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UNIVERSITY**

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Investment Banking and Financial Services

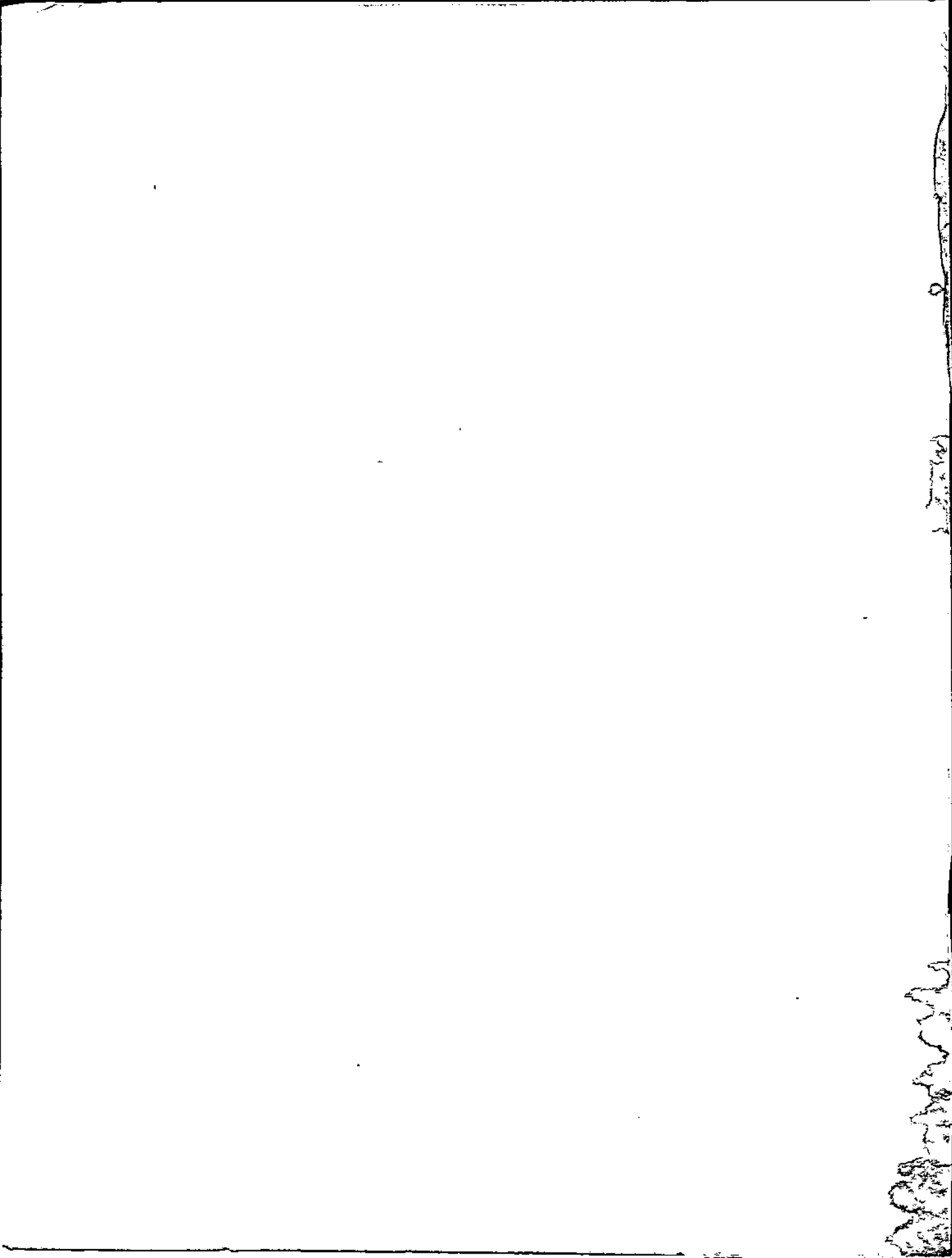
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UNIT 1: INDIAN FINANCIAL SYSTEM

*Indian Financial
System*

Structure:

- 1.0 Objectives
- 1.1 Introduction
- 1.2 Indian Financial System
- 1.3 Investment Banking in India
- 1.4 Recent Developments and Challenges Ahead
- 1.5 Institutional Structure and Functions of Investment/Merchant Banking
- 1.6 Summary
- 1.7 Exercise

Notes

1.0 OBJECTIVES

After reading this Unit, you will be able to:

- define the indian financial system,
- understand the investment banking of india,
- explain the recent developments and challenges ahead,
- discuss the institutional structure and functions of investment/merchant banking.

1.1 INTRODUCTION

The economic scene in the post independence period has seen a sea change; the end result being that the economy has made enormous progress in diverse fields. There has been a quantitative expansion as well as diversification of economic activities. The experiences of the 1980s have led to the conclusion that to obtain all the benefits of greater reliance on voluntary, market-based decision-making, India needs efficient financial systems.

The financial system is possibly the most important institutional and functional vehicle for economic transformation. Finance is a bridge between the present and the future and whether it be the mobilisation of savings or their efficient, effective and equitable allocation for investment, it is the success with which the financial system performs its functions that sets the pace for the achievement of broader national objectives.

Significance and Definition

The term financial system is a set of inter-related activities/services working together to achieve some predetermined purpose or goal. It includes different markets, the institutions, instruments, services and mechanisms which influence the generation of savings, investment capital formation and growth. Van Horne defined the financial system as the purpose of financial markets to allocate savings efficiently in an economy to ultimate users either for investment in real assets or for consumption.

Christy has opined that the objective of the financial system is to "supply funds to various sectors and activities of the economy in ways that promote the fullest possible utilization of resources without the destabilizing consequence of price level changes or unnecessary interference with individual desires." According to Robinson, the primary function of the system is "to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth." From the above definitions, it may be said that the primary function of the financial system is the mobilisation of savings, their distribution for industrial investment and stimulating capital formation to accelerate the process of economic growth.

1.2 INDIAN FINANCIAL SYSTEM

The Indian Financial System is one of the most important aspects of the economic development of our country. This system manages the flow of funds between the people (household savings) of the country and the ones who may invest it wisely (investors/businessmen) for the betterment of both the parties.

This is an important topic with respect to the various Government exams conducted in the country, and aspirants must carefully consider going through this article and prepare themselves accordingly.

In this article, you shall know about what the Indian Financial system is, its components and how it helps in the economic growth of a country. Also, get some Sample Questions on the Indian Financial System further below in this article.

Indian Financial System – An Overview

The services that are provided to a person by the various Financial Institutions including banks, insurance companies, pensions, funds, etc. constitute the financial system.

Given below are the features of the Indian Financial system:

- It plays a vital role in the economic development of the country as it encourages both savings and investment
- It helps in mobilising and allocating one's savings
- It facilitates the expansion of financial institutions and markets
- Plays a key role in capital formation
- It helps form a link between the investor and the one saving
- It is also concerned with the Provision of funds

The financial system of a country mainly aims at managing and governing the mechanism of production, distribution, exchange and holding of financial assets or instruments of all kinds.

Further below in this article, we shall discuss the various components of the financial system in India.

Components of Indian Financial System

There are four main components of the Indian Financial System. This includes:

1. Financial Institutions
2. Financial Assets
3. Financial Services
4. Financial Markets

Let's discuss each component of the system in detail.

1. Financial Institutions: The Financial Institutions act as a mediator between the investor and the borrower. The investor's savings are mobilised either directly or indirectly via the Financial Markets.

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The main functions of the Financial Institutions are as follows:

- A short term liability can be converted into a long term investment
- It helps in conversion of a risky investment into a risk-free investment
- Also acts as a medium of convenience denomination, which means, it can match a small deposit with large loans and a large deposit with small loans

The best example of a Financial Institution is a Bank. People with surplus amounts of money make savings in their accounts, and people in dire need of money take loans. The bank acts as an intermediate between the two.

The financial institutions can further be divided into two types:

- **Banking Institutions or Depository Institutions:** This includes banks and other credit unions which collect money from the public against interest provided on the deposits made and lend that money to the ones in need.
- **Non-Banking Institutions or Non-Depository Institutions:** Insurance, mutual funds and brokerage companies fall under this category. They cannot ask for monetary deposits but sell financial products to their customers.

Further, Financial Institutions can be classified into three categories:

- **Regulatory:** Institutes that regulate the financial markets like RBI, IRDA, SEBI, etc.
- **Intermediates:** Commercial banks which provide loans and other financial assistance such as SBI, BOB, PNB, etc.
- **Non Intermediates:** Institutions that provide financial aid to corporate customers. It includes NABARD, SIBDI, etc.

2. Financial Assets: The products which are traded in the Financial Markets are called Financial Assets. Based on the different requirements and needs of the credit seeker, the securities in the market also differ from each other.

Some important Financial Assets have been discussed briefly below:

- **Call Money:** When a loan is granted for one day and is repaid on the second day, it is called call money. No collateral securities are required for this kind of transaction.

Notes

- **Notice Money:** When a loan is granted for more than a day and for less than 14 days, it is called notice money. No collateral securities are required for this kind of transaction.
- **Term Money:** When the maturity period of a deposit is beyond 14 days, it is called term money.
- **Treasury Bills:** Also known as T-Bills, these are Government bonds or debt securities with maturity of less than a year. Buying a T-Bill means lending money to the Government.
- **Certificate of Deposits:** It is a dematerialised form (Electronically generated) for funds deposited in the bank for a specific period of time.
- **Commercial Paper:** It is an unsecured short-term debt instrument issued by corporations.

3. Financial Services: Services provided by Asset Management and Liability Management Companies. They help to get the required funds and also make sure that they are efficiently invested.

The financial services in India include:

- **Banking Services:** Any small or big service provided by banks like granting a loan, depositing money, issuing debit/credit cards, opening accounts, etc.
- **Insurance Services:** Services like issuing of insurance, selling policies, insurance undertaking and brokerages, etc. are all a part of the Insurance services.
- **Investment Services:** It mostly includes asset management.
- **Foreign Exchange Services:** Exchange of currency, foreign exchange, etc. are a part of the Foreign exchange services.

The main aim of the financial services is to assist a person with selling, borrowing or purchasing securities, allowing payments and settlements and lending and investing.

4. Financial Markets: The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares and other assets is called a financial market.

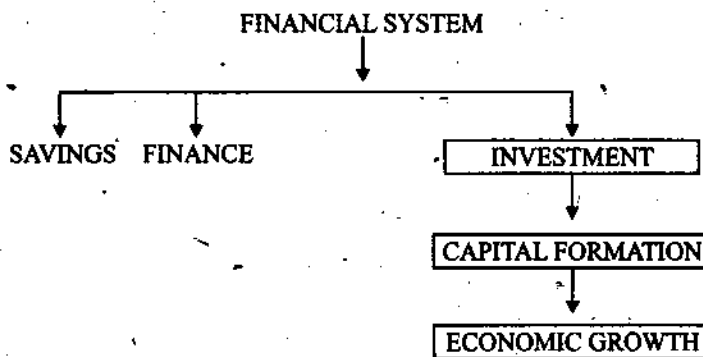
The financial market can be further divided into four types:

- **Capital Market:** Designed to finance the long term investment, the Capital market deals with transactions which are taking place in the market for over a year. The capital market can further be divided into three types:
 - (a) Corporate Securities Market
 - (b) Government Securities Market
 - (c) Long Term Loan Market
- **Money Market:** Mostly dominated by Government, Banks and other Large Institutions, the type of market is authorised for small-term investments only. It is a wholesale debt market which works on low-

risk and highly liquid instruments. The money market can further be divided into two types:

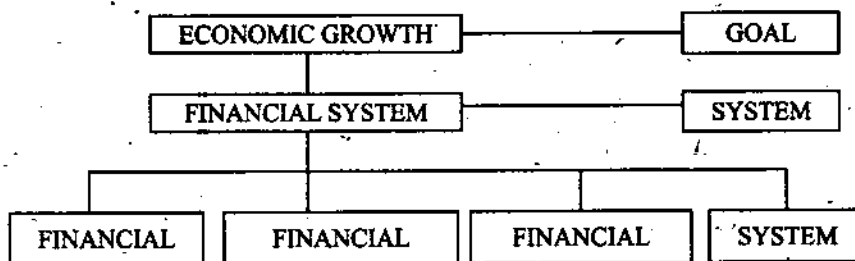
- (a) Organised Money Market
- (b) Unorganised Money Market

- **Foreign exchange Market:** One of the most developed markets across the world, the Foreign exchange market, deals with the requirements related to multi-currency. The transfer of funds in this market takes place based on the foreign currency rate.
- **Credit Market:** A market where short-term and long-term loans are granted to individuals or Organisations by various banks and Financial and Non-Financial Institutions is called Credit Market



The Concept of the Financial System

The process of savings, finance and investment involves financial institutions, markets, instruments and services. Above all, supervision control and regulation are equally significant. Thus, financial management is an integral part of the financial system. On the basis of the empirical evidence, Goldsmith said that "... a case for the hypothesis that the separation of the functions of savings and investment which is made possible by the introduction of financial instruments as well as enlargement of the range of financial assets which follows from the creation of financial institutions increase the efficiency of investments and raise the ratio of capital formation to national production and financial activities and through these two channels increase the rate of growth....." The inter-relationship between varied segments of the economy are illustrated below:



Meaning and Definitions of Financial System: Every country aiming at its progress depends on the efficiency of this economic system which depends upon financial system. The economic development of a nation is reflected by the progress of the various economic units. These units are broadly classified

into corporate sector, government and household sector. While performing their activities these units will be placed in a surplus/deficit/balanced budgetary situations.

There are organisations or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities. The financial system is the network of institutions and individuals who deal in financial claims to various instruments. Financial System of any country consists of financial markets, financial intermediation and financial instruments or financial products.

Definition of Financial System: "It is a set of institutions instruments and markets which fosters saving and channels them to their most efficient use". - **H.R. Machiraju.**

"Financial system allocates savings efficiently in an economy to ultimate users either for investment in real assets or for consumption". - **Van Horne.**

"Financial system consists of a variety of institutions, markets and instruments related in a systematic manner and provides the principal means by which savings are transformed into investments". - **Prasanna Chandra.**

Functions of Financial System: The financial system of a country performs certain valuable functions for the economic growth of that country. The main functions of a financial system may be briefly discussed as below:

1. **Saving function:** An important function of a financial system is to mobilize savings and channelize them into productive activities. It is through financial system the savings are transformed into investments.
2. **Liquidity function:** The most important function of a financial system is to provide money and monetary assets for the production of goods and services. Monetary assets are those assets which can be converted into cash or money easily without loss of value. All activities in a financial system are related to liquidity-either provision of liquidity or trading in liquidity.
3. **Payment function:** The financial system offers a very convenient mode of payment for goods and services. The cheque system and credit card system are the easiest methods of payment in the economy. The cost and time of transactions are considerably reduced.
4. **Risk function:** The financial markets provide protection against life, health and income risks. These guarantees are accomplished through the sale of life, health insurance and property insurance policies.
5. **Information function:** A financial system makes available price-related information. This is a valuable help to those who need to take economic and financial decisions. Financial markets disseminate

information for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment or holding a particular asset.

6. **Transfer function:** A financial system provides a mechanism for the transfer of the resources across geographic boundaries.
7. **Reformatory functions:** A financial system undertaking the functions of developing, introducing innovative financial assets/instruments services and practices and restructuring the existing assts, services etc, to cater the emerging needs of borrowers and investors (financial engineering and re engineering).
8. **Other functions:** It assists in the selection of projects to be financed and also reviews performance of such projects periodically. It also promotes the process of capital formation by bringing together the supply of savings and the demand for investible funds.

Notes

Inter-relationship in the Financial System

A financial system provides services that are essential in a modern economy. The use of a stable, widely accepted medium of exchange reduces the costs of transactions. It facilitates trade and, therefore, specialization in production. Financial assets with attractive yield, liquidity and risk characteristics encourage saving in financial form. By evaluating alternative investments and monitoring the activities of borrowers, financial intermediaries increase the efficiency of resource use.

Access to a variety of financial instruments enables an economic agent to pool, price and exchange risks in the markets. Trade, the efficient use of resources, saving and risk taking are the cornerstones of a growing economy. In fact, the country could make this feasible with the active support of the financial system. The financial system has been identified as the most catalyzing agent for growth of the economy, making it one of the key inputs of development.

The Organisation of the Financial System in India

The Indian financial system is broadly classified into two broad groups:

- (i) Organised sector and
- (ii) unorganised sector.

“The financial system is also divided into users of financial services and providers. Financial institutions sell their services to households, businesses and government. They are the users of the financial services. The boundaries between these sectors are not always clear cut. In the case of providers of financial services, although financial systems differ from country to country, there are many similarities.

- (i) Central bank
- (ii) Banks
- (iii) Financial institutions
- (iv) Money and capital markets and
- (v) Informal financial enterprises.

(i) Organised Indian Financial System: The organised financial system comprises of an impressive network of banks, other financial and investment institutions and a range of financial instruments, which together function in fairly developed capital and money markets. Short-term funds are mainly provided by the commercial and cooperative banking structure. Nine-tenth of such banking business is managed by twenty-eight leading banks which are in the public sector. In addition to commercial banks, there is the network of cooperative banks and land development banks at state, district and block levels. With around two-third share in the total assets in the financial system, banks play an important role. Of late, Indian banks have also diversified into areas such as merchant banking, mutual funds, leasing and factoring.

The organised financial system comprises the following sub-systems:

1. Banking system
2. Cooperative system
3. Development Banking system
 - (i) Public sector
 - (ii) Private sector
4. Money markets and
5. Financial companies/institutions.

Over the years, the structure of financial institutions in India has developed and become broad based. The system has developed in three areas - state, cooperative and private. Rural and urban areas are well served by the cooperative sector as well as by corporate bodies with national status. There are more than 4,58,782 institutions channelling credit into the various areas of the economy.

(ii) Unorganised Financial System: On the other hand, the unorganised financial system comprises of relatively less controlled moneylenders, indigenous bankers, lending pawn brokers, landlords, traders etc. This part of the financial system is not directly amenable to control by the Reserve Bank of India (RBI). There are a host of financial companies, investment companies, chit funds etc., which are also not regulated by the RBI or the government in a systematic manner. However, they are also governed by rules and regulations and are, therefore within the orbit of the monetary authorities.

Indigenous Banking in India

At independence, India had an indigenous banking system with a centuries-old tradition. This system had developed the hundi, a financial instrument still in use that is similar to the commercial bill of Western Europe. Hundi were used to finance local trade as well as trade between port towns and inland centers of production. They were often discounted by banks, especially if they were endorsed by indigenous bankers. Indigenous bankers combined banking with other activities, much as the goldsmiths, merchants, and shippers of eighteenth and nineteenth century Europe had done.

They usually belonged to certain castes or communities, such as the Multanis, Marwaris and Chettiars, and they differed in the extent to which they relied on their own resources, rather than deposits and other funds for their lending. Indigenous bankers often endorsed hundis issued by traders and sometimes provided personal guarantees for loans from commercial banks. Such bankers were collectively known as Shroffs, a term that probably originally referred to money changers but over time came to refer to the more sophisticated and influential indigenous bankers.

The main moneylenders were the Sowkars (who lent to farmers from their own resources or funds borrowed from the Chettiars and other indigenous bankers) and the Pathans (who lent mainly to poor people and often resorted to intimidation to ensure repayment).

Indigenous banking was based on an elaborate and extensive network of personal relations that overcame the problems of dealing with a large number of customers. Brokers were used for making introductions and vouching for the creditworthiness of individual borrowers but did not offer personal guarantees. Some brokers specialized in introducing indigenous bankers to commercial banks, while others brought together traders and indigenous bankers.

Rural Financial System

Rural financial system has been evolved over a period of time from the year 1904, when the first Primary Agricultural Credit Society was organized, by accepting and implementing important recommendations of expert committees appointed by the Government of India/RBI from time to time. During the pre-reform period, more particularly, after the advent of the scientific and technological revolution in the sphere of agriculture, the Government of India and the RBI have evolved several new concepts, innovations and novel approaches, which, the Rural Financial Institutions (RFIs) have responded very favorably by implementing them.

The Banking System

The structure of the banking system is determined by two basic factors – economic and legal. The Development of the economy and the spread of banking habit calls for increasing banking services. The demand for these banking services affects the banks' structure and organisation. National objectives and aspirations result in government regulations, which have a profound influence on the banking structure. These regulations are basically of two types: First, regulations which result in the formation of new banks to meet the specific needs of a group of economic activities. Secondly, legislation that affects the structure by means of nationalisation, mergers or liquidation.

RBI

The Reserve Bank of India as the central bank of the country, is at the head of this group. Commercial banks themselves may be divided into two groups, the scheduled and the non scheduled. The commercial banking system may be distinguished into:

A. Public Sector Banks

- | | | |
|---|---|----------------------------------|
| (i) State Bank of India | } | State Bank Group |
| (ii) Associate Bank | | |
| (iii) 14 Nationalized Banks (1969)
Banks | } | Nationalized |
| (iv) 6 Nationalized Banks (1980) | | |
| (v) Regional Rural Banks
by Public. | } | Mainly sponsored
Sector Banks |

B. Private Sector Banks

- (i) Other Private Banks;
- (ii) New sophisticated Privatized Banks;
- (iii) Cooperative Banks included in the second schedule;
- (iv) Foreign banks in India, representative offices, and
- (v) One non-scheduled banks

Cooperative Sector

The cooperative banking sector has been developed in the country to supplant the village moneylender, the predominant source of rural finance, as the terms on which he made finance available have generally been usurious and detrimental to the development of Indian agriculture. Although the sector receives concessional finance from the Reserve Bank, it is governed by the state legislation. From the point of view of the money market, it may be said to lie between the organized and the unorganised markets.

Primary cooperative Credit Societies

The primary cooperative credit society is an association of borrowers and non-borrowers residing in a particular locality. The funds of the society are derived from the share capital and deposits of members and loans from Central Co-operative banks. The borrowing power of the members as well as of the society is fixed. The loans are given to members for the purchase of cattle, fodder, fertilizers, pesticides, implements etc.

Central Co-operative Banks

These are the federations of primary credit societies in a district. These banks finance member societies within the limits of the borrowing capacity of societies. They also conduct all the business of a joint-stock bank.

State Co-operative Banks

The State Cooperative Bank is a federation of Central cooperative banks and acts as a watchdog of the cooperative banking structure in the State. Its funds are obtained from share capital, deposits, loans and overdrafts from the Reserve Bank of India. The State Co-operative Banks lend money to central cooperative banks and primary societies and not directly to farmers.

Land Development Banks

The Land Development Banks, which are organized in three tiers, namely, State, Central and Primary level, meet the long term credit requirements of farmers for developmental purposes, viz, purchase of equipment like pump sets, tractors and other machineries, reclamation of land, fencing, digging up new wells and repairs of old wells etc. Land Development Banks are cooperative institutions and they grant loans on the security of mortgage of immovable property of the farmers.

