The new issue market in India is not fully developed as compared to other advanced countries like U.S.A., U.K. and Germany. But there has been tremendous growth in the sphere of new issue activity in India in the 2011 and 2016. Table given below shows the trend in the amount of capital raised by non-government public limited companies on the new issues market in India.
A growing number of companies have been accessing the Capital Market rather than depending on loans from financial institutions. Tremendous developments have taken place in the primary market where the corporates issue fresh securities through public issues as well as private placements. Huge amount of resources have been mobilised by the corporates from the primary market.

Table 1 Resource mobilization through primary market(Rscrore)

	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**
Debt	4791	2217	15042	6912	4232	23,893
Equity	11647	7446	3313	3872	18260	24,432
Private placement	156634	237405	177561	221348	3,88,988	4,19,388

Source: SEBI

Table 1 provides statistics on the resources mobilized through primary market. It can be noted from the table that, total resources mobilized through issuance of debt in 2016–17 increased to Rs 23893 crore from Rs 4232 crore.Total resources mobilized through issuance of equity declines continuously for 3 years from 2011-12 to 2014-15 and after that a huge rise is noted. Whereas total resources mobilized through issuance of private placement continuously increased from 2013 onwards.

Advantages of primary market or the New issue market:

These are markets that deal with securities that have been issued for the first time. The money flows directly from transferor (saver of money) to transferee (investing person). They facilitate capital formation.
Economic Advantage of Primary Markets

1. Raising capital for business.
2. Mobilising savings
3. Government can raise capital through sale of Treasury bonds
4. Open market operation to effect monetary policy of the government i.e control of excess liquidity in the economy
5. It is a vehicle for direct foreign investment.

The company receives the money and issues new security certificates to the investors. Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business. The primary market performs the crucial function of facilitating capital formation in the economy. The following are the other basic advantages of Primary Market:

Capital Market

1. It provides opportunity for new investors to start new enterprises: Persons with technical know-how may resort to promote new ventures which are profit-oriented. The new issue market gives them an opportunity to materialize their ideas.
2. Existing companies will be in a position to expand their activities: When the existing companies find their products obsolete, they would like to venture into new areas of production for which they require additional capital. The new issue market helps them raise the required funds.
3. Promotion of partnership firm into Public Limited companies or merger of companies or facilitates buy-back of shares: When new ventures are started, a management may wish to have a control on the ownership and for this purpose, they would like to enter into a buy-back arrangement. By this arrangement, the shares will be issued to a group of persons (NRIs) for a specific period after which they will be bought back from out of the profits. This ensures the retention of ownership and prevents any change in management.

Weblography:

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