Money Market

Money market is concerned with the supply and the demand for investible funds. Essentially, it is a reservoir of short-term funds. Money market provides a mechanism by which short-term funds are lent out and borrowed; it is through this market that a large part of the financial transactions of a country are cleared. It is place where a bid is made for short-term investible funds at the disposal of financial and other institutions by borrowers comprising institutions, individuals and the Government itself. Thus, money market covers money, and financial assets which are close substitutes for money. The money market is generally expected to perform following three broad functions:

- (i) To provide an equilibrating mechanism to even out demand for and supply of short term funds.
- (ii) To provide a focal point for Central bank intervention for influencing liquidity and general level of interest rates in the economy.
- (iii) To provide reasonable access to providers and users of short-term funds to fulfill their borrowing and investment requirements at an efficient market clearing price.

Capital Market

The capital market is the place where the medium-term and long-term financial needs of business and other undertakings are met by financial institutions which supply medium and long-term resources to borrowers. These institutions may further be classified into investing institutions and development banks on the basis of the nature of their activities and the financial mechanism adopted by them. Investing institutions comprise those financial institutions which garner the savings of the people by offering their own shares and stocks, and which provide long-term funds, especially in the form of direct investment in securities and underwriting capital issues of business enterprises. These institutions include investment banks, merchant banks, investment companies and the mutual funds and insurance companies. Development banks include those financial institutions which provide the sinews of development, i.e. capital, enterprise and know-how, to business enterprises so as to foster industrial growth.

Liberalisation of the Financial System

A radical restructuring of the economic system, consisting of industrial deregulation, liberalisation of policies relating to foreign direct investment, public enterprise reforms, reforms of taxation system, trade liberalisation and financial sector reforms have been initiated in 1992-93. Financial sector reforms

in the area of commercial banking, capital markets and non-banking finance companies have also been undertaken. The focus of reforms in the financial markets has been on removing the structural weaknesses and developing the markets on sound lines.

The money and foreign exchange market reforms have attempted to broaden and deepen them. Reforms in the government securities market sought to smoothen the maturity structure of debt, raising of debt at close-to-market rates and improving the liquidity of government securities by developing an active secondary market. In the capital market the focus of reforms has been on strengthening the disclosure standards, developing the market infrastructure and strengthening the risk management systems at stock exchanges to protect the integrity and safety of the market.

Elements of the structural reforms in various market segments are introduction of free pricing of financial assets such as interest rate on government securities, pricing of capital issues and exchange rate, the enlargement of the number of participants and introduction of new instruments. Improving financial soundness and credibility of banks is a part of banking reforms under. Taken by the RBI, a regulatory and supervisory agency over commercial banks under the Banking Companies.

Regulation Act 1949. The improvement of financial health of banks is sought to be achieved by capital adequacy norms in relation to the risks to which banks are exposed, prudential norms for income recognition and provision of bad debts. The removal of external constraints in norms of pre-emption of funds, benefits and prudential regulation and recapitalisation and writing down of capital base are reflected in the relatively clean and healthy balance sheets of banks.

The reform process has, however, accentuated the inherent weaknesses of public sector dominated banking systems. There is a need to further improve financial soundness and to measure up to the increasing competition that a fast liberalising and globalising economy would bring to the Indian banking system. In the area of capital market, the Securities and Exchange Board of India (SEBI) was set up in 1992 to protect the interests of investors in securities and to promote development and regulation of the securities market.

SEBI has issued guidelines for primary markets, stipulating access to capital market to improve the quality of public issues, allotment of shares, private placement, book building, takeover of companies and venture capital. In the area of secondary markets, measures to control volatility and transparency in dealings by modifying the badla system, laying down insider regulations to protect integrity of markets, uniform settlement, introduction of screen-based online trading, dematerialising shares by setting up depositories and trading in derivative securities (stock index futures).

There is a sea change in the institutional and regulatory environment in the capital market area. In regard to Non-Bank Finance Companies (NBFCs), the Reserve Bank of India has issued several measures aimed at encouraging disciplined NBFCs which run on sound business principles. The measures seek

to protect the interests of depositors and provide more effective supervision, particularly over those which accept public deposits. The regulations stipulate an upper limit for public deposits which NBFCs can accept.

This limit is linked to credit rating by an approved rating agency. An upper limit is also placed on the rate of interest on deposits in order to restrain NBFCs from offering incentives and mobilising excessive deposits which they may not be able to service. The heterogeneous nature, number, size, functions (deployment of funds) and level of managerial competence of the NBFCs affect their effective regulation. Since the liberalisation of the economy in 1992-93 and the initiation of reform measures, the financial system is getting market-oriented.

Market efficiency would be reflected in the wide dissemination of information, reduction of transaction costs and allocation of capital to the most productive users. Further, freeing the financial system from government interference has been an important element of economic reforms. The economic reforms also aim at improved financial viability and institutional strengthening. To improve the effective implementation of the monetary policy, linkages among money and foreign exchange markets have been forged.

Role and Importance of Financial System in Economic Development:

1. It links the savers and investors. It helps in mobilizing and allocating the savings efficiently and effectively. It plays a crucial role in economic development through saving-investment process. This savings – investment process is called capital formation.
2. It helps to monitor corporate performance.
3. It provides a mechanism for managing uncertainty and controlling risk.
4. It provides a mechanism for the transfer of resources across geographical boundaries.
5. It offers portfolio adjustment facilities (provided by financial markets and financial intermediaries).
6. It helps in lowering the transaction costs and increase returns. This will motivate people to save more.
7. It promotes the process of capital formation.
8. It helps in promoting the process of financial deepening and broadening.

Financial deepening means increasing financial assets as a percentage of GDP and financial broadening means building an increasing number and variety of participants and instruments. In short, a financial system contributes to the acceleration of economic development. It contributes to growth through technical progress.

Growth and Development of Indian Financial System:

At the time of independence in 1947, there was no strong financial institutional mechanism in the country. The industrial sector had no access to the savings of the community. The capital market was primitive and shy. The

private and unorganized sector played an important role in the provision of liquidity. On the whole, there were chaos and confusions in the financial system.

After independence, the government adopted mixed economic system. A scheme of planned economic development was evolved in 1951 with a view to achieve the broad economic and social objective. The government started creating new financial institutions to supply finance both for agricultural and industrial development. It also progressively started nationalizing some important financial institutions so that the flow of finance might be in the right direction. The following developments took place in the Indian financial system:

1. Nationalisation of financial institutions
2. Establishment of Development Banks
4. Establishment of institution for housing finance
5. Establishment of Stock Holding Corporation of India (SHCIL)
6. Establishment of mutual funds and venture capital institutions
7. New Economic Policy of 1991.

1. Nationalisation of financial institutions: RBI, the leader of the financial system, was established as a private institution in 1935. It was nationalized in 1949. This was followed by the nationalisation of the Imperial bank of India. One of the important mile stone in the economic growth of India was the nationalisation of 245 life insurance Corporation in 1956. As a result, Life Insurance Corporation of India came into existence on 1st September, 1956. Another important development was the nationalisation of 14 major commercial banks in 1969. In 1980, 6 more banks were nationalized. Another landmark was the nationalisation of general insurance business and setting up of General Insurance Corporation in 1972.

2. Establishment of Development Banks: Another landmark in the history of development of Indian financial system is the establishment of new financial institutions to supply institutional credit to industries. In 1949, RBI undertook a detailed study to find out the need for specialized institutions. The first development bank was established in 1948. That was Industrial Finance Corporation of India (IFCI). In 1951, Parliament passed State Financial Corporation Act. Under this Act, State Governments could establish financial corporation's for their respective regions. The Industrial Credit and Investment Corporation of India (ICICI) were set up in 1955. It was supported by Government of India, World Bank etc. The UTI was established in 1964 as a public sector institution to collect the savings of the people and make them available for productive ventures. The Industrial Development Bank of India (IDBI) was established on 1st July 1964 as a wholly owned subsidiary of the RBI.

On February 16, 1976, the IDBI was delinked from RBI. It became an independent financial institution. It co-ordinates the activities of all other financial institutions. In 1971, the IDBI and LIC jointly set up the Industrial Reconstruction Corporation of India with the main objective of reconstruction and rehabilitation of sick industrial undertakings. The IRCI was converted into

a statutory corporation in March 1985 and renamed as Industrial Reconstruction Bank of India. Now its new name is Industrial Investment Bank of India (IIBI).

In 1982, the Export-Import Bank of India (EXIM Bank) was set up to provide financial assistance to exporters and importers. On April 2, 1990 the Small Industries Development Bank of India (SIDBI) was set up as a wholly owned subsidiary of IDBI. The SIDBI has taken over the responsibility of administrating the Small Industries Development Fund and the National Equity Fund.

3. Establishment of Institution for Agricultural Development: In 1963, the RBI set up the Agricultural Refinance and Development Corporation (ARDC) to provide refinance support to banks to finance major development projects, minor irrigation, farm mechanization, land development etc. In order to meet credit needs of agriculture and rural sector, National Bank for Agriculture and Rural Development (NABARD) was set up in 1982. The main objective of the establishment of NABARD is to extend short term, medium term and long term finance to agriculture and allied activities.

4. Establishment of institution for housing finance: The National Housing Bank (NHB) has been set up in July 1988 as an apex institution to mobilize resources for the housing sector and to promote housing finance institutions.

5. Establishment of Stock Holding Corporation of India (SHCIL): In 1987, another institution, namely, Stock Holding Corporation of India Ltd. was set up to strengthen the stock and capital markets in India. Its main objective is to provide quick share transfer facilities, clearing services, support services etc. to investors.

6. Establishment of mutual funds and venture capital institutions: Mutual funds refer to the funds raised by financial service companies by pooling the savings of the public and investing them in a diversified portfolio. They provide investment avenues for small investors who cannot participate in the equities of big companies.

Venture capital is a long term risk capital to finance high technology projects. The IDBI venture capital fund was set up in 1986. The ICICI and the UTI have jointly set up the Technology Development and Information Company of India Ltd. in 1988 to provide venture capital.

7. New Economic Policy of 1991: Indian financial system has undergone massive changes since the announcement of new economic policy in 1991. Liberalisation, Privatisation and Globalisation has transformed Indian economy from closed to open economy. The corporate industrial sector also has undergone changes due to delicensing of industries, financial sector reforms, capital markets reforms, disinvestment in public sector undertakings etc.

Since 1990s, Government control over financial institutions has diluted in a phased manner. Public or development financial institutions have been converted into companies, allowing them to issue equity/bonds to the public.

Government has allowed private sector to enter into banking and insurance sector. Foreign companies were also allowed to enter into insurance sector in India.

Weaknesses of Indian Financial System: Even though Indian financial system is more developed today, it suffers from certain weaknesses. These may be briefly stated below:

1. Lack of co-ordination among financial institutions: There are a large number of financial intermediaries. Most of the financial institutions are owned by the government. At the same time, the government is also the controlling authority of these institutions. As there is multiplicity of institutions in the Indian financial system, there is lack of co-ordination in the working of these institutions.

2. Dominance of development banks in industrial finance: The industrial financing in India today is largely through the financial institutions set up by the government. They get most of their funds from their sponsors. They act as distributive agencies only. Hence, they fail to mobilise the savings of the public. This stands in the way of growth of an efficient financial system in the country.

3. Inactive and erratic capital market: In India, the corporate customers are able to raise finance through development banks. So, they need not go to capital market. Moreover, they do not resort to capital market because it is erratic and enactive. Investors too prefer investments in physical assets to investments in financial assets.

4. Unhealthy financial practices: The dominance of development banks has developed unhealthy financial practices among corporate customers. The development banks provide most of the funds in the form of term loans. So there is a predominance of debt in the financial structure of corporate enterprises. This predominance of debt capital has made the capital structure of the borrowing enterprises uneven and lopsided. When these enterprises face financial crisis, the financial institutions permit a greater use of debt than is warranted. This will make matters worse.

5. Monopolistic market structures: In India some financial institutions are so large that they have created a monopolistic market structures in the financial system. For instance, the entire life insurance business is in the hands of LIC. The weakness of this large structure is that it could lead to inefficiency in their working or mismanagement. Ultimately, it would retard the development of the financial system of the country itself.

6. Other factors: Apart from the above, there are some other factors which put obstacles to the growth of Indian financial system. Examples are:

- a. Banks and Financial Institutions have high level of NPA.
- b. Government burdened with high level of domestic debt.
- c. Cooperative banks are labelled with scams.
- d. Investors confidence reduced in the public sector undertaking etc.,
- e. Financial illiteracy.

In the recent past, the most notable aspect of Indian economy is its financial system. Perhaps no system in the world has changed so much as that of our financial system. Indian financial system undergoing fast development and hence not matured like that of developed countries. The government should take reasonable reforms to mould our financial system as healthy one.

1.3 INVESTMENT BANKING IN INDIA

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Definition of 'Investment Banking'

Definition: Investment banking is a special segment of banking operation that helps individuals or organisations raise capital and provide financial consultancy services to them.

They act as intermediaries between security issuers and investors and help new firms to go public. They either buy all the available shares at a price estimated by their experts and resell them to public or sell shares on behalf of the issuer and take commission on each share.

Description: Investment banking is among the most complex financial mechanisms in the world. They serve many different purposes and business entities. They provide various types of financial services, such as proprietary trading or trading securities for their own accounts, mergers and acquisitions advisory which involves helping organisations in M&As, leveraged finance that involves lending money to firms to purchase assets and settle acquisitions, restructuring that involves improving structures of companies to make a business more efficient and help it make maximum profit, and new issues or IPOs, where these banks help new firms go public.

Let's understand how an investment bank earns money by providing acquisition advisories.

Think of company ABC buying another company XYZ. ABC is not sure how much company XYZ is really worth and what will be the long-term benefits in terms of revenues, costs, etc. In this scenario, the investment bank will go through the process of due diligence to determine the value of the company, settle the deal by helping ABC prepare necessary documents and advising it on the appropriate timing of the deal.

Here the investment bank works on the buy side and some other investment banks may be working on the sell side to help XYZ. The bigger the deal size, the more commission the bank will earn.

Bank of America, Barclays Capital, Citigroup Investment Banking, Deutsche Bank, and JP Morgan are some of the largest investment banks in India.

Do you dream of being a high-flying professional who wants to make it big in the investment world, but don't have a clue where to look?

Here's your answer. If you want to move into Investment Banking, then you should know the overall investment banking scenario in India, List of Top

Investment Banks, Kind of Services Offered, their Culture, investment banking Salaries in India, investment banking jobs in India and whether you are fit for Investment Banking Profile.

In this article, we will go in-depth about the investment banking world prevalent in India.

Overview of Investment Banking in India

Before going into the nitty-gritty of investment banking in India, it's important to throw some light on the history of investment banking in India.

It all started in the 19th Century. During that period, European banks first established their trading industries in the land of India. Since that ancient time, foreign banks have taken the reign of investment banking in India. But that didn't last for a long time:

In the 1970s, State Bank of India started to spread its wings and created a bureau of merchant banking. And in the same decade, ICICI bank started offering various merchant banking services.

After a decade, banking became the thing of many and more than 30 merchant banks, financial institutions, and commercial banks started setting up their operations.

However, until the 1980s, banking didn't get the hype it deserved. In the 1990s, banking became an industry when more than 1500 bankers registered with SEBI (Securities and Exchange Board of India).

To regulate these huge numbers of banks, it was required to build an institution that will help banks adhere to the compliance and regulations. And that's how the Association of Investment Bankers of India (AIBI) got started.

The objective of AIBI is to regulate the legal and ethical practices among members and also to promote and encourage the expansion of the industry.

Under AIBI, now there are many banks and financial institutions are registered. Have a look at the following institutions which are registered under AIBI and have already made their name in the investment banking industry in India –

- Axis Bank Ltd.
- Barclays Bank PLC
- BNP Paribas
- Central Bank of India
- Credit Suisse Securities (India) Private Ltd.
- Deutsche Equities India Private Ltd.
- Edelweiss Financial Services Ltd.
- HDFC Bank Ltd.
- HSBC Securities & Capital Markets (India) Private Ltd.
- ICICI Securities Ltd.
- IDBI Capital Market Services Ltd.
- JP Morgan India Private Ltd.

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- Morgan Stanley India Co. Private Ltd.
- Religare Capital Markets Ltd.
- SBI Capital Markets Ltd.
- SMC Capitals Ltd.

Services Offered by Investment Banks in India

There is a whole gamut of services offered by the investment banks in India. Following are top services that stand out –

- **Mergers & Acquisition Advisory:** Companies need to expand their market share and generate more revenue. Thus, they need to find a better opportunity to merge or acquire other companies that can help them reach their objectives. Investment banks in India help these companies make the right deals (mergers & acquisition deals) and help them make a prudent decision so that the ROI gets to a maximum and the risk becomes the least.
- **Management of Capital Issues:** Usually investment banks in India offer management of public issues under two methods – fixed price method and book building method. They also offer IPO (Initial Public Offering), FPO (Follow on Public Offer), Preferential Issues, Rights Issue, QIP (Qualified Institutional Placement) and Debt Placement. The idea is to help the big organizations expand in the long run and to advise them on various strategies along the way.
- **Debt Syndication:** When a company is looking to finance new opportunities, they always don't have enough cash to go for it. However, if they talk to the investment bankers, they are able to help them with project finance, term loan, working capital loan, mezzanine financing, external commercial borrowing, etc. These services facilitate the public and private companies in tapping into the right opportunities at the right time and ensure solid growth.
- **Buybacks/Takeovers:** Investment bankers in India advise their clients to buyback their shares at the right time. Moreover, they also help them do their due diligence, find out the target company, and facilitate in understanding whether the takeovers are necessary. They also help the companies adhere to compliances and regulations as per SEBI.
- **Corporate Advisory:** Investment bankers in India offer corporate advisory to various companies, especially to giant companies and corporate bodies. As corporate advisory is a huge area, first they understand the needs of the companies and then offer tailor-made services. They start with business appraisals, and then the investment banks in India help the companies develop a business plan. Once the business plan is developed, they go for strategic project advisory. And then they also help companies with a business valuation, project identification, and corporate restructuring.

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List of Top Investment Banks in India

There are many investment banks in India that offer excellent services and have been gradually expanding their reach. But among all of them, here is the list of top 10 Indian investment banks as per the deal volume (these deals are purely based on M&A deals) –

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Rank	Name of the Investment Bank	No. of Deals (2016)
1	Ernst & Young Private Ltd.	26
2	Price Water House Coopers, Investment Banking Arm	11
3	Deloitte Touche Tohmatsu India, LLP	11
4	O3 Capital Global Advisory Private Ltd.	8
5	KPMG India Private Ltd.	8
6	Axis Capital Ltd.	7
7	Standard Chartered Bank, Investment Banking Division	6
8	Avendus Capital Private Ltd.	6
9	JM Financial Institutional Securities Ltd.	6
10	KPMG Corporate Finance LLC	6

Now, let's have a look at the list of top 10 investment banks as per deal value (M&A) in 2016 –

Rank	Name of the Investment Bank	Deal Value (in \$ millions)	No. of Deals
1	Arpwood Capital Private Ltd.	21,891.71	4
2	JM Financial Institutional Securities Ltd.	13,599.77	6
3	Morgan Stanley	11,950.00	4
4	Ernst & Young Global Ltd.	10,898.72	4
5	Kotak Mahindra Capital Co. Ltd.	10,149.96	4
6	Ambit Private Ltd.	9,730.00	3
7	DH Consultants Private Ltd.	9,730.00	1
7	Citigroup Global Markets India Private Ltd.	9,730.00	1
8	Lazard Ltd.	9,407.42	4
9	J.P. Morgan Securities LLC	8,000.00	1

Rank	Name of the Investment Bank	Deal Value (in \$ millions)	No. of Deals
9	Evercore Partners Inc.	8,000.00	1
10	Standard Chartered Bank, Investment Banking Division	3,667.80	6

Now, let's look at the list of investment banks that have topped the list in 2016 in terms of IPO in the domestic market –

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Rank	Name of the Investment Bank
1	ICICI Securities
2	Edelweiss Financial Services
3	Axis Bank
4	HSBC
5	Kotak Mahindra Bank
6	IIFL Securities
7	IDFC Bank
8	State Bank of India
9	JM Financial Institutional Securities Ltd.
10	Elara Capital

The best part of this list is that only one foreign bank has been included in the list, i.e. HSBC. Remaining all 9 banks belong to India. That means, the reign of foreign investment banking has been declining and more and more Indian investment banks are coming up on the top.

Recruitment process – Investment Banks in India

If you ever dream of being part of the investment banking industry in India, here's how you can crack the code. But a word of caution – thousands and thousands of students are going the same route and as a result, you may get lost in the crowd.

Have a glance at the recruitment process of these investment banks in India, so that you can prepare well and reach your dream jobs –

- **No HR business:** As the investment banking industry in India is quite different, rarely HR goes through investment banking resumes. It is done by MD directly. As investment banking professions are not for the faint-hearted, it's important that the screening is done by the most important executives in the business.
- **Never try to tap insider's information to crack the interview:** As an investment banker, you need to be trustworthy as you will be handling millions of bucks of important clients. So, don't try for any quick fix. Rather try to highlight why you are a good match for the job.
- **Selection process:** Selecting the best candidates for investment banking is quite different than other sorts of jobs. Usually, the candidates are judged on the basis of their technical skills, leadership

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ability, communication & interpersonal skills and self-motivation. First of all, the resumes are selected by the MD and then the shortlisted candidates are called for the interview. During the first round, most of the candidates are screened out. Only a few best candidates fit the bill and asked for the last round. If the number of candidates is huge, then there is a chance of biases as not all interviewers would be able to all the candidates. In the final round, HR will brief the candidates about what they can expect during the interview. And then on the basis of consensus, the offer is released to the person who turns out to be most suitable for the company and its clients.

- **The most important thing:** When an MD of an investment banker asked what is the one thing that separates the best candidate from the rest, he mentioned that GPAs are only important for first time screening; but ultimately what matters most is the willingness of the candidate to make their mark in the investment banking industry. He also mentioned that most of the candidates apply in investment banking jobs in India just for money; very few want to go for the love of investment banking and they are the best of the lot in most cases.

Culture in Investment Banks in India

- The culture in investment banking in India is not something most will look up to. Because there is a huge imbalance between taking risks and love for the work!
- In investment banking, risk-taking abilities and initiatives are directly proportionate to how much money the investment bankers will make, not how much love they have for the job. That's why unfortunately not all candidates are suitable for investment banking jobs in India.
- It may seem like labor market though, but usually, in the long term, very few investment bankers stay in one organization as they are offered higher positions by competitors.
- Moreover, there is no work-life balance. You may need to work for 16-18 hours a day to clinch the deals. Only one thing is pretty good here and that is the money. If you can stick to this culture, you will make huge money within a few years.
- Having said that, let's look at some data about the salaries of investment banking professionals in India.

Investment Banking in India – Exit Opportunities

If you get bored in investment banking in India or can't seem to take the pressure, you may have few options to go to like –

- Private Equity
- Hedge Funds
- Venture Capital
- Corporate Finance
- Entrepreneurship

However, know that exit from investment banking in India will not always seem worthy especially if you are looking for fewer hours of work and you don't like the financial analysis.

In each of the above options, you need to put in a lot of hours (often more) to get to a good position and each of the options would need you to invest your time and energy in looking through financial analysis.

Thus, exit only when you know that you want to explore other opportunities and dimensions; not because you want to escape the daily grind. The idea that you will work 2-3 years in investment banking and then will take a different route is nothing but a myth.

Various roles as an Investment Banker: You can work as an investment banker in different capacities which are discussed below-

1. **Underwriting** is one of the primary functions of investment banks which helps in raising capital for companies and governments through the issuance of equity, and debt.
2. You can work in the **Mergers and Acquisition (M&A)** department, which gives strategic guidance to companies to merge or acquire another company. They advise buyers and sellers on business valuation, pricing and structuring of a transaction, negotiation, and implementation. These people possess a specialized skill to make sure that such deals really makes sense and is viable for the company in the long run.
3. **Private Equity** is one of the most prestigious jobs in today's time. It involves investment in asset class comprising of debt and equity in companies which are not listed on the stock exchange. Some of the popular private equity firms include KKR and Blackstone.
4. **Venture Capital** shares similarity with private equity firms, but the only difference is that they provide capital to startup companies while private equity deals with established firms. Becoming a venture capitalist requires a special set of skills as their role involves picking companies which are at the nascent stage but have huge potential going forward. The chances of failure are very high for most of the companies, but few winners are enough to outweigh a large number of losers.
5. **Equity research** is one of the important arms of Investment Banking career. They come with buy and sell side research which helps to facilitate the trading of securities. Their reports are usually meant for internal use, but they may sell it to hedge funds or mutual fund managers so as to generate additional revenue.
6. Some firms also engage in **proprietary trading**. It's a trading desk which gives a platform to the traders to trade in different securities like equity, bonds, currencies or commodities with firm's own money as compared to the depositor's money.

7. They also play the role of **Asset Management** company where they manage huge portfolios for their clients including insurance companies, pension funds, etc. They help their clients in achieving their goals using the right mix of various instruments like equity, bonds, real estate etc in their portfolio.

Though an investment banking career is a prestigious job and can fetch you a good payoff, make sure you are ready for the intense competition to get into it and also ready to work for long hours.

There is one misconception that you got to have a finance background to become an investment banker.

Investment banker usually comes from different backgrounds including a bachelor's degree in finance, mathematics, physics, computer science, etc.

However, a good base in mathematics is very important.

Set of Skills Required

Entry into an Investment banking career is usually not possible without a degree, preferably a CFA or an MBA from Top B-Schools.

However, getting into it is based on competence and you got to possess various skills to qualify for an investment banking career.

Some of the qualities are mentioned below-

- a. Strong number crunching and analytical skill
- b. Good communication skill
- c. Leadership quality
- d. Excellent in teamwork
- e. Able to work under pressure and to handle stressful situations

Life of an Investment Banker

There is no doubt that an Investment Banker has one of the most prestigious jobs in the world. You get to live in the best cities in the world with the likes of New York, London, Mumbai, and Singapore. Along with that you also get a hefty cheque at the end of every month.

But all these perks also come as a result of hard work unlike any other in the financial world.

Are you prepared to put in the effort required to fill in the shoes of an Investment Banker?

It is believed that investment bankers have all 3 meals in their office. Working hours are long and can stretch up to 2 A.M many times. Amidst all this, they are always checking hundreds of emails, calls and crunching thousands of key data points and financial numbers every day.

All this is just an ordinary day in the life of an Investment Banker.

But if you can deliver on all these fronts and regularly, then promotions can be equally quick too.

Pay of an Investment Banker

The pay of an Investment Banker is one of the best in the finance-related jobs across the world. In India, the average salary of an IB can range between Rs.25 Lakhs to Rs.50 Lakhs per annum. Such a payment would only be after a few years of experience as a subordinate.

If you are able to travel outside of India and are qualified enough to land a job on Wall Street in the USA, you can easily expect to make at least \$125,000 as a base salary and up to \$10 Million as a managing director. You can accomplish such a feat by working for a few years and gaining experience in an Indian company, then transferring there.

1.4 RECENT DEVELOPMENTS AND CHALLENGES AHEAD

Recent Development in Merchant Banking

Setting up of bank subsidiaries Finance is the lifeblood of every business activity. In order to succeed in a competitive corporate world various financial services are necessary for corporates. So demand for financial services from the corporate sector is increasing day by day. In order to meet this growing demand the merchant banking divisions of the nationalized banks have started forming independent subsidiaries. Through these subsidiaries they offer specialized service to their clients.

Re-organization of private firms

In order to meet the growing demand for broad based financial services from the corporate sector, the merchant banking divisions of the nationalized banks have started forming independent subsidiaries. Due to the tough competition from these subsidiaries, private merchant bankers have also started reorganizing their activities.

Establishment of Stockbroker Underwriters Association (SUA)

In order to protect the interest of investors and to provide information about capital market and to render legal and other services to members and public, the Stockbroker Underwriters Association (SUA) was started in 1984. SUA works with merchant bankers and promote the activities of capital market.

Discount and Finance House of India (DFHI)

Discount and Finance House of India (DFHI) was set up in April 1988, by RBI jointly with public sector banks and all India financial institutions to develop the money market in India. The main objective of this institution is to facilitate smoothening of the short term liquidity imbalances by developing an active secondary market for the money market instruments.

Securities and Exchange Board of India (SEBI)

In order to protect the interest of investors and to promote the development of securities market and to regulate the securities markets the Securities and Exchange Board of India (SEBI) was established on April 12, 1992. Persons, dealing in security market like merchant bankers, underwriters, sub-brokers etc. have to seek authorization from the board for running their operations. In India,

a substantial number of Merchant bankers are operating under the supervision and control of Securities and Exchange Board of India (SEBI).

Credit Rating Information Services of India Ltd. (CRISIL)

CRISIL was the first credit rating agency in India, introduced in 1988 whose main objective is to make financial markets function better. It provides ratings, research, risk and advisory services to numerous companies and financial institutions. Stock-Holding Corporation of India Ltd. (SHC) SHC was set up in 1986 by the All India financial institutions to take care of safe custody, delivery of securities and collection of sale proceeds of securities.

Indian banking – The challenges ahead

1. In recent years, there has been a considerable widening and deepening of the Indian financial system, of which banking is a significant component. With greater liberalisation, the financial system has come to play a much larger role in the allocation of resources than in the past and its role in future can be expected to be much larger than at present. The growing role of the financial sector in the allocation of resources has significant potential advantages for the efficiency with which our economy functions. Consequently, the adverse consequences of malfunction of the financial system are likely to be more severe than they used to be in the past. Hence, all our efforts today are focused at ensuring greater financial stability. Given the significance of the Indian banking system, one cannot afford to underplay the importance of a strong and resilient banking system.

2. The pre-reform period witnessed the following major regulatory constraints on the banking sector which not only distorted the efficiency of the interest rate mechanism but also adversely affected the viability and profitability of banks:

- large pre-emptions – both in terms of the statutory holding of Government securities (statutory liquidity ratio, or SLR) and cash reserve ratio (CRR); and
- complex structure of administered interest rates;

One of the major objectives of banking sector reforms in India has been to enhance efficiency and productivity, which were achieved through:

- reductions in the pre-emptions;
- de-regulation of interest rates;
- enhancement of competition through establishment of new banks in the private sector, more liberal entry of foreign banks, enhancing the role of public shareholders in nationalised banks by gradual reduction of Government shareholding in these banks and allowing foreign direct investment in the private sector banks up to 74 per cent, subject to conformity with the guidelines issued from time to time.

The cumulative effect of these measures is that banks have been accorded greater discretion in sourcing and utilisation of resources albeit in an increasingly competitive environment.

Present position and the challenges ahead

The enhanced role of the banking sector in the Indian economy; the increasing levels of deregulation and the increasing levels of competition have placed numerous demands on banks. Operating in this demanding environment has exposed banks to various challenges.

(i) **Customer service:** It is no longer adequate for banks to provide only traditional banking services. Apart from providing the conventional banking services, banks have begun offering a bouquet of financial services to their clients, including cross selling of financial products. The ultimate aim is to offer a one-stop-shop for meeting varied customers' financial needs. Some banks have begun employing customer relationship management systems to not only retain the existing customers but also to attract new customers. The establishment of new private sector banks and foreign banks has rapidly changed the competitive landscape in the Indian consumer banking industry and placed greater demands on banks to gear themselves up to meet the increasing needs of customers. For the discerning current day bank customers, it is not only relevant to offer a wide menu of services but also provide these in an increasingly efficient manner in terms of cost, time and convenience.

While banks are focusing on the methodologies of meeting the increasing demands placed on them, there are legitimate concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, in particular pensioners, self-employed and those employed in unorganised sector. While commercial considerations are no doubt important, banks have been bestowed with several privileges, especially of seeking public deposits on a highly leveraged basis, and consequently they should be obliged to provide banking services to all segments of the population, on equitable basis. Further, experience has shown that consumers' interests are at times not accorded full protection and their grievances are not properly attended to. Feedback received reveals recent trends of levying unreasonably high service/user charges and enhancement of user charges without proper and prior intimation. It is in this context that the Governor, Reserve Bank of India had mentioned in the Annual Policy Statement 2005-06 that RBI will take initiatives to encourage

- greater degree of financial inclusion in the country;
- setting up of a mechanism for ensuring fair treatment of consumers; and
- effective redressal of customer grievances.

It would, therefore, be reasonable to expect banks to focus on the above aspects while designing their products for customers.

(ii) **Branch banking:** Traditionally banks have been looking to expansion of their branch network to increase their business. Against this background it is interesting to observe that the new private sector banks as well as the foreign banks have been able to achieve business expansion through other means. It has been realized that it might not be necessary to establish a wider brick and mortar network to reach a wider population. Banks are, therefore, examining

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the potential benefits that may accrue by tapping the agency arrangement route and the outsourcing route. While proceeding in this direction banks ought not to lose sight of the new risks that they might be assuming and hence put in place appropriate strategies and systems for managing these new risks.

(iii) Competition: With the ever increasing pace and extent of globalisation of the Indian economy and the systematic opening up of the Indian banking system to global competition, banks need to equip themselves to operate in the increasingly competitive environment. This will make it imperative for banks to enhance their systems and procedures to international standards and also simultaneously fortify their financial positions.

(iv) Technology: A few banks which have impressive branch networks have not been able to meet their customers' expectations due to inefficiencies arising out of inadequate investment in technology and consequently faced an erosion of their market shares. The beneficiaries are those banks which have invested in technology. Another distinct advantage of use of technology is the ability to effectively use quantitative techniques and models which can enhance the quality of their risk management systems. Recognising the benefits of modernising their technology infrastructure banks are taking the right initiatives. The challenge in this regard will be for banks to ensure that they derive maximum advantage out of their investments in technology and to avoid wasteful expenditure which might arise on account of

- a. uncoordinated and piecemeal adoption of technology;
- b. adoption of inappropriate/ inconsistent technology and
- c. adoption of obsolete technology.

A case in point is the implementation of core banking solutions by some banks without assessing its scalability or adaptability to meet Basel II requirements.

(v) Basel II implementation: As you are aware, Basel II is the revised framework for capital adequacy for banks. Implementation of Basel II is seen as one of the significant challenges facing the banking sector in many jurisdictions. With the introduction of capital charge for market risks with effect from the year ended March 31, 2005 banks in India are compliant with all elements of Basel I. I will now outline the approach to Basel II implementation in India. Commercial banks in India will start implementing Basel II with effect from March 31, 2007. They will initially adopt the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk. After adequate skills are developed, both by the banks and also by the supervisors, some banks may be allowed to migrate to the Internal Rating Based (IRB) Approach. Implementation of Basel II will require more capital for banks in India due to the fact that operational risk is not captured under Basel I, and the capital charge for market risk was not prescribed until recently. Though last year has not been a very good year for banks, they are exploring all avenues for meeting the capital requirements under Basel II. The cushion available in the system, which has a CRAR of over 12 per cent now, is, however, comforting.

With a view to ensuring migration to Basel II in a non-disruptive manner, a consultative and participative approach has been adopted for both designing and implementing Basel II in India. A Steering Committee comprising senior officials from 14 banks (public, private and foreign) has been constituted wherein representation from the Indian Banks' Association and the RBI has also been ensured. The Steering Committee had formed sub-groups to address specific issues. On the basis of recommendations of the Steering Committee, draft guidelines to the banks on implementation of the New Capital Adequacy Framework have been issued. Though Basel II implementation is considered as a challenge generally, the above approach has lightened the burden on banks in India.

Notwithstanding the above, capacity building, both in banks and the regulatory bodies is a serious challenge, especially with regard to adoption of the advanced approaches. We have initiated supervisory capacity-building measures to identify the gaps and to assess as well as quantify the extent of additional capital which may be required to be maintained by such banks. The magnitude of this task appears daunting since we have as many as 90 scheduled commercial banks in India.

(vi) Improving Risk Management Systems: With the increasing degree of deregulation and exposure of banks to various types of risks, efficient risk management systems have become essential. As you are aware, as a step towards further enhancing and fine-tuning risk management systems in banks, Reserve Bank has issued guidelines on asset-liability management and risk management systems in banks in 1999 and Guidance Notes on Credit Risk Management and Market Risk Management in October 2002 and the Guidance Note on Operational risk management in 2005. Though Basel II focuses significantly on risks its implementation should not be seen as an end in itself. It should be seen as a medium whereby the risk management systems in banks are constantly upgraded to address the changing environment.

At the initial stages of development of the risk management systems, banks were managing each risk in isolation. The current business environment demands a more integrated approach to risk management. It is no longer sufficient to manage each risk independently or in functional silos. Enterprises worldwide are, therefore, now putting in place an integrated framework for risk management which is proactive, systematic and spans across the entire organisation. Banks in India are also moving from the individual silo system to an enterprise wide risk management system. This is placing greater demands on the risk management skills in banks and has brought to the forefront the need for capacity building. While the first milestone would be risk integration across the entity, banks are also aware of the desirability of risk aggregation across the group both in the specific risk areas as also across the risks. Banks would be required to allocate significant resources towards this objective over the next few years.

In the Reserve Bank, we have adopted the risk based approach to supervision since 2003 and have brought about 23 banks under the fold of risk based supervision (RBS) on a pilot basis. On the basis of the feedback received

from the pilot project, the RBS framework has now been reviewed. The risk based approach to supervision is also serving as a catalyst to banks' migration to the integrated risk management systems. In view of the relevance of improved risk management systems under the changing circumstances and the larger emphasis placed on risk management systems in banks under Basel II, it is essential that the RBS stabilizes at an early date and serves as an important feedback not only to bank managements but also to RBI. However, taking into account the diversity in the Indian banking system, stabilizing the RBS as an effective supervisory mechanism will be a challenge to the RBI.

(vii) Implementation of new accounting standards: Derivative activity in banks has been increasing at a brisk pace. While the risk management framework for derivative trading, which is a relatively new area for Indian banks (particularly in the more structured products), is an essential pre-requisite, the absence of clear accounting guidelines in this area is matter of significant concern. It is widely accepted that as the volume of transactions increases, which is happening in the Indian banking system, the need to upgrade the accounting framework needs no emphasis. The World Bank's ROSC on Accounting and Auditing in India has commented on the absence of an accounting standard which deals with recognition, measurement and disclosures pertaining to financial instruments. The Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) is considering issue of Accounting Standards on the above aspects pertaining to financial Instruments. These will be the Indian parallel to International Accounting Standards 32 and 39. The proposed Accounting Standards will be of considerable significance for financial entities and could therefore have implications for the financial sector. The formal introduction of these Accounting Standards by the ICAI is likely to take some time in view of the processes involved. In the meanwhile, the Reserve Bank is considering the need for banks and financial entities adopting the broad underlying principles of IAS 39. Since this is likely to give rise to some regulatory / prudential issues all relevant aspects are being comprehensively examined. The proposals in this regard would, as is normal, be discussed with the market participants before introduction. Adoption and implementation of these principles are likely to pose a great challenge to both the banks and the Reserve Bank.

(viii) Transparency and Disclosures: In pursuance of the Financial Sector Reforms introduced since 1991 and in order to bring about meaningful disclosure of the true financial position of banks to enable the users of financial statements to study and have a meaningful comparison of their positions, a series of measures were initiated. The disclosure requirements broadly covered the following aspects:

- Capital adequacy
- Asset quality
- Maturity distribution of select items of assets and liabilities
- Profitability

- Country risk exposure
- Risk exposures in derivatives
- Segment reporting
- Related Party disclosures

With a view to moving closer towards international best practices including International Accounting Standards (IAS) and the disclosure requirements under Pillar 3 of Basel II, Reserve Bank has proposed enhanced disclosures which lay a greater emphasis on disclosure of certain qualitative aspects. Transparency and disclosure standards are also recognised as important constituents of a sound corporate governance mechanism. Banks are required to formulate a formal disclosure policy approved by the Board of directors that addresses the bank's approach for determining what disclosures it will make and the internal controls over the disclosure process. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency.

(ix) Supervision of financial conglomerates: In view of increased focus on empowering supervisors to undertake consolidated supervision of bank groups and since the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision have underscored consolidated supervision as an independent principle, the Reserve Bank had introduced, as an initial step, consolidated accounting and other quantitative methods to facilitate consolidated supervision. The components of consolidated supervision include, consolidated financial statements intended for public disclosure, consolidated prudential reports intended for supervisory assessment of risks and application of certain prudential regulations on group basis. In due course, consolidated supervision as introduced above would evolve to cover banks in mixed conglomerates, where the parent may be non-financial entities or parents may be financial entities coming under the jurisdiction of other regulators.

The financial landscape is increasingly witnessing entry of some of the bigger banks into other financial segments like merchant banking, insurance etc., which has made them financial conglomerates. Emergence of several new players with diversified presence across major segments and possibility of some of the non-banking institutions in the financial sector acquiring large enough proportions to have systemic impact make it imperative for supervision to be spread across various segments of the financial sector. In this direction, an inter-regulatory Working Group was constituted with members from RBI, SEBI and IRDA. The framework proposed by the Group will be complementary to the existing regulatory structure wherein the individual entities are regulated by the respective regulators and the identified financial conglomerates would be subjected to focussed regulatory oversight through a mechanism of inter-regulatory exchange of information. As a first step in this direction, an inter-agency Working Group on Financial Conglomerates (FC) comprising the above three supervisory bodies identified 23 FCs and a pilot process for obtaining information from these conglomerates has been initiated. The complexities

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involved in the supervision of financial conglomerates are a challenge not only to the Reserve Bank of India but also to the other regulatory agencies, which need to have a close and continued coordination on an on-going basis.

(x) 'Know Your Customer' (KYC) Guidelines – Anti Money Laundering Standards: Banks were advised in 2002 to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority. These 'Know Your Customer' guidelines were revisited in the context of the recommendations made by the Financial Action Task Force on Anti Money Laundering standards and on Combating Financing of Terrorism. These standards have become the international benchmark for framing Anti Money Laundering and combating financing of terrorism policies by the regulatory authorities. Compliance with these standards both by the banks/financial institutions and the country has become necessary for international financial relationships. Detailed guidelines based on the Recommendations of the Financial Action Task Force and the paper issued on Customer Due Diligence for banks by the Basel Committee on Banking Supervision, with indicative suggestions wherever considered necessary, were issued to banks in November 2004. Banks were required to ensure that a proper policy framework on 'Know Your Customer' and Anti-Money Laundering measures is formulated and put in place with the approval of the Board within three months and be fully compliant with these guidelines before December 31, 2005. Compliance with the above is a significant challenge to the entire banking industry to fortify itself against misuse by anti-social persons/entities and thus project a picture of solidarity and financial integrity of the Indian banking system to the international community.

(xi) Corporate Governace: Banks are "special" as they not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also leverage such funds through credit creation. Banks are also important for smooth functioning of the payment system. In view of the above, legal prescriptions for ownership and governance of banks laid down in Banking Regulation Act, 1949 have been supplemented by regulatory prescriptions issued by RBI from time to time. In this context, one must remember that profit motive should not be the sole criterion for business decisions. Flow of bank finance for productive purposes must always take priority over the granting of credit for speculative investment no matter how profitable the latter may be. If bank finance flows increasingly to finance speculative activities, it will be to the detriment of real productive investment for research, development and the production of real goods/ services. One might conclude that such uncontrolled flow would ultimately affect economic growth. Hence, funding of speculative activities must be subject to prudential limits, even though it might yield attractive returns. This will be a significant challenge to banks where the priorities and incentives might not be well balanced by the operation of sound principles of corporate governance. If the internal imbalances are not re-balanced immediately, the correction may evolve through external forces and may be painful and costly to all stakeholders. The focus, therefore, should be on enhancing and fortifying operation of the principles of sound corporate governance.

1.5 INSTITUTIONAL STRUCTURE AND FUNCTIONS OF INVESTMENT/MERCHANT BANKING

Institutional Structure

In tracing the history of the merchant banking in India, the structure of merchant bankers appeared as follows at one point of time:

1. Merchant banking divisions of commercial banks, both Indian and Foreign.
2. Merchant banking divisions of financial institutions (e.g. IDBI, IFCI, etc.)
3. Merchant banking companies promoted by stock broking firms. (e.g. JM Financial, DSP)
4. Merchant banking services of NBFCs. However, the above structure has undergone a transformation now. The merchant banking divisions of the commercial banks exist now as independent subsidiary companies of the parent firms. For example, the SBI Capital Markets Ltd is the subsidiary of SBI. The merchant banking activities of the NBFCs almost cease to exist.

Merchant Banking

A merchant bank is a firm or the financial institution providing capital to the companies in the form of share ownership instead of loan. Merchant bank also work as a consultancy and provide advisory on corporate matters to firm in which they invest, these banks are experts in international trade, which makes them pundit in dealing with multinational corporation. Merchant bankers helps firms or companies in raising finance by way of issue of a share, bank loans, debenture etc. merchant bank do not provide financial service to normal public.

Merchant Banking is a combination of Banking and consultancy services.

- It provides consultancy, to its clients, for financial, marketing, managerial and legal matters.
- Consultancy means to provide advice, guidance and service for a fee.
- It helps a businessman to start a business.
- It helps to raise (collect) finance.
- It helps to expand and modernise the business.
- It helps in restructuring of a business.
- It helps to revive sick business units.
- It also helps companies to register, buy and sell shares at the stock exchange.
- In short, merchant banking provides a wide range of services for starting until running a business.
- It acts as Financial Engineer for a business.
- According to SEBI, "a merchant banker is one who is engaged in the business of issue management either by making arrangements

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regarding selling, buying or subscribing to the securities as manager, advisor or rendering corporate advisory services in relation to such issue management".

Functions of Merchant Banker

- A merchant banker is not merely an issue manager.
- The scope of his activities extends beyond issue management.
- He undertakes new responsibilities such as syndication of project financing, global fund raising, designing new financial instruments and deal making in corporate takeovers.
- From dealing in shares for major industrial houses to takeovers, the merchant bankers have come a long way in the spectrum of services that are offered.
- Their operations have considerably widened and have become more specialized. The following are the functions of merchant bankers in India:

Functions of MB:

1. **Managing Public Issue of Companies:** Merchant bank advice and manage the public issue of companies. They provide following services:
 - a. Advise on the timing of the public issue.
 - b. Advise on the size and price of the issue.
 - c. Acting as manager to the issue, and helping in accepting applications and allotment of securities.
 - d. Help in appointing underwriters and brokers to the issue.
 - e. Listing of shares on the stock exchange, etc.
2. **Management of Interest and Dividend:** Merchant bankers help their clients in the management of interest on debentures/loans, and dividend on shares.
 - They also advise their client about the timing (interim/yearly) and rate of dividend.
3. **Project Management:** Merchant bankers help their clients in the many ways.
 - For e.g. advising about location of a project,
 - preparing a project report,
 - conducting feasibility studies,
 - making a plan for financing the project,
 - finding out sources of finance,
 - advising about concessions and incentives from the government
4. **Portfolio Management:**
 - A merchant bank manages the portfolios (investments) of its clients.

- This makes investments safe, liquid and profitable for the client.
- It offers expert guidance to its clients for taking investment decisions.

5. Raising Finance for Clients:

- Merchant Banking helps its clients to raise finance through issue of shares, debentures, bank loans, etc.
- It helps its clients to raise finance from the domestic and international market.
- This finance is used for starting a new business or project or for modernization or expansion of the business.

6. Revival of Sick Industrial Units:

- Merchant banks help to revive (cure) sick industrial units.
- It negotiates with different agencies like banks, term lending institutions, and BIFR (Board for Industrial and Financial Reconstruction).
- It also plans and executes the full revival package.

7. Special Assistance to Small Companies and Entrepreneurs:

- Merchant banks advise small companies about business opportunities, government policies, incentives and concessions available.
- It also helps them to take advantage of these opportunities, concessions, etc.

8. Services to Public Sector Units:

- Merchant banks offer many services to public sector units and public utilities.
- They help in raising long-term capital, marketing of securities, foreign collaborations and arranging long term finance from term lending institutions.

9. Corporate Restructuring:

- It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment.
- This requires proper negotiations, preparation of documents and completion of legal formalities.
- Merchant bankers offer all these services to their clients.

10. Handling Government Consent for Industrial Projects:

- A businessman has to get government permission for starting of the project.
- Similarly, a company requires permission for expansion or modernization activities. For this, many formalities have to be completed.
- Merchant banks do all this work for their clients.

11. Advice on Expansion and Modernization:

- Merchant bankers give advice for expansion and modernization of the business units.
- They give expert advice on mergers and amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology up gradation, etc.

12. Broker in Stock Exchange:

- Merchant bankers act as brokers in the stock exchange.
- They buy and sell shares on behalf of their clients. They conduct research on equity shares.
- They also advise their clients about which shares to buy, when to buy, how much to buy and when to sell.
- Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer merchant banking services.

13. Underwriter/Money Market Operation:

- Merchant bankers deal with and underwrite short-term money market instruments, such as:
 - a. Government Bonds.
 - b. Certificate of deposit issued by banks and financial institutions.
 - c. Commercial paper issued by large corporate firms.
 - d. Treasury bills issued by the Government (Here in India by RBI).

14. Leasing Services:

- Merchant bankers also help in leasing services.
- Lease is a contract between the lessor and lessee, whereby the lessor allows the use of his specific asset such as equipment by the lessee for a certain period.
- The lessor charges a fee called rentals.

Merchant bankers in India: There are 135 merchant bankers in India who are registered with SEB. In India it includes private sectors, public sector and foreign players, some of them are:

Private Sector merchant banking

- Bajaj Capital Ltd.
- ICI Securities
- Tata Capital Market Ltd.
- ICI Bank Ltd.
- Reliance Securities Ltd.
- Kotak Mahindra Capital Ltd.
- Yes Bank Ltd.
- Axis Bank (Formerly Uti Bank Ltd.)

Public sector merchant banking

- (PNB) Punjab National Bank
- Bank of Maharashtra
- State Bank of Bikaner and Jaipur
- State Bank of India Capital Market Ltd.
- IFCI Financial Service Ltd.
- Karur Vysya Bank Ltd.

Foreign players in merchant banking

- Morgan Stanley India company Pvt. Ltd.
- Goldman Sachs (India) Securities
- Bank of America
- Duetshe Bank
- Fedex Securities
- Barclays Bank Plc
- Citigroup Global Market India

Investment Banking Vs Merchant Banking

The term 'merchant banking' and 'investment banking' are often used interchangeable in the financial literature.

- The term 'Investment Banking' has the US origin whereas the term 'merchant banking' is in vogue in countries such as the UK and India.
- The first merchant banking activity in India started in 1969 by the Grindlays Bank by opening a merchant banking division.
- Initially they were issue managers looking after the issue of shares and raising capital for the company.
- But subsequently they expanded their activities such as working capital management; syndication of project finance, global loans, mergers, capital restructuring, etc., initially the merchant banker in India was in the form of management of public issue and providing financial consultancy for foreign banks.
- In 1973, SBI started the merchant banking and it was followed by ICICI.
- Between 1974 and 1985, the merchant banker has promoted lot of companies.
- However, they were brought under the control of SEBI in 1992.
- Merchant banks were brought under the ambit of SEBI regulations and this lead to a disciplined growth of the industry.
- New checks and balances have been introduced in the functioning of merchant banks in India.
- Collaborative arrangements with the foreign merchant banks were also common.

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Investment Banks vs. Merchant Banks: An Overview

Investment banks and merchant banks are different types of financial institutions. These banks do not serve consumers—individual clients or small and mid-sized businesses. Some of the services they provide are the same including underwriting and investment services. But the fine line that theoretically separates the functions of these two institutions tends to blur, as the activities often bleed into one another's territories. Investment banks conduct trade finance activities while merchant banks take part in international finance and underwriting activities.

- Merchant banks lend their services to international finance, business loans for companies, and underwriting.
- Investment banking is usually fee- or fund-based, providing a wider variety of services to its clients.
- Merchant banks help companies and high-net-worth individuals.
- Investment banking clients include institutional investors, governments, and corporations.

Investment Banks

Investment banks are institutions that serve as intermediaries for a variety of purposes. Their activities usually vary from one institution to another. Most of the services in which they engage tend to be large and complex financial transactions. Investment banking clients are normally governments and other financial institutions as well as institutional clients such as hedge funds, pension funds, and large companies.

Pure investment banks are chiefly responsible for raising funds for businesses, governments, and municipalities by registering and issuing debt or equity and selling these investments on an open market through initial public offerings (IPOs). Investment banks traditionally underwrite and sell these securities in large blocks. Small boutique investment banking firms may narrow their focus to a small area of expertise. They also facilitate mergers and acquisitions (M&A) of companies through share sales and provide research and financial consulting to companies.

Investment banks may be fee-based because they provide banking and advisory services. They may also be fund-based because they can earn income from interest and other leases from their clients.

Some of the world's best-known and biggest investment banks include Barclays (BCS), UBS (UBS), and Credit Suisse (CS). Many of these banks also operate smaller retail and commercial branches for the general public.

While investment banks focus on larger companies, merchant banks offer their services to corporations that are too large for venture capital firms but small enough to make a compelling public share offering on a large exchange.

Merchant Banks

Just like investment banks, the precise list of offerings differs depending on the merchant bank in question. Interestingly, the term merchant bank was the British term used to describe investment banks.

Merchant banks don't deal with the general public, so they don't take deposits or make withdrawals. Instead, they serve high-net-worth individuals (HNWIs) and multinational corporations. Some of their primary functions include international financing and underwriting activities. These may include—but aren't limited to—foreign corporate investing, foreign real estate investment, trade finance, and the facilitation of international transactions.

Merchant banks may be involved in issuing letters of credit, internationally transferring funds, and consulting on trades and trading technology. These banks earn money from fees because they provide advisory and other related services to their clients.

Several of today's leading merchant banks include J.P. Morgan (JPM), Goldman Sachs (GS), and Citigroup (C).

Key Differences

There's a fine line between merchant and investment banks. While both operate within the financial realm, there are some key overall distinctions. As a general rule, investment banks focus on IPOs and large public and private share offerings. Merchant banks tend to focus on small-scale companies by offering creative equity financing, bridge financing, mezzanine financing, and a number of highly delineated corporate credit products.

In order to bridge the gap between venture capital and a public offering, larger merchant banks tend to privately place equity with other financial institutions and, in the process, often take on large portions of ownership in companies they believe exhibit strong balance statements, solid fundamentals, and strong growth potential.

While merchants offer trade financing products to their clients, investment banks rarely do so because most investment banking clients have outgrown the need for trade financing and the various credit products linked to it.

Special Considerations

While investment banks mainly service large companies such as major mutual fund houses, they can also provide consulting services to private investors through their private wealth management and private client services divisions. The research provided typically contains buy, sell, and hold ratings on various stock investments. Merchant banks provide services to corporations and high-net-worth individuals who typically have businesses around the world.

Remember functions as this short form:

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Managing Public Issue of Companies

Management of Interest and Dividend:

Project Management

Portfolio Management

Raising Finance for the Clients
Revival of Sick Industrial Units:
Special Assistance to Small Companies and Entrepreneurs:
Services to Public Sector Units:
Corporate Restructuring:
Broker in Stock Exchange:
Underwriter/Money Market Operation:
Leasing Meaning

1.6 SUMMARY

The above Indian financial system article increases awareness regarding the Indian Financial System. It helps prepare well for competitive exams.

This also encourages people to know more about the economic functioning of their country holds them able to make beneficial decisions regarding various investments.

Investment banking in India is a bit different than it is in Europe and the USA. India is still an emergent market for investment banking. Slowly the Indian market is ripening and realizing the value of investment banking.

1.7 EXERCISE

1. What are the main features of Indian Financial System?
2. Is investment banking financial services or banking?
3. What is Merchant banking? What are the functions of Merchant bank?
4. Discuss the recent developments and challenges ahead?
5. Explain the Merchant banker?

UNIT 2: SEBI GUIDELINES FOR MERCHANT BANKERS

*SEBI Guidelines For
Merchant Bankers*

Structure:

- 2.0 Objectives
- 2.1 Introduction
- 2.2 SEBI Guidelines for Merchant Bankers
 - 2.2.1 Meaning of Merchant Banking
 - 2.2.2 SEBI Guidelines
 - 2.2.3 Regulations by SEBI on Merchant Banking
 - 2.2.4 Functions of a Merchant Banker
 - 2.2.5 Registration of Merchant Banker
 - 2.2.6 Obligations and Responsibilities of Lead Managers
- 2.3 Continuance of Association of Lead Managers with an Issue
- 2.4 Summary
- 2.5 Exercise

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2.0 OBJECTIVES

After reading this Unit, you will be able to:

- explain the SEBI guidelines for merchant bankers,
- define the registration of merchant banker,
- understand the obligations and responsibilities of lead managers,
- discuss the continuance of association of lead managers with an issue.

2.1 INTRODUCTION

A merchant banker is an organization which performs and renders different financial services for its clients. They do not provide regular banking services, but specialized services, generally dealing within large corporate clients. The merchant banker is engaged in the business of issue management of securities, helping companies in pre issue and post issue management of securities, in return for commission or fees. This service enables a company to raise funds without having to engage in the legal and documentation procedures and pursuing the potential investor. They help companies in arranging for finance and in project management as well. Whenever new securities are issued, it is managed by Merchant Bankers. All Merchant Bankers have to be registered under SEBI in order to carry out such activities. After 1980, new industries came up and equity financing became popular. As per SEBI guidelines, Merchant Bankers services are essential for making an issue of securities. This is done in order to regularize and make the security issue safe and transparent. Therefore, hiring merchant banking services is mandatory for the company.

After 1990, the new economic policy adopted by the government has resulted in the promotion of a number of new companies. This has resulted in the enlargement of capital market. The Government abolished the Office of Controller of Capital Issue and the regulation of stock market was taken over by SEBI. In such a situation, to link the investors on the one side and cater to the needs of the entrepreneurs on the other, a new organization came into existence called merchant banker.

A merchant banker is able to raise capital from the investing public and provide the same to the companies which are in need of them. Thus, a merchant banker is a critical link between a company raising funds and the investors. There are nearly 600 merchant bankers in India.

2.2 SEBI GUIDELINES FOR MERCHANT BANKERS

2.2.1 Meaning of Merchant Banking

A merchant banker underwrites corporate securities and provides guidelines to clients on issues like corporate mergers. The merchant banker may be in the form of a bank, a firm, company or even a proprietary concern. It is basically service banking which provides non-financial services such as arranging for funds rather than providing them.

The merchant banker understands the requirements of the business concerns and arranges finance with the help of financial institutions, banks, stock exchanges, and money market.

2.2.2 SEBI Guidelines

MERCHANT BANK According to SEBI (merchant bankers) rules 1992, "A merchant banker has been defined as any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant advisor or rendering corporate advisory services in relation to such issue management".

GUIDELINES FOR MERCHANT BANKING

The merchant banking activity in India is governed by SEBI (merchant bankers) regulations, 1992. Registration with SEBI is mandatory to carry out the business of merchant banking in India. An applicant should comply with the following norms:

- (i) the applicant should be a corporate body.
- (ii) the applicant should not carry on any business other than those connected with the securities market.
- (iii) the applicant should have necessary infrastructure like office space, equipment, manpower, etc.
- (iv) the applicant must have at least two employees with prior experience in merchant banking.
- (v) any associate company, group company, subsidiary or interconnected company of the applicant should not have been a registered merchant banker.

SEBI (MERCHANT BANKERS) REGULATIONS, 1992. A merchant banker will require authorization by SEBI to carry out the business. SEBI has classified the merchant bankers into four categories based on the nature and range of the activities and the responsibilities.

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- CATEGORY I – THEY ARE ALLOWED TO CARRY ON THE ACTIVITY OF ISSUE MANAGEMENT AND TO ACT AS ADVISER, CONSULTANT, MANAGER, UNDERWRITER, PORTFOLIO MANAGER.
- CATEGORY II – THEY ARE ALLOWED TO ACT AS ADVISER, CONSULTANT, CO-MANAGER, UNDERWRITER, PORTFOLIO MANAGER.
- CATEGORY III – THEY ARE PERMITTED TO ACT AS UNDERWRITER, ADVISER OR CONSULTANT TO AN ISSUE.
- CATEGORY IV – THEY CAN ACT ONLY AS ADVISER OR CONSULTANT TO AN ISSUE. CAPITAL ADEQUACY NORMS:
 - CATEGORY I : RS. 1 CRORES
 - CATEGORY II : RS.50 LAKHS
 - CATEGORY III : RS.20 LAKHS
 - CATEGORY IV : NIL

From 9 December 1997, however, all other categories were abolished, and merchant bankers can now only be registered under category- I by SEBI. Capital adequacy norms The securities exchange board of India (SEBI) has prescribed capital adequacy norms for merchant bankers to register under the various categories. The minimum 'net worth' set by SEBI for category- I of merchant bankers was initially fixed at the value of Rs. 1 crore and later raised to the value of Rs. 5 crores through an amendment of the regulations in the year 1995.

Every merchant banker should maintain copies of balance sheet, Profit and loss account, statement of financial position 3. Half-yearly unaudited result should be submitted to SEBI 4. Merchant bankers are prohibited from buying securities based on the unpublished price sensitive information of their clients 5. SEBI has been vested with the power to suspend or cancel the authorization in case of violation of the guidelines 6. Every merchant banker shall appoint a 'Compliance Officer' to monitor compliance of the Act 7. SEBI has the right to send inspecting authority to inspect books of accounts, records etc. of merchant bankers.

Inspections will be conducted by SEBI to ensure that provisions of the regulations are properly complied 9. SEBI will give authorization for a merchant banker to operate for 3 years only. Without SEBI's authorization, merchant bankers cannot operate 10. An initial authorization fee, an annual fee and renewal fee may be collected by SEBI 11. A lead manager holding a certificate under category I shall accept a minimum underwriting obligation of 5% of size of issue or Rs.25 lakhs whichever is less.

-It is mandatory under SEBI rules that every issuing company must appoint one or more SEBI registered merchant bankers as lead manager(s) for the management of issue. Issue amount No of lead managers Up to 50 crores not more than Two 50 to 100 crores Three 100 to 200 crores four 200 to 400 crores five Above 400 Five or more as may be agreed by the SEBI. However, the limit to the maximum number of lead managers to be appointed in a single issue was omitted through amendment in this regulations on April 19, 2006

RBI exempted merchant banking companies from compulsory registration (section 45 IA), maintenance of liquid assets (section 45 IB), creation of reserve fund (section 45 IC) and all the provisions of the recent directions relating to deposit acceptance and prudential norms. Conditions:

- Such companies are registered with SEBI under section 12 of the SEBI Act, 1992 and are carrying on the business of merchant banker in accordance with rules/regulations framed by SEBI;
- They require securities only as part of their merchant banking business
- They do not accept/ hold public deposits. Exemption from RBI Regulations.

1. Operational Guidelines

SEBI has pronounced the following guidelines for merchant bankers:

1. Submission of offer document: The offer documents of issue size up to Rs. 20 crores shall be filed by lead merchant bankers with the concerned regional office of the Board under the jurisdiction of which the registered office of the issuer company falls. The jurisdiction of regional offices/head office shall be as per Schedule XXII.

According to Clause 5.6 of Chapter V of the Guidelines, the draft offer document filed with the Board shall be made public. The lead merchant banker shall make available 10 copies of the draft offer document to the Board and 25 copies to the stock exchange(s) where the issue is proposed to be listed. Copies of the draft offer document shall be made available to the public by the lead merchant bankers/Stock Exchange.

The lead merchant banker and the Stock Exchange(s) may charge a reasonable charge for providing a copy of the draft offer document. The lead merchant banker shall also submit to the Board the draft offer document on a computer floppy in the format specified in Schedule XXIII. The Lead Merchant Banker shall submit two copies of the printed copy of the final offer document to dealing offices of the Board within three days of filing offer document with Registrar of companies/concerned Stock Exchange(s) as the case may be.

The lead merchant banker shall submit one printed copy of the final offer document to the Primary Market Department, SEBI, Head Office, within three days of filing the offer document with Registrar of Companies/concerned Stock Exchange(s) as the case may be. The lead merchant banker shall submit a computer floppy containing the final prospectus/letter of offer to the Primary

Market Department, SEBI, Head Office, as specified in Schedule XXIII within three days of filing the final prospectus/letter of offer with the Registrar of Companies/concerned Stock Exchange(s).

Along with the floppy, the lead manager shall submit an undertaking to SEBI certifying that the contents of the floppy are in HTML, format, and are identical to the printed version of the proposes/letter of offer filed with the registrar of Companies/concerned Stock Exchange, as the case may be. Wherever offer documents (for public/rights issues, takeovers or for any other purpose) are filed with any Department/Office of the Board, the following details —certified shall be given by the lead as merchant correct banker in the forwarding letters:

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- (a) Registration number
- (b) Date of registration/Renewal of registration
- (c) Date of expiry of registration
- (d) If applied for renewal, date of application
- (e) Any communication from the Board prohibiting them from acting as a
- (f) merchant banker
- (g) Any inquiry/investigation being conducted by the Board
- (h) Period up to which registration/renewal fees has been paid
- (i) Whether any promoter/group and/or associate company of the issuer company is associated with securities-related business and registered with SEBI
- (j) If any one or more of these persons/entities are registered with SEBI, their respective registration numbers
- (k) If registration has expired, reasons for non-renewal
- (l) Details of any enquiry/investigation conducted by SEBI at any time
- (m) Penalty imposed by SEBI
- (n) Outstanding fees payable to SEBI by these entities, if any Offer documents not accompanied by the information as contained above may be rejected. Lead merchant bankers shall obtain similar information from other intermediaries to ensure that they comply with these guidelines and are eligible to be associated with the concerned issue. The intermediaries shall also indicate in their letters that they have obtained such information from other intermediaries.

2. Dispatch of issue material: Lead merchant bankers shall ensure that whenever there is a reservation for NRIs, 10 copies of the prospectus together with 1000 application forms are dispatched in advance of the issue opening date, directly along with a letter addressed in person to Adviser (NRI), Indian Investment Centre, Jeevan Vihar Building Sansad Marg, and New Delhi. Twenty copies of the prospectus and application forms shall be dispatched in advance of the issue opening date to the various Investors Associations.

Underwriting while selecting underwriters and finalizing underwriting arrangement, lead merchant bankers shall ensure that the underwriters do not overexpose themselves so that it becomes difficult to fulfill their underwriting commitments. The overall exposure of underwriter(s) belonging to the same group or management in an issue shall be assessed carefully by the lead merchant banker.

OTC Dealers registered with the Board under SEBI (Stock Brokers and Sub-Brokers) Rules and Regulations, 1992 shall be treated at par with the brokers of other stock exchanges in respect of underwriting arrangement.

3. Compliance obligations: The merchant banker shall ensure compliance with the following post-issue obligations

- (a) **Association of resource personnel:** In terms of Clause 7.1 of Chapter VII of these Guidelines, in case of over-subscription in public issues, a Board nominated public representative shall be associated in the process of finalization of the basis of allotment. The lead merchant banker shall intimate to the person so nominated the date, time, venue etc. regarding the process of finalization of the basis of allotment.

The expenses of the public representatives associated in the allotment process of oversubscribed issues shall be borne by the lead merchant bankers, and recovered from the issues. Honorarium at a minimum of Rs.500/- per day, plus normal conveyance charges shall be paid to them, and the Board's Regional Managers at New Delhi, Chennai and Calcutta shall be associated with them.

- (b) **Redressal of investor grievances:** The merchant bankers shall assign high priority to investor grievances, and take all preventive steps to minimize the number of complaints. The lead merchant banker shall set up a proper grievance monitoring and redressal system in coordination with the issuers and the Registrars to Issue.

They shall take all necessary measures to resolve the grievances quickly. They shall actively associate with post-issue refund and allotment activities and regularly monitor investor grievances arising there from.

- (c) **Submission of post issue monitoring reports:** The concerned lead merchant banker shall submit, in duplicate, the Post Issue Monitoring Reports specified in Clause 7.2 of Chapter VII of these Guidelines, within 3 working days from the due dates, either by registered post or deliver them at the respective regional offices/head office give in Schedule XXII:

Where the offer documents have been dealt with by any of the regional offices of the Board, a copy of the report shall be sent to the Boards Head office, Mumbai. The Lead Merchant Banker(s) shall inform the Board on important developments about the particular issues being lead managed by them during the period intervening the reports.

- (d) **Issue of No objection Certificate (NOC):** In accordance with the Listing Agreement of the Stock Exchanges, the issuer companies shall deposit 1% of the amount of securities offered to the public and/or to the holders of the existing securities of the company, as the case may be, with the regional Stock Exchange.

These securities can be related by the concerned Stock Exchange only after obtaining an NOC from the Board. An application for NOC shall be submitted by the issue company to the Board in the format specified in Schedule XXIV. The following conditions shall be complied with before submitting the application for the issue of NOC.

- Completion of 4 months from the date of obtaining the listing permission from the concerned Regional Stock Exchange, or the last date when the listing permission was obtained from any of the other Stock Exchanges, where the securities are proposed to be listed, whichever is later
- Satisfactory Redressal of all complaints received by the Board against the company
- Certificate from the Regional Stock Exchange to the issuer company to the effect that underwriting/brokerage commission as well as the Registrars/Lead merchant bankers fees been duly paid by the company Application for issue of NOC shall be filed with the concerned regional office of the Board, under the jurisdiction in which the registered office of the issuer company falls, as specified in Schedule XXII.

In cases where issues fail, and the investors' monies are fully refunded, an NOC from the Board may not be required, and the concerned regional Stock Exchange can refund the 1% security deposit after duly verifying that the refund orders have actually been dispatched.

The complaints with respect to non-receipt of underwriting/brokerage commission and Registrars/Lead merchant bankers fees may be filed with the concerned regional Stock Exchanges. Responses to complaints forwarded by the Board to the concerned companies shall be submitted to the Board in the proforma specified in Schedule XXV for updating of records.

- (e) **Registration of merchant bankers:** Application for renewal of Certificate of Registration shall be made by the merchant bankers according to Regulation 9 of SEBI (Merchant Bankers) Rules and Regulations, 1992.

While filing the renewal application for the certificate of registration as merchant banker, it shall provide a statement highlighting the changes that have taken place in the information that was submitted to the Board for the earlier registration, and a declaration stating that no other changes besides those mentioned in the above statement have taken place.

Merchant Bankers, while forwarding the renewal application in Form A of the SEBI (Merchant Bankers) Rules and Regulations, 1992, shall also forward the additional information as specified in Schedule XXVI. Registered Merchant Bankers shall inform the Board of their having become a member of AMBI, with the relevant details.

(f) **Reporting requirements:** In terms of Regulation 28 of SEBI (Merchant Bankers Regulation) 1992, the merchant bankers shall send a half yearly report, in the format specified in Schedule XXVII, relating to their merchant banking activities. The report referred to in sub-clause (a) shall be submitted twice a year, on March 31 and September 30, and it should reach the Board within three months from the close of the period to which it relates.

(g) **Impositions of penalty points:** Penalty points may be imposed on the merchant banker for violation of any of the provisions for operational guidelines. The merchant banker, on whom penalty points of four or more has been imposed, may be restrained from filing any offer document or associating or managing any issues for a particular period.

The Board may initiate action under the SEBI (Merchant Bankers) Regulations against the merchant bankers, irrespective of whether any penalty point is imposed or not. Imposition of penalty point is not a precondition for initiation of proceedings against the merchant banker under the SEBI (Merchant Bankers) Regulations.

Guidelines on Advertisement: Following are the guidelines applicable to the lead merchant banker who shall ensure due compliance by the issuer company:

Factual and truthful: An issue advertisement shall be truthful, fair and clear, and shall not contain any statement that is untrue or misleading. Any advertisement reproducing, or purporting to reproduce, any information contained in an offer document shall reproduce such information in full and disclose all relevant facts.

It should not be restricted to select extracts relating to that item. An issue advertisement shall be considered to be misleading, if it contains :

- (a) Statements made about the performance or activities of the company in the absence of necessary explanatory or qualifying statements, which may give an exaggerated picture of the performance or activities.
- (b) An inaccurate portrayal of past performance, or its portrayal in a manner which implies that past gains or income, will be repeated in the future.

Clear and concise: An advertisement shall be set forth in a clear, concise and understandable language. Extensive use of technical, legal terminology or complex language and the inclusion of excessive details, which may distract the investor, shall be avoided.

1. **Promise or profits:** An issue advertisement shall not contain statements which promise or guarantee rapid increase in profits. An issue advertisement shall not contain any information that is not contained in the offer document.
2. **Mode of advertising:** No models, celebrities, fictional characters, landmarks, caricatures or the likes shall be displayed on or form part of the offer documents or issue advertisements. Issue advertisements shall not appear in the form of crawlers (the advertisements which run simultaneously with the program in a narrow strip at the bottom of the television screen) on television.

Similarly, no advertisement shall include any issue slogans or brand names for the issue, except the normal commercial name of the company or commercial brand names of its products already in use. No slogans, expletives or non-factual and unsubstantiated titles shall appear in the issue advertisements or offer documents.

3. **Financial data:** If any advertisement carries any financial data, it shall also contain data for the past three years and shall include particulars relating to sales, gross profit, net profit, share capital, reserves, earnings per share, dividends, and book values.
4. **Risk factors:** All issue advertisements carried in the print media such as newspapers, magazines, brochures or, pamphlets shall contain highlights relating to any issue, besides containing detailed information on the risk factors. The print size of highlights and risk factors in issue advertisements shall not be less than point 7 sizes.

It shall contain the names of Issuer Company, address of its registered office, names of the main lead merchant bankers and Registrars to the Issue. No issue advertisement shall be released without giving —Ri respect of the concerned issue, provided that an issue opening/closing advertisement which does not contain the highlights need not contain risk factors.

5. **Issue date:** No corporate advertisement of Issuer Company shall be issued after 21 days of filing of the offer document with the Board until the closure of the issue, unless the risk factors which are required to be mentioned in the offer document, are mentioned in the advertisement.
6. **Product advertisement:** No product advertisement of the company shall contain any reference, directly or indirectly, to the performance of the company during the period.
7. **Subscription:** No advertisement shall be issued stating that the issue has been fully subscribed or oversubscribed during the period the issue is open for subscription, except to the effect that the issue is open or closed.
8. **Issue closure:** No announcement regarding closure of the issue shall be made except on the closing date. If the issue is fully subscribed before the closing date stated in the offer document, the announcement

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should be made only after the issue is fully subscribed and such announcement is made on the date on which the issue is to be closed. Announcements regarding closure of the issue shall be made only after the lead merchant banker is satisfied that at least 90% of the issue has been subscribed, and a certificate has been obtained to that effect from the Registrar to the issue.

9. **Incentives:** No incentives, apart from the permissible underwriting commission and brokerage, shall be offered through advertisements to anyone associated with marketing the issue.
10. **Reservation:** In case there is a reservation for NRIs, the issue advertisement shall specify the same, and also indicate the place in India from where the individual NRI applicant can procure application forms.
11. **Undertaking:** An undertaking has to be obtained from the issuer as part of the MoU between the lead merchant banker and the issue company to the effect that the issuer company shall not directly or indirectly release, during any conference or at any other time, any material or information which is not contained in the offer documents.
12. **Availability of copies:** To ensure that the issuer company obtains approval for all issue advertisements and publicity materials from the lead merchant banker responsible for marketing the issue and also ensure the availability of copies of all issue related materials with the lead merchant banker, at least until the allotment is completed by the SEBI.

2.2.3 Regulations by SEBI on Merchant Banking

Reforms for the Merchant Bankers

SEBI has made the following reforms for the merchant banker

1. Multiple categories of merchant banker will be abolished and there will be only one equity merchant banker.
2. The merchant banker is allowed to perform underwriting activity. For performing portfolio manager, the merchant banker has to seek separate registration from SEBI.
3. A merchant banker cannot undertake the function of a non banking financial company, such as accepting deposits, financing others' business, etc.
4. A merchant banker has to confine himself only to capital market activities.

Recognition by SEBI on Merchant Bankers

SEBI will grant recognition a merchant banker after taking into account the following aspects

1. Considering how much the merchant are professionally competent.
2. Whether they have adequate capital

3. • Track record, experience and general reputation of merchant bankers.
4. Quality of staff employed by merchant bankers, their adequacy and available infrastructure are taken into account. After considering the above aspects, SEBI will grant permission for the merchant banker to start functioning.

Conditions by SEBI for Merchant Bankers

SEBI has laid the following conditions on the merchant bankers, for conducting their operations. They are

1. SEBI will give authorization for a merchant banker to operate for 3 years only. Without SEBI's authorization, merchant bankers cannot operate.
2. The minimum net worth of merchant banker should be Rs. 1 crore.
3. Merchant banker has to pay authorization fee, annual fee and renewal fee.
4. All issue of shares must be managed by one authorized merchant banker. It should be the lead manager.
5. The responsibility of the lead manager will be clearly indicated by SEBI.
6. Lead managers are responsible for allotment of securities, refunds, etc.
7. Merchant banker will submit to SEBI all returns and send reports regarding the issue of shares.
8. A code of conduct for merchant bankers will be given by SEBI, which has to be followed by them.
9. Any violation by the merchant banker will lead to the revocation of authorization by SEBI.

2.2.4 Functions of a Merchant Banker

- Corporate Counseling
- Project Counseling and Pre-investment Studies
- Capital Restructuring
- Loan Syndication
- Project Appraisal, Approval and Finance
- Issue Management
- Underwriting
- Portfolio Management
- Working Capital Finance
- Acceptance Credit and Bill Discounting
- Mergers, Amalgamations and Takeovers
- Venture Capital Financing
- Lease Financing
- Fixed Deposit Broking

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History of Merchant Banking in India

In USA it is called as investment banks, while in the UK it is known by the name of issuing house. In India, National Grindlays Bank initiated merchant banking services in 1969. Then Citibank joined the financial service in 1970. The State Bank of India was the first Indian commercial bank to set up a separate Merchant Banking Division in 1973, followed by ICICI followed it in 1974. Categories of Merchant Banker The merchant bankers can be categorized into four types on the basis of activities permitted to be carried by them :

1. **Category I:** These can carry on a number of activities ranging from preparation of prospectus and other documents relating to the security issue, deciding on the financial structure, contracting with financiers, final allotment and refund of the subscription, and to act as adviser, consultant, manager, underwriter, portfolio manager.
2. **Category II:** These can act as adviser, consultant, co-manager, underwriter, portfolio manager.
3. **Category III:** They act as underwriter, adviser, and consultant to an issue.
4. **Category IV:** They act only as adviser or consultant to an issue.

Code of Conduct for Merchant Banker

The SEBI has issued guidelines in view to regularize the functions of merchant bankers in the form of a specific code of conduct . It includes the following salient points :

- It must make efforts to protect the interests of investors and act in their best interest.
- It must maintain high standards of integrity, dignity and fairness in the conduct of its business.
- All merchant bankers must work towards to ensure that copies of the prospectus, offer document, letter of offer or any other related literature is made available to the investors at the time of issue.
- They should fulfill their obligations in a prompt, ethical, and professional manner.
- They must ensure that at all times they exercise due diligence, ensure proper care and exercise independent professional judgment.
- They should ensure that investors are able to take timely and accurate decisions by providing them adequate disclosures in accordance with the applicable regulations and guidelines.
- They should not make any statement, either oral or written, which would misrepresent the services that the merchant banker is capable of performing for client.
- They should try avoid conflict of interest and make adequate disclosure of its interests to the investors along with devising a mechanism to resolve any conflict of interest that may arise in the conduct of its business.

2.2.5 Registration of Merchant Banker

The SEBI grants a certificate of registration on the fulfillment of necessary conditions:

- Merchant banker should be a body corporate other than a non-banking financial company. However, in case a merchant banker who has been granted registration by the RBI to act as Primary Dealer may carry on such activity provided that it would not accept/hold any public deposit;
- They must fulfill the capital adequacy requirement (as per the category they belong to,) of a minimum net worth (ie paid up capital and reserves) of Rs 5 crore;
- They must maintain adequate infrastructure like adequate office space, equipment and manpower to effectively discharge the functions;
- They should have employed at least two persons with experience to conduct business:
 - The merchant banker /partners/directors/principal offices should not be convicted or involved in any litigation concerning the securities market, which has an adverse effect on their business. They should have attained professional qualification in finance, law or business.
 - The applicant is a fit and proper person. SEBI as per the rules given in the SEBI Intermediaries Regulation 2004 shall determine whether an applicant is a fit and proper person or not.

Eligibility Norms for grant of Certificate of Registration of Merchant Banker

1. The applicant shall be a body corporate
2. The applicant shall have necessary infrastructure like perform adequate office space, equipment, and manpower to carry on the business activities and to discharge his activities and services effectively
3. The applicant shall employ at least two persons having experience in the field of merchant banking activities
4. The applicant shall fulfil the minimum capital adequacy requirement i.e. the applicant must have a net worth of at least Rupees Five Crores
5. The applicant, his partner, director, or his principal officer shall not at any time been:
 - (i) Involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant;
 - (ii) Convicted for any offence involving moral turpitude or has been found guilty of any economic offence;

The applicant shall Possess the professional qualification in finance, law or business management from any Government recognized institution.

Applicant Not eligible for grant of Certificate of Registration of Merchant Banker

- The Company registered with Reserve Bank of India as a non-banking financial company as defined under Clause (f) of Section 45-I of RBI Act, 1934, as amended from time to time. shall not be eligible for Merchant Banker License

Exception: those companies can apply for merchant banker license which has been granted registration by the Reserve Bank of India to act as a primary or satellite dealer, subject to the condition that it shall not accept or hold a public deposit

- Any person who is directly or indirectly connected to an "applicant" whose application for grant of Merchant Banker license has been rejected by the Board

Fit and Proper Criteria

For grant of Certificate of Registration of Merchant Banker, the Board ensures that the applicant making the application shall be a "fit and proper person."

The Board can reject the application for grant of Certificate of Registration of Merchant Banker on the ground that the Applicant or any of his Principal Officer or the key management persons does not fulfil the "Fit and Proper Criteria."

"Fit and Proper Person" here includes that the applicant, the principal officer, and the key management persons by whatever name called shall possess the following:-

- integrity, reputation, and character
- absence of convictions and restraint orders
- competence including financial solvency and net worth

Further, it must be noted that the Board has the power to take into account some other considerations while assessing whether the applicant is a "fit and proper person" or not.

Process for grant of Certificate of Registration:

- The Applicant shall make an application for grant of certificate of Registration of Merchant Banker to the Board in *Form A*

Special note:

The Application as mentioned above shall be made for carrying on the activities as done by category I Merchant Banker

A separate certificate of registration is required under Securities and Exchange Board of India (Portfolio Manager) Regulations, 1993 for a Merchant Banker to carry on the Business Activity as Portfolio Manager

- The applicant shall at the time of making an application for registration, pay a non-refundable application fee of Rupees fifty thousand by way of direct credit in the bank account through NEFT/RTGS/IMPS or any other mode allowed by RBI or by a demand draft in favour of

“Securities and Exchange Board of India” payable at Mumbai or the respective regional office.

- The applicant shall furnish the further information or clarification as may be called upon by the Board, for disposal of Application, which may be regarding:
 1. any other matter as may be prescribed by the Board
 2. matters related to the activity of a merchant banker or
 3. information as filed in the application or
- The applicant, its principal officer or Key managerial Persons shall personally Appear before the Board for making the representation, if so required by the Board.
- The Board, after making full inquiry in the application made for grant of Certificate of Registration and on being satisfied that the applicant is eligible, shall grant a certificate of registration in Form B and shall send intimation to the applicant.
- The merchant Banker shall pay a fee upon the grant of Certificate of Registration to act as Merchant Banker.

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Consequences where Certificate of registration of Merchant Banker is not granted:

- The Board has the power to reject the application for grant of a certificate of registration of Merchant Banker, where the application does not satisfy the set-out criteria, after giving an opportunity of being heard to the applicant.
- The Board shall within thirty days of such refusal for grant of registration, communicate to the applicant the Grounds on which the application has been rejected.
- The applicant can apply to the Board for reconsideration of his application for grant of Certificate of Registration within thirty days of receipt of such intimation from the Board regarding rejection.
- The Board shall reconsider the application received for reconsideration and shall communicate its decision as soon as possible in writing to the applicant.

Payment of fees by Merchant Banker:

1. At the time of grant of the Certificate of Registration, the merchant Banker shall pay a fee of Rupees Twenty lacs only.
2. Merchant Bankers holding a certificate of Registration shall pay a fee of Rupees nine lakh only for every three years from:
 - the date of grant of certificate of registration or
 - from the date of the grant of certificate of initial registration granted prior to the commencement of the Securities and Exchange Board of India (Change in Conditions of Registration of Certain Intermediaries) (Amendment) Regulations, 2016, as the case may be

Time Limit for Payment of Fees:

1. The fees payable at the time of grant of Certificate of Registration shall be paid within fifteen days from the date of receipt of intimation regarding grant Certificate of Registration from the Board
2. Fees payable by Merchant Bankers holding Certificate of Registration shall be paid within three months before the expiry of the block for which fee has been paid.

Consequences of Non – Payment of fees: Where a merchant banker fails to pay the annual fees, the Board may suspend the certificate of registration of merchant banker, whereupon the merchant banker shall cease to carry on any activity as a merchant banker for the period during which the suspension subsists.

The validity of Certificate of Registration: The certificate of registration granted to the merchant Banker shall be valid unless it is suspended or cancelled by the Board.

2.2.6 Obligations and Responsibilities of Lead Managers

Obligations of Merchant Bankers:

Obligation # 1. Merchant Banker not to Associate with any Business other than that of the Securities Market:

No merchant banker, other than a bank or a public financial institution, who has been granted a certificate of registration under these regulations, shall [after June 30th, 1998] carry on any business other than that in the securities market.

Notwithstanding anything contained above, a merchant banker who prior to the date of notification of the Securities and Exchange Board of India (Merchant Bankers) Amendment Regulations, 1997, has entered into a contract in respect of a business other than that of the securities market, may, if he so desires, discharge his obligations under such contract.

Provided that a merchant banker who has been granted certificate of registration to act as primary or satellite dealer by Reserve Bank of India, may carry on such business as may be permitted by the Reserve Bank of India (SEBI/ Merchant Bankers) (Second Amendment) Regulations, 1999.

Obligation # 2: Maintenance of Book of Accounts, Records, etc.:

Every merchant banker shall keep and maintain the following books of accounts, records and documents, namely:

- (a) A copy of balance sheet as at the end of each accounting period;
- (b) A copy of profit and loss account for that period;
- (c) A copy of the auditor's report on the accounts for that period; and
- (d) a statement of financial position.

Every merchant banker shall intimate to the Board the place where the books of accounts, records and documents are maintained.

Without prejudice to sub-regulation (I), every merchant banker shall, after the end of each accounting period furnish to the Board copies of the balance sheet, profit and loss account and such other documents for any other preceding five accounting years when required by the Board.

Obligation # 3. Submission of Half-yearly Results:

Every merchant banker shall furnish to the Board half-yearly unaudited financial results when required by the Board with a view to monitor the capital adequacy of the merchant banker.

Obligation # 4. Maintenance of Books of Accounts, Records and other Documents:

The merchant banker shall preserve the books of accounts and other records and documents for a minimum period of five years.

Obligation # 5. Report on Steps taken on Auditor's Report:

Every merchant banker shall within two months from the date of the auditors' report take steps to rectify the deficiencies, made out in the auditor's report.

Obligation # 6. Appointment of Lead Merchant Bankers:

All issues should be managed by atleast one merchant banker functioning as the lead merchant banker:

Provided that, in an issue of offer of rights to the existing members with or without the right of renunciation the amount of the issue of the body corporate does not exceed rupees fifty lakhs, the appointment of a lead merchant banker shall not be essential.

Every lead merchant banker shall before taking up the assignment relating to an issue, enter into an agreement with such body corporate setting out their mutual rights, liabilities and obligations relating to such issue and in particular to disclosures, allotment and refund.

Obligation # 7. Restriction on Appointment of Lead Managers:

The number of lead merchant bankers may not, exceed in case of any issue of;

Size of issue	No. of lead merchant bankers
(a) Less than rupees fifty crores	two
(b) Rupees fifty crores but less than rupees one hundred crores	— three
(c) Rupees one hundred crores but less than two hundred crores	— four
(d) Rupees two hundred crores but less than rupees four hundred crores	— five
(e) Above rupees four hundred crores	— Five or more as may be agreed by the Board.

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Obligation # 8. Responsibilities of Lead Managers:

No lead manager shall agree to manage or be associated with any issue unless his responsibilities relating to the issue mainly, those of disclosures, allotment and refund are clearly, defined, allocated and determined and a statement specifying such responsibilities is furnished to the Board atleast one month before the opening of the issue for subscription:

Provided that, where there are more than one lead merchant banker to the issue the responsibilities of each of such lead merchant banker shall clearly be demarcated and a statement specifying such responsibilities shall be furnished to the Board atleast one month before the Opening of the issue for Subscription.

No lead merchant banker shall, agree to manage the issue made by anybody corporate, if such body corporate is an associate of the lead merchant banker.

Obligation # 9. Lead Merchant Banker not to Associate with a Merchant Banker without Registration:

A lead merchant banker shall not be associated with any issue if a merchant banker who is not holding a certificate is associated with the issue.

Obligation # 10. Underwriting Obligations:

In respect of every issue to be managed, the lead merchant banker holding a certificate under Category I shall accept a minimum underwriting obligation of five per cent of the total underwriting commitment or rupees twenty-five lacs, whichever is less:

Provided that, if the lead merchant banker is unable to accept the minimum underwriting obligation, that lead merchant banker shall make arrangement for having the issue underwritten to that extent by a merchant banker associated with the issue and shall keep the Board informed of such arrangement.

Obligation # 11. Submission of Due Diligence Certificate:

The lead merchant banker, who is responsible for verification of the contents of a prospectus or the letter of offer in respect of an issue and the reasonableness of the views expressed therein; shall submit to the Board atleast two weeks prior to the opening of the issue for subscription, a due diligence certificate in Form C.

Obligation # 12. Documents to be Furnished to the Board:

The lead manager responsible for the issue shall furnish to the Board, the following documents, namely:

- (i) Particulars of the issue;
- (ii) Draft prospectus or where there is an offer to the existing shareholders, the draft letter of offer;
- (iii) Any other literature intended to be circulated to the investors, including the shareholders; and
- (iv) Such other documents relating to prospectus or letter of offer, as the case may be.

The documents referred to in sub-regulation (1) shall be furnished at least two weeks prior to date of filing of the draft prospectus or the letter of offer, as the case may be, with the Registrar of Companies or with the Regional Stock Exchanges, or with both.

The lead manager shall ensure that the modifications and suggestions, if any, made by the Board on the draft prospectus or the letter of offer, as the case may be, with respect to information to be given to the investors are incorporated therein.

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Obligation # 13. Continuance of Association of Lead Manager with an Issue:

The lead manager undertaking the responsibility for refunds or allotment of securities in respect of any issue shall continue to be associated with the issue till the subscribers have received the share or debenture certificates of refund or excess application money.

Provided that where a person other than the lead manager is entrusted with the refund or allotment of securities in respect of any issue, the lead manager shall continue to be responsible for ensuring that such other person discharges the requisite responsibilities in accordance with the provisions of the Companies Act and the listing agreement entered into by the body corporate with the stock exchange.

Obligation # 14. Acquisition of Shares Prohibited:

No merchant banker or any of its directors, partner or manager or principal officer shall either on their respective accounts or through their associates or relatives enter into any transaction in securities of bodies corporate on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment either from the clients or otherwise.

Obligation # 15. Information to the Board:

Every merchant banker shall submit to the Board complete particulars of any transaction for acquisition of securities of anybody corporate whose issue is being managed by that merchant banker within fifteen days from the date of entering into such transaction.

Obligation # 16. Disclosures to the Board:

A merchant banker shall disclose to the Board as and when required, the following information, namely:

- (i) His responsibilities with regard to the management of the issue;
- (ii) Any change in the information or particulars previously furnished, which have a bearing on the certificate granted to it;
- (iii) The names of the body corporate whose issues he has managed or has been associated with;
- (iv) The particulars relating to breach of the capital adequacy requirement;
- (v) Relating to his activities as a manager, underwriter, consultant or adviser to an issue as the case may be.

Obligation # 17. Appointment of Compliance Officer:

Every merchant banker shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc. issued by the Board or the Central Government and for redressal of investors' grievances.

The compliance officer shall immediately and independently report to the Board any non-compliance observed by him and ensure that the observations made or deficiencies pointed out by the Board on/in the draft prospectus or the Letter of Offer as the case may be, do not recur.

Obligation # 18: Board's right to Inspect:

The Board may appoint one or more persons as inspecting authority to undertake inspection of the books of accounts, records and documents of the merchant banker for any of the following purposes:

- (a) To ensure that the books of account are being maintained in the manner required.
- (b) That the provisions of the Act, rules, regulations are being complied with;
- (c) To investigate into the complaints received from investors, other merchant bankers or any other person on any matter having a bearing on the activities of the merchant banker, and
- (d) To investigate suo moto in the interest of securities business or investors interest into the affairs of the merchant banker.

Obligation # 19. Obligations of Merchant Banker on Inspection by the Board:

It shall be the duty of every director, proprietor, partner, officer and employee of the merchant banker, who is being inspected, to produce to the inspecting authority such books, accounts and other documents in his custody or control and furnish him with the statements and information relating to his activities as a merchant banker within such time as the inspecting authority may require.

The merchant banker shall allow the inspecting authority to have reasonable access to the premises occupied by such merchant banker or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the merchant banker or any such other person and also provide copies of documents or other materials which, in the opinion of the inspecting authority are relevant for the purposes of the inspection.

The inspecting authority, in the course of inspection, shall be entitled to examine or record statements of any principal officer, director, partner, proprietor and employee of the merchant banker.

It shall be the duty of every director, proprietor, partner, officer or employee of the merchant banker to give to the inspecting authority all assistance in connection with the inspection which the merchant banker may reasonably be expected to give.

Responsibilities of Lead Managers

Every lead manager has to enter into an agreement with the issuing companies setting out their mutual rights, liabilities and obligation relating to such issues and in particular to disclosures, allotment and refund. A statement specifying these is furnished to the SEBI at least one month before the opening of the issue for subscription.

In case of more than one lead manager, the statement has to provide details about their respective responsibilities. A lead merchant banker cannot manage an issue if the issuing company is his associate. He can also not associate with a merchant banker who does not hold a certificate of registration with the SEBI.

It is necessary for a lead manager who is Category I merchant banker, to accept a minimum underwriting obligation of 5 percent of the total underwriting commitment or Rs 25 lakh, whichever is less. If he is unable to do so, he has to make arrangements for underwriting of an equal amount by a merchant banker associated with that issue under intimation to the SEBI.

Due Diligence Certificate: The lead manager is responsible for the verification of the contents of a prospectus/letter of offer in respect of an issue and the reasonableness of the views expressed in them.

He has to submit to the SEBI, at least two weeks before the opening of the issue for subscription, a due diligence certificate to the effect that (1) they are in conformity with the documents/materials and papers relevant to the issue, (2) all legal requirements connected with the issue have fully complied with, and (3) the disclosures are true, fair and adequate to enable the investors to make a well-formed decision as to the investment in the proposed issue.

Submission of Documents: The lead managers to an issue have to submit to the SEBI, at least two weeks before the date of filing with the registrar of companies/regional stock exchanges or both, particulars of the issue, draft prospectus/letter of offer, other literature to be circulated to the investors/ share holders and so on to the SEBI.

They have to ensure that the modifications/suggestions made by it with respect to the information to be given to the investors are duly incorporated. They have to continue to be associated with the issues till the subscribers have received the share/debenture certificates or the refund of excess application money.

Acquisition of Shares: A merchant banker is prohibited from acquiring securities of any company on the basis of unpublished price sensitive information obtained during the course of any professional assignment either from the

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client or otherwise. He has to submit to the SEBI complete particulars of any acquisition of securities of a company whose issue is being managed by him within 15 days from the date of the transaction.

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Disclosure to SEBI: As and when required, a merchant banker has to disclose to the SEBI:

- (1) his responsibilities with regard to the management of the issue,
- (2) any change in the information/particulars previously furnished which have a bearing on the certificate of registration granted to it,
- (3) the names of the companies whose issues he has managed or has been associated with
- (4) the particulars relating to the breach of capital adequacy requirements, and
- (5) information relating to his activities as manager, underwriter, consultant or advisor to an issue.

Procedure for Inspection: The SEBI can undertake inspection of the books of accounts, records, and documents of a merchant banker to ensure that the books are maintained in the manner required, the provision of the SEBI Act, rules, regulations are being complied with, and to investigate complaints from investors/other merchant bankers/any other person or any matter having a bearing on his activities as a merchant banker and to investigate suo moto in the interest of securities business/investors into the affairs of the merchant banker.

The merchant banker has an obligation to furnish all information called for, allow a reasonable access to the premises, extend reasonable facility for examination of books/records/documents/computer data and provide copies of the same and give all assistance to the inspecting authority in connection with the inspection.

2.3 CONTINUANCE OF ASSOCIATION OF LEAD MANAGERS WITH AN ISSUE

Do you know about the obligation of the merchant banker and of the issuer? From general understating merchant banker is the one who is associated with high worth individuals and companies for the purpose of selling, buying and subscribing to the securities. Subsequently, the issuer is the one who issues the security with the intent to raise capital for the purpose of its project.

The present article provides the snapshot of who merchant banker and issuer is along with the help of illustration to connect the working of same in the practical aspect. Further, this article primarily focuses upon the obligation of merchant banker and issuer which they are obligated to perform as provided under their governing regulation and act along with the emphasis on the case laws to highlight the penalty and strict adherence to the obligations.

Existing as well as new companies raise funds through various sources for implementing their projects. One of the sources of raising funds is mobilising capital by issuing securities. This can be done in the following three ways:

- Public Issue
- Right Issue
- Private Placement

Public Issue: The most common method of raising funds from public at large is called public issue. Public issue is made by a company through prospectus for a fixed number of shares at: (i) a stated price which may be at par or premium, and (ii) a rate determined by the issuer on the basis of market demand (book building mechanism). The prospectus has to disclose all material and essential factors about the company to the intending purchasers of shares. Securities and Exchange Board of India has laid down guidelines for raising funds from the public. The guidelines relate to adequate disclosures in the prospectus so that the investors can take informed decision while making an investment in a company

Right Issue: Right issues are issues of new shares in which existing shareholders are given preemptive rights to subscribe to new issue of shares. Such additional shares are offered in proportion to the capital paid-up on the shares held by them at the date of such offer. The shareholders to whom the offer is made are not under any legal obligation to accept the offer. On the other hand, they have right to renounce the offer in favour of any person. Right shares are usually offered on terms advantageous to the shareholders. For example, shares of the face value of Rs. 10 may be offered at par value, while market price of the share at the time of offer may be Rs. 15 or more.

Private Placement: The direct sale of securities by a company to investors is called private placement. In private placement no prospectus is issued. Private placement covers shares, preference shares and debentures. It is assumed that the investors have sufficient knowledge and experience to be capable of evaluating the merits and risks of the investment. The financial intermediary, however, plays a vital role in preparing an offer memorandum, and negotiating with investors. The private placement has obvious advantages of speed and confidentiality. Private placement offers access to capital more quickly than public issue which may take six months to one year.

However, it is possible to raise funds through private placement within 2 to 3 months. Access to primary market is quite costly on account of various mandatory and non-mandatory expenses. Some public companies are too small to afford a public issue, such companies choose to use private placement.

Further the requirement of companies may be smaller than the minimum stipulated for public issue for listing at different stock exchanges. Finally private placement is not influenced like the primary market by the prevailing bull or bear phases in the stock market. The attitude of institutional investors towards the regular issue of securities in private placement market is more stable and continuous.

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Who is a merchant banker and issuer?

It was National Grindlays Bank who first introduced the concept of merchant bank in the year 1967. Subsequently, the State Bank of India became the first Indian commercial bank to establish the Merchant Banking division in the year 1972. As per Webster's New Collegiate Dictionary defines merchant bank as, "*that specializes in bankers' acceptances and in underwriting or syndicating equity or bond issues*".

Further, as per Regulation 2 (cb) of Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992 defines the term merchant banker as "*any person who is involved in the business of issue management either by making arrangements pertaining to selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management*".

Therefore, in simple words, merchant bankers are in charge of the issue process and act as a linking pin between the investor and the company. They are also obligated with the preparation of prospectus and marketing advertisement for the issue. Also, the obligations of merchant banker are covered further in this article.

Moreover, Section 2(1) (f) of the Depository Act, 1996 defines the term "issuer" as any person who is indulged in making the issue of the securities. In furtherance of this, the issuer is a legal entity who sells securities to provide finance to its operations and issuer can be investment trusts, corporation or domestic or foreign government and Securities issued by the issuer include equity, shares, bonds and warrants etc.

Illustration to understand the concept of issuer is provided below:

XYZ is a corporation sells shares to the general public in order to generate the capital to finance its project or say its business operation. The selling of shares by XYZ makes it the issuer and is required to relevant financial statements with the regulator such as Securities and Exchange Commission.

After, understanding the concept of merchant banker and issuer let's see what are the regulations and acts governs their obligation.

Regulation governing merchant bankers

Security Exchange Board of India (hereinafter referred to as SEBI) has made regulation for different components of the capital market after exercising its power under Section 30 of the SEBI Act, 1992. In furtherance of which merchant bankers are regulated by SEBI (Merchant Bankers) Regulations, 1992 (hereinafter referred to as the Merchant Banker Regulation). Present regulation consists of five chapters that are definitions, compulsory registration with SEBI, obligation and responsibilities, code of conduct, code of conduct, the procedure for inspection by SEBI, of documents, records and books of accounts, the procedure in case of default, i.e. the action to be taken against concerned merchant banker (cancellation or suspension of registration by SEBI).

Merchant Banking is the noble profession, like other professions and merchant banker also has to abide by some of the obligations as provided by the above-mentioned Merchant banker Regulations.

To move further with the aspect of merchant baker obligation it is pertinent to mention here the general definition of term "obligation" which means that "A duty imposed on one, either legally or socially with the duty to perform and not to perform some action."

Therefore, the obligation of the merchant bankers governed by Chapter III of the SEBI (Merchant Bankers) Regulations, 1992. Further, in the light of above-mentioned chapter the obligation of the merchant banker is provided below:

Merchant Banker not to Associate with any Business other than that of the Securities Market

No, merchant banker as per Regulation 13A of the Merchant Banker Regulation who have obtained the certificate of registration after 30th June 1988 can carry on any business apart from business in the securities market. But, the Bank or Public Financial Institution can do so.

However, if a merchant banker has entered into a contract with respect to the business apart from the securities market, prior to the Merchant Banking Regulation, 1997, then he may if so desire can discharge his obligation under such contract.

Maintenance of Book of Accounts, Records, etc.

As per Regulation 14 of the Merchant Banking Regulation merchant banker has to maintain the copy of balance sheet at the end of each accounting year along with profit and loss account of the respective period and an auditors report for the accounting period with a statement of financial position. Further, merchant bankers also have to maintain all records and documents related to due diligence related to per-issue and post-issue activities of issue management as well as in case of a takeover, delisting of securities and buyback of securities.

Moreover, Board should be informed about the place where above mentioned pertinent document are maintained and every merchant banker shall, after the end of each accounting period furnish to the Board copies of the balance sheet, profit and loss account and such other documents for any other preceding five accounting years when required by the Board.

Submission of Half-yearly Results and Maintenance of Books of Accounts, Records and other Documents

Regulation 15 of the Merchant Banker Regulation obligates every merchant banker to provide half-yearly unaudited financial results to the Board with a view to keep a tab on the capital adequacy of the merchant banker. Further, in accordance with Regulation 16, he should also maintain the records such as books of accounts and other pertinent records for the minimum period of 5 years.

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Report on Steps taken on Auditor's Report

Regulation 17 provides that within 2 months from the receipt of the auditor's report, the merchant banker shall rectify the deficiencies mentioned in such report.

Responsibilities of Lead Managers

Regulation 20 of the Merchant Banker Regulation governs the provision related to the responsibilities of the lead merchant banker to which he has to compulsorily oblige with. As per this regulation lead manager shall not agree to take care or be associated with any issue unless his responsibilities have been determined and a statement specifying the same furnished by the board at least 1 month prior to the issue for a subscription. Also, prior to such period as mentioned above if there is more than one lead merchant banker then their responsibilities should be clearly demarcated along with such statements mentioning the same.

Further, if the issue is made by any other body corporate and that body corporate is an associate of the lead merchant banker then he shall not agree to manage the same. Subsequently, as per regulation 21 of the Merchant Banking Regulation, lead merchant bankers should not be associated with the merchant banker associated with the issue without holding a certificate.

Underwriting Obligations

This obligation is provided under Regulation 22 of the Merchant Banking Regulation which provides that the lead merchant banker shall accept a minimum underwriting obligation of 5% of total commitment or INR 25 Lacs, whichever is less.

The proviso to this regulation states that, if the lead merchant banker is unable to accept the minimum underwriting obligation, then he shall make the merchant banker associated with the issue to underwrite the up to the minimum extent and should inform the same to the Board. This regulation further provides that in any issue in the light of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, the merchant banker shall, itself or jointly with other merchant bankers connected with the issue, underwrite at least 15% of the issue size.

Acquisition of Shares Prohibited: Regulation 26 provides that merchant bankers shall not enter into any transaction related to the securities of the bodies corporate based upon unpublished price sensitive information obtained by them either from the clients or otherwise through the course of any professional duty.

Information to the Board: Regulation 27 of the Merchant Banker Regulation provides that merchant bankers shall within 15 days from the date of entering into any transaction for the acquisition of securities of anybody corporate, submit the report of such particulars related pertaining to the abovementioned transaction to the board. This regulation further provides that complete particulars of any transaction for the acquisition of securities made

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in pursuance of underwriting or market-making obligations in accordance with Chapter XA of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 shall be submitted to the Board on a quarterly basis.

Disclosures to the Board: Regulation 28 of the Merchant Banker Regulation governs the provision related to the disclosures of the board and provides that a merchant banker shall disclose to the Board following information provided below:

- Responsibilities with respect to the management of the issue;
- If any particulars changed which were previously furnished, have a bearing on the certificate granted to it;
- Names of body corporates whose issue is managed by him or he has been related/associated with;
- The particulars relating to the breach of the capital adequacy requirement;
- Disclose information related to the activities carried by him as a manager, underwriter, consultant or adviser to an issue as the case may be.

Appointment of Compliance Officer: This obligation is governed by regulation 29 of the Merchant Banker Regulation which mandates that merchant baker shall appoint compliance officers for carrying out responsibilities as provided under the above-mentioned regulation. The compliance officer appointed by the merchant banker shall report to the board independently and spontaneously about any of the non-compliance noticed by him and make sure that non-compliance marked out in the draft prospectus and letter of offer should not persist.

Obligations of Merchant Banker on Inspection by the Board: Under this head of the obligation, every employee of the merchant banker shall, while he is being inspected to produce the relevant books, accounts and other documents as required by the inspecting officer. Further, it should also provide the statements and information relating to his activities as a merchant banker at the time required by the inspecting officer.

Reasonable access to the premises that are occupied by the merchant banker or by any person on his behalf along with that the reasonable access to examine books, records, and data stored in the computer should also be provided by the merchant banker. Moreover, a copy of the documents as asked by the inspecting officer for the purpose of investigation should be provided by the merchant banker.

Furthermore, merchant bankers should provide reasonable assistance as expected to the inspecting officer for the purpose of conducting investigation smoothly.

At last, above mentioned are the obligations which merchant bankers have to abide by. Moreover, in case of default, he is liable under Regulation 34 which provides that if a merchant banker contravenes any provision of the regulation,

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Case Laws

Do you know that penalty is imposed upon merchant bankers as soon as the statutory obligation is contravened and neither the intention of the merchant banker nor the impact of that violation is not considered relevant at the time of assessing the violation?

In response to the above, it is relevant to mention the recent case of Medicamen Biotech Limited (Target Company) where SEBI held that merchant banker has failed to exercise required due diligence pertaining to the compliance record of the promoters of the Target Company because he did not disclose in its due diligence findings that shareholding of the promoter would trigger the requirement to make an open offer under Takeover Regulation.

Further, in this respect, SEBI highlighted that due diligence is a very crucial part and was an independent duty of every merchant banker and identified the non-compliance that was already available in the public domain. Thus, SEBI states it was reasonable to expect from the merchant banker to remain careful and diligent about the same. Therefore, in the light of Supreme Court order in the case of SEBI v Shriram Mutual Fund (2006) 5 SCC 361, SEBI opined that penalty is to be imposed upon the merchant banker for its failure to comply with the provisions of SEBI (Merchant Banker) Regulations, 1992 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

In view of the above imposition of the penalty by SEBI, it is clear that onus of diligence is upon the merchant banker to provide complete compliance status of the promoters and acquirer irrespective of the fact that these details are provided by the target company or stock exchanges. SEBI has imposed penalty upon merchant bankers so that every merchant banker should take care of its obligation to provide a complete wider picture of the target company as these disclosures and details might impact the decision of the shareholders. Thus, merchant bankers have to abide by its obligation as well as a duty as prescribed under the above-mentioned regulation.

Act Governing Issuer

After seeing the regulation governing merchant banker above, present section covers the act governing issuer obligation. Chapter III of Depositors Act, 1996 (hereinafter referred to as the Act) provides the provision governing the obligation of issuer. The obligations of the issuer are provided below:

Duty to register the name of depository as the registered owner: The obligation of the issuer starts when any person who wants to avail the services of a depository has to enter into an agreement with him as prescribed under section 5 of the Act and in furtherance of this that person has to surrender its certificate of security to the issuer in the light of section 6 of the Act. From here the role of issuer begins that on receipt of security, the issuer that is the company, shall cancel the certificate security provided earlier under section 6 and enter the name

of the depository as a registered owner accordingly and inform the depository about the same. Subsequently, on receipt of the information by the depository, he enters the name of the person who has entered into a contract with him as the beneficial owner.

Inform the details of allotment: In the light of section 8 of the Act if a person subscribing to the security offered to hold the same with the depository then the issuer shall provide the depository with the details of allotment of the security.

Obligation to enter into an agreement: This obligation is governed by section 19B and covers depository or participant or any issuer or agent but for the present article is focused upon the issuer part. So in the light of above-mentioned section issuer if registered as an intermediary under Section 12 of the SEBI Act, 1992 then he is required to enter into an agreement under the present act and rules and regulation in this respect and if an issuer fails to enter into such an agreement then he shall be liable to pay a penalty of Rupees 1 lakh for each day till such failure to enter into an agreement continues or Rupees 1 crore, whichever is less for such failure.

Duty to redress the investor's grievances: This also a penal provision under section 19C which provides that if the issuer is registered as an intermediary under section 12 of the SEBI Act, then failure to redress the investor's grievance within the time period prescribed by the SEBI then issuer shall be liable to pay One lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Dematerialization of shares or issue of certificate of securities in time: If the issuer has failed to perform his obligation related to the dematerialization or issue the certificate of securities on choosing out of a depository by the investors, within the time specified under this Act or regulations then he is liable for the penalty prescribed under section 19D of the Act.

Obligation to reconcile records: If the issuer failed to maintain/merge the records of dematerialized securities with that of securities that have been issued by the issuer in the spirit of the regulation concerning the same then issuer shall be liable to pay the penalty of INR 1 lakh or INR 1 Crore, whichever is less.

Thus, above-mentioned are the obligations to which the issuer has to be abiding by and if he doesn't abide by the obligations then he would be liable under the penal provisions as mentioned hereinbefore.

2.4 SUMMARY

Hence, in view of the above discussion, it can be understood that a Registered Merchant banker has a variety of functions and areas to serve the Companies. Regulators like Securities and Exchange Board of India, Reserve Bank of India, and certain other regulators have recognised only Merchant Banker for providing specified services. Apart from this, the Income Tax Act 1961 has also recognised merchant banker for making valuation under the Act, which also makes the Merchant Banker an important Professional in the industry.

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While applying for Certificate of Registration, one should carefully go through the documents and forms as submitted to the Securities and Exchange Board of India. To ensure the chances of getting a Certificate of Registration, Merchant Banker shall appoint a professional having vast knowledge and experience in the field of Merchant Banking License.

At last, as mentioned in the article above defined the term "obligation" which makes the person perform the duty which he is legally or socially bound by to perform. Therefore, merchant banker and issuer are also legally obligated as per the SEBI (Merchant Banker) Regulation, 1992 and the Depositories Act, 1996. Further, merchant banker plays a very crucial role and of prime importance, while it's being associated with the enterprise or any person or body corporate for issuing management or takeover because the moment any violation of obligation provided in the Merchant Banking Regulation took place merchant banker would be held accountable for the same and penalty will be imposed irrespective of his intention or impact of his negligence upon the transaction. Therefore, the importance of obligation related to due diligence is highlighted in the above-mentioned case of Medicamen Biotech Limited.

Moreover, the same reliance is placed upon the issuer to perform his obligations diligently. SEBI and SAT have taken strict stance related to the obligations of both to provide full and fair disclosures and where there is a lapse in the abiding by the obligations it would lead to wrong information among shareholders and investors. So, obligations are expected to be performed with the utmost care in accordance with the applicable regulation and act as mentioned above.

2.5 EXERCISE

1. What are SEBI guidelines?
2. What is the procedure for getting registration as a Merchant banker?
3. What are the obligations and responsibilities of lead managers?
4. Discuss the continuance of association of lead managers with an issue.

UNIT 3: ISSUE MANAGEMENT

Issue Management

Structure:

- 3.0 Objectives
- 3.1 Introduction
- 3.2 Issue Management
- 3.3 Public Issue Management
 - 3.3.1 Classification of Companies
 - 3.3.2 Eligibility
 - 3.3.3 Pricing of Issues
 - 3.3.4 Promoters' Contribution
 - 3.3.5 Minimum Public Offer
 - 3.3.6 Prospectus
 - 3.3.7 Allotment
 - 3.3.8 Preferential Allotment
 - 3.3.9 Private Placement
 - 3.3.10 Book Building Process
 - 3.3.11 Designing and Pricing
- 3.4 Rights Issues
 - 3.4.1 Promoters' Contribution
 - 3.4.2 Minimum Subscription
 - 3.4.3 Advertisements
 - 3.4.4 Content of Offer Document
 - 3.4.5 Bought Out Deals
 - 3.4.6 Post Issue Work & Obligation
 - 3.4.7 Investor Protection
 - 3.4.8 Broker
 - 3.4.9 Sub Broker
 - 3.4.10 Underwriters
- 3.5 Summary
- 3.6 Exercise

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3.0 OBJECTIVES

After reading this Unit, you will be able to:

- discuss the issue management,
- understand the public issue management,
- explain the promoters' contribution,
- appreciate why and how it is a minimum public offer,

- list the concepts of book building process,
- define the rights issues,
- analysis the minimum subscription,
- understand the broker, sub broker and underwriters.

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3.1 INTRODUCTION

Issue management refers to managing issues of corporate securities like equity shares, preference shares and debentures or bonds. It involves marketing of capital issues, of existing companies including rights issues and dilution of shares by letter of offer. Management of issue also involves other issues. The decisions concerning size and timing of the public issue in the light of the market conditions are advised by the merchant bankers.

In addition to these, the merchant bankers also assist the corporate units on the designing of a sound capital structure acceptable to the financial institutions and determining the quantum and terms of the public issues of different forms of securities.

Further, they also advise the issuing company whether to go for a fresh issue, additional issue, bonus issue, right issue or combination of these. In brief, managing public issue is a complicated and technical job. It involves various strategic decisions and coordination of various agencies.

The public issues are managed by the involvement of various agencies i.e., under writers, brokers, bankers, advertising agencies, printers, auditors, legal advisers, registrar to the issue and merchant bankers providing specialized services to make the issue a success.

However, merchant bank is the agency at the apex level, who plans, coordinates and controls the entire issue activity and directs different agencies to contribute to the successful marketing of securities. Issue management has tremendous scope and potential in a growing economy where capital market functions as catalyst for the funding needs of the industry.

Issue managers in capital market parlance are known as Merchant Bankers or Lead Managers. Although, the term Merchant Banking, in generic terms, covers a wide range of services such as project counselling, portfolio management, investment counselling, mergers and acquisitions, etc. yet, Issue Management constitutes perhaps the most important and sizeable function within it. So much so, that very often, the terms merchant banking and Issue Management are almost used synonymously.

The significance of Issue Management for a Merchant Banker is succinctly displayed in the definition of 'Merchant Banker' as contained in the Securities and Exchange Board of India (Merchant Banker) Rules & Regulations, 1992, viz., "any person who is engaged in the business of issue management either by making arrangement regarding selling, buying or subscribing to securities as manager, consultant, advisor or rendering corporate advisory services in relation to such issue management".

Issue Manager And SEBI

Issue Managers are required to be registered with SEBI to carry on their Issue Management activities, since setting up of SEBI. SEBI has formulated Rules and Regulations for merchant bankers which bring out the requirements for Registration of issue managers apart from prescribing the conduct rules for them. In terms of these regulations, issue managers are required to mainly comply with the following requirements for registration:

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- (i) Issue manager should be a corporate body, not being a Non Banking Financial Company (as per RBI).
- (ii) He should have necessary infrastructure like adequate office space, equipments and manpower to effectively discharge his activities.
- (iii) He should have minimum two persons who have the experience to conduct the business of Merchant Banking.
- (iv) He should fulfill capital adequacy requirements i.e. should have a minimum net worth of Rs.5 crores.
- (v) He should have professional qualification from an institute recognized by government in Law, Finance or Business Management.

Under SEBI guidelines, a public/rights issue cannot be floated without the association of a Merchant Banker. Merchant banker, like pilots of air-crafts are repositories of special skills required to execute the management of issues. Thus, Issue manager is an indispensable pilot. He is a financial architect as one of the important areas of Issue Management relates to capital structuring, capital gearing and financial planning for the company. While performing these activities, Merchant Bankers act as Financial Architects.

He is an Investors as well as an underwriter since Merchant Bankers also underwrite (Annexure 1) and invest in the Issues lead managed by them. Companies consider the issue managers as their Co-traveller, as Merchant bankers also sometimes act as market makers in the Issues lead managed by them. They invest, continue to hold and offer, buy and sell quotes for the scrips of the company after listing.

Thus, as market makers, their association is not merely restricted to management of issue but continues like co-traveller with the company. Under SEBI guidelines, every Merchant Banker while managing a Capital Issue is expected to perform Due Diligence (Annexure 2) and furnish a Due Diligence Certificate to SEBI in a prescribed format.

Association of Merchant Bankers of India (AMBI) has prescribed detailed due diligence guide to its members to facilitate their performance of due diligence. While managing issues they are required to interact and file offer documents with SEBI. They are also required to file a number of reports related to Issues being managed by them, with SEBI. In a nut shell, merchant banker necessarily revolves around SEBI while managing an Issue and thus can be called as a satellite of SEBI.

It will not be out of context if we term issue manager as Zubin Mehta because while managing an Issue, a Merchant banker is required to co-ordinate with a large number of institutions and agencies. Merchant banker, like an able conductor of orchestra, has to ensure that all the players complete their jobs timely and with proper co-ordination, so as to produce the end result effectively.

Marketing of an Issue is an essential and perhaps the most important component of issue Management. Merchant banker makes number of promises and commitments to the prospective investors which puts him in the shoes of a dream merchant Under SEBI Guidelines, each Public Issue and Rights Issue with size exceeding ₹ 50 lakhs is required to be managed by a Merchant Banker, registered with SEBI.

Since setting up of SEBI, Issue Managers are required to be registered with SEBI. SEBI (Merchant Bankers) Regulations 1992 has laid down the rules, regulations and conduct rules for them. They are to be governed by the code of conduct laid down in the regulations. SEBI Regulations have laid down restrictions on the number of Issue Managers who can be associated with an Issue.

Size of the Issue	Permissible No. of Lead Managers
Less than ₹ 50 crores	2
₹ 50 crores but less than ₹ 100 crores	3
₹ 100 crores but less than ₹ 200 crores	4
₹ 200 crores but less than ₹ 400 crores	5
₹ 400 crores and above	5 or more

All lead managers, before taking up the assignment relating to an issue, shall enter into an agreement with the concerned company setting out their rights and obligations. In case more than one lead manager is associated, their demarcation of responsibilities is a must. A minimum underwriting agreement is to be made. A Lead manager cannot manage an issue of its associate company. No lead manager can exit during the issue period.

Selecting A Public Issue Proposal

Before selecting a Public Issue proposal, the Merchant banker has to keep in mind the following aspects: Background of the Promoters/Management: Success of a company is very much dependent on the background of the promoters and the management viz., their education, business/technical expertise, financial strength capability and reputation, etc. If a new company is launched from the platform of an already existing group, having successful track record, it is well received in the market.

Performance of the group/associate concerns or the holding company, against the promises made by them at the time of their public issues is also looked into seriously by the prospective investors. If the group/associate concerns are financially strong enough, they can also lend support to the public

offering. Another important aspect, which should be considered by the Merchant banker before picking a Public Issue proposal is to see whether there is any pending litigation, defaults and disputes of the promoters for the company with any person, bank or institution.

Company Profile: Merchant Banker also has to look at the track record of the company and the quality of its management, industry in which it operates, product mix of the Company and business prospects of the product proposed to manufacture. He also needs to decide the profitability of the product and sustainability of the project. Financial health also has to be gauged by probing the existing capital structure, debt equity ratio, level of gearing, nature and extent of various resources/provisions etc.

Project Profile: It is also considered whether the project is appraised by a Financial Institution, whether there is participation of Institutions in the financing of project, if any, and the level of financial participation of the Institution. Appraisal and funding of project by an Institution also certifies the viability of the project to an extent.

Capital Market Position: If the group/associate concerns are already listed on stock exchanges, the pattern of their share price movement should be analysed. Trading behaviour of shares of leading companies in the similar field should be compared with the share quotations of the group concern companies to see the stability in share quotations.

Other Important Factors: Other important factors which influence selection of a project include outlook of the investors generally towards other companies operating in similar industries which are already listed and towards the group in particular. Investor's response to previous Public Issues of similar companies will also have a bearing on the decisions to come out with a Public Issue. Dividend payment schedule of the Company and its associate concerns should also be considered. From the point of view of Merchant Banker, the cost benefit analysis is also important before accepting assignment of issue management.

3.3 PUBLIC ISSUE MANAGEMENT

Issue managers play vital role in fund raising through public issue of securities. Whether through book building (discussed later) or otherwise, their role is catalytic for the making of the issue a success. They are involved from cradle to grave in the issue. Hence companies coming with new issue of capital decide about Issue managers after due diligence and carefully analysing the competence and capabilities of the merchant banker to handle the issue.

They provide valuable service in preparation and drafting the prospectus, pricing the issue, marketing and underwriting the issue, coordinating the activities of different agencies/institutions involved in this context to carry out legalities involved in the process, deciding the basis of allotment, making the allotment, despatch of share certificates/refund orders as the case may be, and

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finally, in listing of shares on stock exchanges and sometimes as marketmaker as well.

SEBI has issued compendium of circulars to merchant bankers from time to time and broadly has divided these activities into two groups i.e., Pre-issue activities and Post-issue activities. Some important aspects about these activities are discussed here.

Notes

A. Pre-Issue Activities

1. Memorandum of Understanding: In terms of Regulation 18(2), before taking any issue management, every merchant banker (lead manager) must invariably enter into a Memorandum of Understanding (MoU) with the company making the issue (issuer) clearly setting out their mutual rights, liabilities and obligations relating to the issue. A draft of the MoU is prescribed. The lead manager may adopt the draft and incorporate such clauses as may be considered necessary for defining his rights and obligations vis-à-vis the issuer.

While doing so, it must be ensured that neither party should reserve for themselves any rights, which would have the effect of diminishing in any way their liabilities and obligations under the Companies Act, 1956 and SEBI (Merchant Bankers) Rules and Regulations, 1992. The lead manager who is responsible for drafting of the offer documents shall ensure that a copy of the MoU entered into with the issuer should also be submitted to SEBI along with the offer document.

2. Obtaining Appraisal Note: After the contract for issue management is awarded, an appraisal note is prepared either in-house or is obtained from outside appraising agencies viz., Financial Institutions/ Banks etc. The appraisal note thus prepared throws light on the proposed capital outlay on the project and the sources of funding it. Project may be funded either by borrowing money from outside agencies or by injecting capital. Optimum Capital Structure is determined considering the nature and size of the project.

If the project is capital intensive, funding is generally biased in favour of equity funding. After the fund appraisal a meeting of Board of Directors of the Issuing Company is convened followed by an Extra Ordinary General Meeting (EGM) of its members wherein various aspects related to issue of securities are decided. If the issue of capital include issue of shares to NRIs/OCBs or FIIs, then an application to the Reserve Bank of India seeking its permission is made.

3. Appointment of Other Intermediaries: Lead manager should ensure that the requisite intermediaries, who are appointed, are registered with SEBI. Before advising the issuer on the appointment of other intermediaries, lead manager shall independently assess the capability and the capacity of the various intermediaries to handle the issue. Wherever required, the issuer shall be advised by the lead manager to enter into a Memorandum of Understanding with the Intermediary(ies) concerned.

Lead manager should ensure that bankers to the issue are appointed in the mandatory collection centres. In case of public issues, there should be at least 30

mandatory collection centres which should invariably include the places where stock exchanges have been established. The issuers are also permitted to appoint authorised collection agents in consultation with the lead manager subject to necessary disclosures.

While the modalities of selection and appointment of collection agents are left to the discretion of the lead manager, it should be ensured that the agents so selected are properly equipped for the purpose, both in terms of infrastructure and manpower requirements. While appointing Registrars to an Issue, lead manager should note that in respect of an issue in which he is the sole/one of the lead managers, he cannot act as Registrar to the said issue.

Similarly, where the issuer of capital is a registered Registrar to an issue, the issuer will have to appoint an outside Registrar to process its issue. SEBI may not object to a lead manager acting as Registrar to an Issue where the post-issue responsibilities rest with another lead manager, provided the lead manager is registered with SEBI for both function. Lead manager shall, ensure that the number of co-managers to an issue does not exceed the number of lead managers to the said issue and that the number of advisors to the issue is only one.

4. Issue Management Inter-se Allocation of Responsibilities: Where an issue is managed by more than one lead manager, the responsibility of each lead manager shall be clearly delineated, preferably as indicated in Annexure (3). In case of under-subscription in an issue; the lead manager responsible for tying up underwriting arrangements will be held responsible for invoking underwriting obligations and for ensuring that the underwriters pay the amount of development the Inter-se Allocation of responsibilities accompanying the Due Diligence Certificate must specifically indicate the name of the lead manager responsible for this.

5. Preparing Prospectus: Lead manager should ensure proper disclosures to the investors, keeping in mind their responsibilities as per Merchant Bankers Rules and Regulations. The lead manager should, therefore, not only furnish adequate disclosures but also ensure due compliance with the Guidelines for Disclosure and Investor Protection issued by SEBI which also specifies the contents of prospectus as well as application form.

The application form should contain necessary details and instructions to applicants to mention the:

- number of application form on the reverse of the instruments to avoid misuse of instruments submitted along with the applications for share/debentures in public issues.
- particulars relating to savings bank/current account number and the name of the bank with whom such account is held, to enable the Registrars to print the said details in the refund orders after the names of the payees: Suitable Instructions to investors in this behalf in the application form under the head "How to apply" should be incorporated.

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6. Submission of Draft Offer Documents: The Lead Manager shall hand over not less than 25 copies of the draft offer document to SEBI and also to the Stock Exchange(s) where the issue is proposed to be listed. The Lead Manager shall submit to SEBI the Draft Prospectus in a computer floppy. Copies of the Draft Prospectus will be made available by the Lead Managers/Stock Exchange to prospective investors. After a period of 21 days from the date the draft prospectus was made public, the Lead Manager shall file with SEBI a statement giving a list of complaints received by it from SEBI and any amendment done in the document.

The Lead Manager responsible for drafting of the offer documents shall ensure that the terms of the issue and the offer documents, namely, prospectus or letter of offer are in conformity with the SEBI Guidelines for Disclosure and Investor Protection. Due Diligence Certificate as specified by SEBI accompanies each draft offer document submitted to SEBI. It is to be ensured that the format of prospectus conforms to the format prescribed by the Department Company Affairs. A 'letter of offer' is also submitted.

The format of letter of offer should conform to disclosures prescribed in the Memorandum 2A under section 56(3) of the Companies Act, 1956, and the Guidelines issued by the Stock Exchange Division of Ministry of Finance. Every draft offer, document submitted to SEBI shall be accompanied by the following undertakings / certificates from company or its specific officials.

(a) Undertakings are from:

- The Chief Executive Officer of the Company that the complaints received in respect of the issue would be attended to expeditiously and satisfactorily the Company Secretary that the Company will get the instruments of issue listed within the prescribed time period and would take necessary steps in time for the purpose;
- The Company Secretary that the company would apply in advance for listing of the shares which would be generated by the conversion of Debentures/Bonds;
- The issuer that the requisite funds for the purpose of despatching refund orders/allotment letters/certificates by registered post will be made available to the Registrar to the Issue.

(b) In the case of public issue, an undertaking from the issuer that the promoter's contribution, including premium, in full will be brought in advance before the issue opens.

(c) Certificate signed by the Company Secretary confirming the following:

- all refund orders against the previous issues have been despatched to the applicants;
- all shares/debenture certificates have been despatched to the allottees; and the instrument(s) has been listed on the Stock Exchanges mentioned in the concerned offer documents.

(d) In the case of public issue, an undertaking from the Lead Manager to get the issue fully underwritten to the extent of offer to the public and to include details thereof in the final prospectus.

7. Launching of a Public Issue: Once the legal formalities and statutory permission for Issue of Capital are complete, the process of marketing the Issue starts. Lead Manager has to arrange for distribution of public issue stationery to various collecting banks, brokers, investors, etc. Public Issue is launched formally by conducting Press Conference, Brokers Meets, issuing advertisements in various newspapers and mobilising Brokers and Sub Brokers.

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The announcement regarding opening of Issue in the newspapers is also required to be made by advertising (Annexure 4) in newspapers 10 days before the Issue opens. A certificate to the effect that the required contribution of the promoters has been raised before opening of the Issue obtained from a Chartered Accountant is also required to be filed with SEBI. During the currency of the Issue, collection figures are also obtained on daily basis from Bankers to the issue. Another announcement through the newspapers is also made regarding the closure of the Issue.

B. Post-Issue Activities

After the closure of the Issue, Lead Manager has to manage the Post-Issue activities pertaining to the Issue. He is to ensure the submission of the post issue monitoring report as desired by SEBI.

Finalisation of Basis of Allotment (BOA): In case of a public offering, besides post-issue lead-manager, registrar to the issue and regional stock-exchange officials, association of public representative is required to participate in the finalisation of Basis of Allotment (Annexure 5). Data of accepted applications is finalised and Regional Stock Exchanges are approached for finalisation of BOA.

Despatch of Share Certificates, etc.: Then follows despatch of share certificates to the successful allottees, demat credit, cancelled stock-invest and refund orders to unsuccessful applicants.

Issue of Advertisement in Newspapers: An announcement in the newspaper is also made regarding BOA, number of applications received and the date of despatch of share certificates and refund orders, etc.

Post-issue Obligations

Lead manager responsible for post-issue activities shall maintain close coordination with the Registrars to the Issue, and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from collecting bank branches, processing of the applications including those accompanied by stockinvest and other matter till the basis of allotment is finalised, despatch completed and listing done. Any act of omission or commission on the part of any such intermediaries noticed during such visits should be duly reported to SEBI.

SEBI imposes considerable responsibility on merchant bankers for proper redressal of investor grievances. It is, therefore, necessary for the merchant bankers to actively associate themselves with the post-issue refund and allotment activities and regularly monitor investor grievances arising there from. To achieve this, the merchant bankers need to evolve effective inter-linkages with the Issuers and the Registrars to Issue.

SEBI has launched an all out drive to bring down substantially the number of investor grievances. The merchant bankers are to assign high priority to the area of investor grievances and take all preventive steps to minimise the number of complaints. They are also to set up proper grievance monitoring and redressal system in coordination with the issuers and the registrars to Issue, and take all necessary measures to resolve the grievances quickly to avoid penal action. In case of delay in refund, lead manager shall ensure that the issuer pays interest for the delayed period as per provisions of the Companies Act, 1956. The lead manager shall be responsible for ensuring despatch of refund orders/ allotment letters/certificates by registered post only.

Post-issue Monitoring Reports

SEBI prescribed certain post-issue reports which are required to be submitted by the lead managers. Two post-issue reports each for public issue are to be sent by lead managers to SEBI i.e., (a) 3-day post-issue monitoring report and (b) 78-day postissue monitoring report. The merchant bankers are expected to keep SEBI informed on important developments about the particular issues being lead managed by them during the intervening period of the reports.

General: With a view to ensuring that all Rules, Regulations, Guidelines, Notifications, etc. issued by SEBI, the Government of India, and other regulatory organisations are complied with, the merchant bankers shall designate a senior officer as Compliance Officer, who shall co-ordinate with regulatory authorities in various matters and provide necessary guidance and also ensure compliance internally. The Compliance Officer shall also ensure that observations made/ deficiencies pointed out by SEBI do not recur.

Necessary Code of Conduct for the officers and employees of the merchant bankers should be framed to prevent insider trading, in the light of SEBI Insider Trading Regulations, 1992. Lead manager should bring to the specific notice of ROCs instances of non-compliance with the Companies Act requirements with regard to appointment of whole-time qualified company secretaries. In view of this, lead managers may like to ensure necessary compliance in this regard before filling of documents with ROC.

3.3.1 Classification of Companies

Commercially speaking, a public issue may be defined as an offer for subscription by a company of its securities to the general public. Most people are familiar with the concept of a public issue. However, at the same time there are a few misconceptions associated with it. Many people interchange the terms Public Issue and IPO. The term IPO refers to an Initial Public Offer/ Offering.

Thus, any company can have only one IPO in its lifetime since it cannot have an Initial Offer time and again.

A public issue on the other hand is a much wider term and includes within its purview both IPOs as well as all other subsequent public offerings also known as FPOs or Follow-on Public Offers. An IPO can only be made by an unlisted company whereas an FPO can only be made by a listed company. This is one fundamental difference which should be borne in mind.

The public issue by a company is governed by the SEBI (Disclosure and Investor Protection) Guidelines, 2000 also known as the DIP Guidelines. These Guidelines have been framed by SEBI to facilitate and regulate different forms of capital offerings by companies and other related and ancillary issues. The DIP Guidelines are amended from time to time by SEBI. There are three types of Public Issues by which a public company can raise funds:

- (a) **IPO:** Initial Public Offer, which is once in the Company's lifetime
- (b) **FPO:** Follow-on Public Offers, which a Company can raise any number of times
- (c) **Rights Issue:** When a Company makes an Offer to raise capital from its existing shareholders

The Indian economy has a variety of companies existing in its market such as public companies, private companies, investment companies, limited liability companies etc. These numerous entities in the market may look different from each other on the surface, but based upon certain identifiable common characteristics they can be grouped into below-mentioned classifications: This article aims to draw your attention towards the conventional classification of the companies that are made based upon factors such as liability, control, incorporation, transferability of shares etc.

The companies may be classified based upon the mode of their incorporation and incorporation process which is defined under Section 7 of the Companies Act, 2013.

Incorporation is the day when the company acquires a legal identity i.e. the day when a company takes birth in the eyes of law. Section 2 of the Companies Act, 2013 defines the various kinds of companies and their facets.

(I) Classification of Companies on the basis of incorporation

Royal Charter Company: It may be better understood as the company born out of the authorization of the sovereign or the crown. This was the mode of incorporation which was followed earlier to the Registration under the Companies Act. A charter is granted by the crown to the people requesting to form a cooperative or a company. To name a few, The Bank of England (1694), The East India Company (1600) were formed by the means of charters passed by the then Crown of England. The authorization given by the sovereign gives legal existence to these companies by means of the body of the charter. This mode of incorporation is no more recognised in any Companies Act to incorporate new Companies.

Statutory Company: As the name suggests, these are the companies that are formed by the means of a special statute passed by the Parliament or the State Legislature. The examples of statutory companies in India are the Reserve bank of India, the Life Insurance Corporation of India Act, etc.

The Statutory origins of these companies provide power to such companies to be bound by their own statute, i.e. whenever there is any dispute between statute under which these companies were formed and the Companies Act 2013, the statute being special legislation persists over the general law of Companies Act. The parliaments both State and Centre are empowered to make such legislation for incorporation under the power endowed to them by the Constitution of India.

Registered Company: As defined under Section 2(20) of the Companies Act, 2013, registered companies are the companies which get registered under the statute of the Companies Act. Companies are also provided with a certificate of incorporation by the Registrar of the Company.

(II) Classification of Companies on the basis of liability of members

The liability upon the members is also used to classify the companies, it describes the limit to which member will be liable if such liability were to befall upon the company. On the basis of liability of the members, the companies may be classified into:

Companies limited by shares: These types of companies are mentioned in Section 2(22) of the Companies Act, 2013. The liability of the members of such a company is based upon the number of shares kept unpaid. This liability against the shares kept may be brought to the authority. Once the payment towards the security is made by the shareholder or member then no liability beyond that is placed upon such member. The liability may be enforced during the company's existence and even during its winding-up process.

Companies limited by guarantee: These types of companies are mentioned in Section 2(21) of the Companies Act, 2013. In a Company where the liability is limited by guarantee, it means the member of the Company has agreed on the Memorandum of Association to repay the same amount during winding up of such Company. In such companies, the liability of the members is limited to the undertaking given by them. Trust research associations, etc. are examples of companies liability limited by guarantee.

Unlimited Liability Company: These companies as defined under Section 2(92) of the Companies Act, 2013 do not have a cap on the amount of liability that may add on their members in case the company has to repay any debt. For any amount that the company owes these members, the unlimited liability company shall be liable to the extent of their interest in the company. These companies do not draw any popularity when it comes to Indian Market.

Limited liability company	Unlimited liability company
Liability of the members is only in proportion to the sum they have invested in the company.	Liability of the members is not in proportion to the investment in their company.
Personal properties or assets will not be forfeited if the company goes bankrupt or winds up.	Even the personal property of the member will be forfeited against the liability of the company.

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(III) Classification of Company on the basis of the number of members

The number of members in a company is looked upon while classifying them. This classification of the company has been discussed in detail under the below-mentioned headings. On the basis of the number of members in the companies may be classified into:

Private Company: The private companies as defined under Section 3(1) (b) of the Companies Act, 2013 are very restrictive in nature wherein it may in its Articles of Association restrict the right to transfer shares. The number of members in such a company might be a maximum of 50. The shares and debentures of such companies are not available for the public at large. The number of members in a company to be called a private company is two, wherein it is clearly set that two members jointly holding a single share shall be considered as one member and not two members. The easy identification of Private companies is the 'Pvt. Ltd.' attached to its name.

Public Company: As defined under Section 2(71) of the Companies Act, 2013, Public Companies are the ones which are not a private company. As mandated under Section 3(1)(a) of the Companies Act, 2013, there should be at least 7 members to form a public company. It is the intrinsic nature of the public company that there is the right to transfer shares and debentures of the public company to the public at large.

(IV) Classification of Companies on the basis of domicile

On the basis of their domicile the companies may be classified into:

Foreign Company: A Company which is situated outside India, but has a registered place in India may be physical or electronic address or perhaps company has ownership itself or through the agents, representatives or managers of the company is known as a foreign company under Section 2 (42) of the Companies Act, 2013. The aforementioned definition included in the new Companies Act has widened the scope of the definition of foreign companies extending the same to the entities having their electronic presence in India. The list of foreign companies listed in India has names of the corporate giants such as Whirlpool of India Ltd., Timex Group India Ltd., Ambuja Cements Ltd., etc.

Indian Company: Indian Company has been defined under Section 2(20) of the Companies Act, 2013 as any company registered under the Companies Act, 2013, or any other previous law is known as an Indian Company. An Indian

company may prove its locus standi with the help of its office address and the legislation provides a guideline to be followed while using such powers by an Indian company.

(V) Classification of companies on the basis of Miscellaneous factors

On the basis of other miscellaneous factors the companies may be classified into:

Government Company: As defined under Section 2(45) of the Companies Act, 2013, any company in which a minimum of 51 per cent of the paid-up share capital is held by the Central/State Government, and/or held fractionally by the Central Government and partly by one or more State Governments is known as a Government Company. The major drawback of having a government company is the lack of autonomy.

Holding, Subsidiary Companies and Associated Companies: Under Section 2(46) of the Companies Act, 2013, a company is known as the holding company of another company if it has administrative control over another company. Such control may be regarding the affairs of the company. Under Section 2(87) of the Companies Act, 2013, a company is known as a subsidiary company of another company when control is exercised by the other company over the subsidiary company.

A company is deemed to be a subsidiary company of another:

(1) If the other company

- Exercises or controls more than 50% of the total voting power i.e. where the holders of preference shares have the same voting rights as the equity shares holder, or,
- 50% in nominal value of its equity share capital held, or,
- Possesses power regarding the composition of the Board of directors.

(2) If it is a subsidiary of a company which is a subsidiary of the controlling company.

The holding power also includes another kind of Company known as Associate Company, which is now being explained with respect to the above-mentioned Holding and subsidiary company.

Associate Company: These Companies as defined under Section 2(6) of the Companies Act, 2013 are the one in which the other company has significant influence but these Companies are not the subsidiaries of such influencing companies known as the Associate Company. The Joint Venture Companies are such associate companies.

The significant control can be inferred directly from the explanation attached to the provision which requires the influencing company to hold 20% of the share capital or any agreement whereby the decision making of the associate is placed upon such Influencing Company. The Associate Company concept has been seen as a harbinger of transparency in the working of the Company since it provides a more rationale grundnorm for an associated relationship between the two companies.

One man Company: Under Section 2(62) of the Companies Act, a company in which one person is the whole and sole owner of the share capital of the company is known as a One Man Company. In order to meet the statutory requirement of a minimum number of members, some namesake company shareholders hold one or two shares each. The namesake shareholder members are usually nominated by the principal shareholder. The principal shareholder enjoys all the profits of the business with the protective shield of limited liability. Such companies have been given legal sanctity.

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Difference between One person company and Sole Proprietorship

The major or fundamental difference between a one-person company and the sole proprietorship is based upon the limitations or extent of liability in the one-person company. One person company is different from the Sole proprietorship as the one person company differentiates the promoter from the separate entity of the company. The liability of the director of the one-man company is limited in the event of any legal liability or claims made against the company.

Investment Company: The Investment Companies as defined under section 186 of the Companies Act, 2013, are the companies which have a fundamental business or transaction relating to the securities of other companies. Securities may be of a nature of shares or debenture or other securities offered by such entity. The word investment in its predominant sense means to acquire a resource and hold it for the interest earned over it, but in the case of an investment company, the investment is aimed not only at the acquisition and holding but perhaps to even the sale of the securities whenever they reach a better price.

The Investment company under Section 186 of the Companies Act, 2013 are based upon the market trend relating to the shares analyses the maximum profit investment for the Company. The commonly used terminology of stock market relating to the bear and bull market and the understanding of the trend plays a crucial role to attain profits aimed at by the company.

There are still two perspectives towards the investment company functioning and the characteristics of the transactions made by such company. One set of claims suggests that the Investment Companies are only supposed to purchase security and earn interest by maintaining them. The other school of thought suggests that the investment company may earn not only by purchase and hold but also selling of the securities.

New kind of Companies recognised under the Act, 2013

Dormant Companies: Where a company is formed under Section 455 of the Company Act, 2013 for a future endeavour or to hold an asset which may be a physical or intellectual property and has no significant accounting transaction, such a company or inactive company can make an application to the Registrar in the prescribed manner for obtaining the status of the dormant company.

The explanation attached to this provision states about the inactive company prescribing a period of 2 years of inactivity in terms of business transactions,

operations etc, or the companies which have not filed their annual returns or the financial statement in the last 2 years. Such transactions do not include all the necessary payment which are made by the company to the Registrar and other payments which are supposed to be made under any other law.

The Registrar allows the certificate of the inactive company to the applicant company. The registrar must maintain the list of dormant companies. A company to remain a dormant company on the books of the registrar has to pay the required sum. The Company on request may make the Dormant Company back to an active company.

3.3.2 Eligibility

The DIP Guidelines define a Public Issue to mean an invitation by a Company to the public to subscribe to its securities offered by a prospectus. Thus, the essential features of a public issue are:

- (a) there must be a prospectus
- (b) there must be an invitation to the public
- (c) the offer must be to subscribe to the securities of the company. It is important to note that a public issue could be for any security of the company and not just equity shares. Security is defined in s.2(h) of the Securities Contracts (Regulation) Act, 1957 (see para 20.2) and includes within its scope equity shares, convertible preference shares, non-convertible preference shares, convertible debentures, warrants, etc.

The earlier Guidelines contained various stringent conditions for a company to make a public issue. However, SEBI has relaxed these conditions to a great deal. Any company can now make a Public Issue only after:

- (a) a Draft Prospectus has been filed with SEBI by the Merchant Banker at least 21 days prior to the filing of the same with the ROC;
- (b) SEBI's corrections, if any, have been incorporated in the Prospectus;
- (c) The company has made an application for listing of the securities to the Exchanges; and
- (d) It has entered into an Agreement for the dematerialisation of its securities with a Depository. There are currently two Depositories in India, namely, NSDL (National Securities Depository Ltd.) and CSDL (Central Securities Depository Ltd.).

In addition to the above, the DIP Guidelines lay down specific conditions for an Initial Public Offer and a Further Public Offer.

Conditions for making an IPO

As explained above, an IPO means an Initial Public Offer and is made by Unlisted Companies. An Unlisted Company can make a Public Issue/ IPO under any of the two options mentioned below. Under Option-A it needs to fulfill all the conditions. However, under Option-B, it must fulfill any one condition from (a) and any one condition from (b), in addition to (c).

Option A: If it satisfies the following conditions	Option B: If it does not satisfy the conditions stated in Option-A
(a) It has Net Tangible Assets \geq ₹ 3 crores in each of the 3 preceding full years of 12 months each, of which a maximum of 50% can be held as monetary assets. If it has more than 50% of its net tangible assets in monetary assets, then it must have made a firm commitment to deploy such monetary assets in its business or in a project.	(a) The Offer must only be made by way of a Book Building (see chapter 3). Further, at least 50% of the Offering must be allotted to Qualified Institutional Buyers (QIBs), e.g., PFIs; banks, VCs, MFs, etc., failing which the full subscription money must be refunded (see para 2.3.2(e) for a definition of QIBs). OR
(b) It has a minimum net worth \geq Rs. 1 crore in each of the 3 preceding full years of 12 months each	(a) The Project is appraised by FIs/Scheduled Banks and at least 10% participation comes from the Appraiser and a further minimum 5% from other FIs/Scheduled Banks. A further 10% must be allotted to QIBs. If these conditions are not met, then the full subscription money must be refunded.
(c) It has a track record of distributable profits for 3 out of immediately preceding 5 years. The distributable profits must be computed under S.205 of the Companies Act.	(b) The minimum post-issue face value (i.e., without considering the premium component) of the capital is Rs. 10 crores. OR
(d) The proposed issue + all other issues made in the same financial year \leq 5 times the pre-issue net worth as per the latest audited balance sheet of the last financial year. While reckoning, the issue size. The IPO, any firm allotment and any promoters contribution made through the offer document/prospectus are included.	(b) There is a compulsory market-making for 2 years from date of listing. The minimum buy and sell quotes must be for 300 shares and the difference between sell and buy quotes must not exceed 10%. Further, the market maker must keep at least 5% of the issue size as inventory.

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(e) In case of a name change in the last one year, at least 50% of the revenue of the last one full year is from the activity suggested by the name. E.g., if XYZ Finance Ltd. becomes XYZ Biotech Ltd., then in the full year preceding the IPO, at least 50% of the company's revenue must arise from biotech activities.	(c) The minimum number of prospective allottees must be 1,000.
(f) The Offer can be by way of a Book Building or by way of a Fixed Price Offer.	
(g) The minimum number of prospective allottees must be 1,000.	

Certain key terms used in Option-A and Option-B are defined below:

- (a) Net Tangible Assets means the sum of all net assets of the Company excluding intangible assets as defined in AS 26 issued by the ICAI on Intangible Assets. AS 26 defines an intangible asset as an identifiable nonmonetary asset, without physical substance, held for use in production or supply of goods or services, for rental to others or for administrative purposes.
- (b) Net worth means Paid-up Equity + Free Reserves (-) Accumulated Losses(-) Miscellaneous and Deferred Revenue Expenditure not written off as per the audited balance sheet. Revaluation reserve is excluded. Thus, preference shares are not to be counted in net worth computation.
- (c) If a partnership firm has been converted into a company and the company is making an IPO, then the track record of distributable profits of the firm would be considered only if the financial statements of the partnership business conform to and are revised in the Schedule VI Format under the Companies Act, 1956.

Further, they must also comply with the following:

- (i) adequate disclosures, as required under Schedule VI, must be made;
- (ii) the financial statements must be certified by a CA stating that:
 - the accounts as revised or otherwise and the disclosures made are in accordance with Schedule VI; and
 - the accounting standards of ICAI have been followed and that the financial statements present a true and fair picture of the firm's accounts.

(d) If an unlisted company is formed out of a division of an existing company, then the track record of distributable profits of the division spun off shall be considered only if the requirements regarding financial statements as specified for partnership firms above are complied with. For example, Tata Consultancy Services earlier operated as a division of Tata Sons Ltd., which was then spun off into a new company before the IPO. In the prospectus, it restated the financial statements in accordance with the above requirements.

Notes

(e) Qualified Institutional Buyers or QIBs are a special category of investors. They are institutional investors and comprise of the following investors:

- (i) Public financial institutions as defined in section 4A of the Companies Act, 1956. These include IFCI, IDBI, LIC, UTI, IDFC, ARCIL;
- (ii) Scheduled commercial banks. These include commercial banks which are specified in the Second Schedule to the Reserve Bank of India Act;
- (iii) Mutual funds;
- (iv) Foreign Institutional Investors or FIIs registered with SEBI;
- (v) Multilateral and bilateral development financial institutions;
- (vi) Venture capital funds registered with SEBI;
- (vii) Foreign venture capital investors registered with SEBI;
- (viii) State industrial development corporations;
- (ix) Insurance companies registered with the Insurance Regulatory and Development Authority (IRDA);
- (x) Provident funds with a minimum corpus of Rs. 25 crores;
- (xi) Pension funds with a minimum corpus of Rs. 25 crores.

At the time of an IPO, there can be no outstanding warrants or other convertible instruments (other than those relating to ESOPs granted in accordance with the SEBI ESOP Guidelines) which would entitle the existing promoters or shareholders any option to receive equity shares after the IPO.

Conditions for making a Public Issue/ FPO

As stated above, only a listed company can make a Further Public Offer of equity shares or any convertible security. The conditions for a listed company to make an FPO are as follows:

- (a) The proposed issue + all other issues made in the same financial year \leq 5 times the pre-issue net worth as per the latest audited balance sheet of the last financial year. While reckoning the issue size, the IPO, any firm allotment and any promoters' contribution made through the offer document/ prospectus are included.

- (b) In case of a name change in the last one year, at least 50% of the revenue of the last one full year is from the activity suggested by the name. E.g., if XYZ Finance Ltd. becomes XYZ Biotech Ltd., then in the full year preceding the IPO, at least 50% of the company's revenue must arise from biotech activities. In case a listed company does not satisfy the above conditions, then it can make an issue subject to compliance with the conditions specified under Option-B stated above which apply to an unlisted company which wants to make an IPO.
- (c) The conditions specified in para 2.3.1 and 2.4.1 above would not be applicable to a listed company in case of:
 - (a) a public issue by a Banking Company set up under the Banking Regulation Act;
 - (b) a public issue by a Public Sector Bank
 - (c) a public issue by an infrastructure company whose project has been appraised in a certain manner.
 - (d) a Rights Issue.

3.3.3 Pricing of Issues

The guidelines for capital issues issued by Securities Exchange Board of India in June 1992 have opened the capital market to free pricing of issues. Pricing of issues is done by companies themselves in consultation with the merchant bankers. If the premium is too low the issue gets oversubscribed and if the premium is too high it is bound to be undersubscribed and fail. The merchant banker while deciding the premium has to take the following two factors into account:

- (a) Qualitative factors
- (b) Quantitative factors

The Qualitative Factors Include: The prospects of the industry, track record of the promoters, the competitive advantage the company has in making best use of the business opportunities, and growth of the company as compared to the industry, etc.

The Quantitative Factors Include: The earnings per share, book value, the average market price for two or three years, dividend payment record, the profit margins, the composite industry price earnings ratio and future prospects of the company, etc. Above all the lead manager and the company has to assess whether the market can absorb the premium on the issue.

This will depend upon the stock market condition prevailing at the time of the issue. (See Annexure 6) Earlier, such premium was fixed as per the guidelines of Controller of Capital Issues. Since the adoption of free pricing and the abolition of the office of Controller of Capital Issues there have been spate of Issues at premium.

Necessity for Aggressive Sales Campaign: It is not enough if the Company takes all steps to comply with the statutory regulations. In the growing competitive market, aggressive sales campaign is also called for. Now a days, the investors are bombarded with advertisements through all sorts of media such as T.V., Radio, Newspapers, Brochures, Direct Mailing etc. It is, therefore, essential to plan a marketing strategy to reach and convince the prospective investors.

Packaging and Marketing the Issue: For smooth marketing of the Issue, Lead Manager has to first identify the target market segments for the offering, whether it be retail investors, wholesale investors or institutional investors. This should be followed by targeting the regions where the management can expect maximum number of subscriptions. If a Company is operating in a particular region, it is better to concentrate on that region only, where its name is popularly known. Mood, of the market should also be gauged before launching an Issue. If the market is going downwards, even offering from a good company may not attract good response. Pricing of instruments should be done after assessing expectations of investors from the Issue. Pricing of the Issue also influences design of capital structure.

Final instrument should be made attractive by offering some unique features. There are many ways of doing it. Some of these are offering safety net, making terms of payment attractive, offering multiple options for conversion, attaching warrants, etc. Underwriters, Brokers/Sub-Brokers, Fund arrangers should be mobilised with great efforts to make the offering a success. At the same time, offer document for issue should be educative and purposive for the retail investors and should contain relevant information which will be statutorily and otherwise required for providing maximum information.

Institutional investors and high net worth investors should also be provided with detailed research on the project specifying its uniqueness and the advantage which it scores over other existing or upcoming projects in the similar field.

Launching Marketing Campaign: A high volt advertising campaign is launched to push the public issue. Lead Manager should be very selective in choosing the advertising agency for this purpose. Only those agencies which specialize in launching capital offerings should be entrusted with the job of advertising the Issue. Advertisement themes should be finalised keeping in view SEBI guidelines in this regard. A proper mix of media vehicles viz., Press, Radio, Television campaign and Hoarding, etc., should be used. Lead Manager should also arrange for press briefings, brokers, and investors' conferences, etc. in targeted regions.

Some Market Research Organisations specialise in carrying out opinion polls by contacting wide range of people in different areas. These can be engaged

Notes

to collect data on investors' opinion and reactions relating to the public issue and the company's in particular. There is a vast potential of investors in semi-urban and rural areas who can be developed into a solid block of investors. These persons are not attuned to the investment culture. It is necessary to educate them about the various avenues available for investment.

Brokers' and Investors' Conferences: As part of the issue campaign, Brokers' and Investors' conferences at the Metropolitan cities and other important centres with sufficient investors population have to be arranged. Advance Planning is necessary to make such conference successful. Conference materials such as banners, brochures, application forms, posters, etc, should reach the venue of conference in time. Invitation to all the important people, underwriters, bankers at the respective places, investors' associations, should be sent.

Timing of the Issue: One of the most critical factors for the success of the issue is the timing of the issue. A bad market condition can result in under subscription of a public issue even from an excellent company with a track record and whose shares have been rightly priced. Too many issues hitting the market at the same time can also affect the success of the public issue. The merchant bankers as part of their marketing efforts have to decide the timing of the issue keeping in view the various factors.

3.3.4 Promoters' Contribution

In any public issue, the promoters of the company are required to infuse certain amount of funds in the company by way of promoters' contribution. It is interesting to note that although the DIP Guidelines speak of promoters' contribution, it does not contain a general definition of the term "promoters". One may refer to the definition contained in Explanation I to cl.6.8.3.2(k)-(l) under the Capital Structure to be given in a Prospectus. Although, the Explanation states that the definition is applicable for the purposes specified therein, the definition may be used even for the purposes of determining the promoters' contribution.

The term Promoter has been defined to include:

- (a) the person or persons who are in over-all control of the company;
- (b) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public;
- (c) the persons or persons named in the prospectus as promoters(s).
However, persons who are merely professional directors would not be included within this definition.

2.6.2 The requirements for the minimum promoters' contribution is as under:

Issue Type	Minimum PC
IPO by Unlisted Companies	≥ 20% of Post-issue Capital
Public Issue by Listed Companies	≥ 20% of the proposed issue or ensure shareholding of 20% of Post-issue Capital
Rights-cum-Public Issue	≥ 20% of proposed issue or 20% of Post-issue Capital (excluding the Rights Issue) – Option to the Promoters

Notes

The key points in respect to promoters' contribution are as follows:

- The requirement of promoters' contribution is not applicable in the case of:
 - issues by companies listed for at least 3 years and which have a dividend track record for at least 3 preceding years;
 - rights issues; or
 - companies where no identifiable promoter group exists, e.g., in the case of professionally managed companies.
- Certain types of capital contribution are ineligible for being considered for the promoters' contribution.
- The entire promoters' contribution must be brought in at least one day prior to the date of the public issue. If it exceeds Rs. 100 crores, then at least Rs. 100 crores must be brought in prior to the issue and the balance on a pro-rata basis but before calls are made to the public.
- Any promoters' contribution in excess of the minimum requirements, is treated as a preferential allotment and the SEBI(DIP) Guidelines on preferential allotment would accordingly apply (see Chapter 7).
- In case of an issue of a convertible security, where the conversion price of the equity component is fixed, then the promoters' contribution, can at the option of the promoters, be in the form of contribution to equity or by subscribing to the instrument.

Practice Pointer: Every allotment of securities to promoters should be by way of a Board Resolution and a Chartered Accountant's Certificate stating that the contribution has been brought in before opening of the issue. This certificate should be accompanied by a list of names and addresses of friends, relatives and associates of the promoters which make up the promoters' contribution. All these details should also be filed with SEBI.

Lock-in

Lock-in period refers to the period during which the shares are non transferable. Earlier when the shares were in physical format, they bore an inscription to that effect. Now specific instructions to such effect are given to the depository participant.

The lock-in period for different issues is as follows:

Notes

Capital	Lock-in period
Minimum Promoters' Contribution in case of a Public Issue	3 years from the date of allotment in the public issue or the commencement of commercial production, whichever is later
Excess Promoters' contribution in case of a public issue	1 year from the date of allotment of securities
Entire pre-IPO capital of an Unlisted Company	1 year from the date of allotment in the public issue

2.7.3 The lock-in for the pre-IPO capital of an unlisted company does not apply in the following situations:

- (a) pre-IPO capital held by SEBI registered Venture Capital Funds and Foreign Venture Capital Funds provided they are held for at least one year prior to the date of filing of the Prospectus with SEBI or the shares are locked-in as per the Venture Capital Regulations;
- (b) pre-IPO capital held at least for one year at the time of filing of the draft offer document with SEBI and being offered to the public by way of an offer for sale;
- (c) pre-IPO capital held by non-promoter employees and issued under an preIPO ESOP. However, the requirements of the SEBI Guidelines on ESOPs in this respect must be satisfied;
- (d) transfer inter se non-promoter shareholders who are holding such locked-in pre-IPO capital provided that they comply with the SEBI Takeover Regulations and that the balance lock-in continues in the hands of the transferees.

Locked-in securities can be pledged with banks as a collateral security for loans. Further, the case of promoters' contribution which is locked-in can be transferred inter se the promoters provided that they comply with the SEBI Takeover Regulations and that the balance lock-in continues in the hands of the transferees.

3.3.5 Minimum Public Offer

One of the key factors to be determined in any public issue is what percentage stake of the post-issue capital should be offered to the public. It is but natural that the company would like to dilute as little equity as possible. The minimum stake which the company must offer is determined by the SEBI Guidelines. The key points in this respect are as follows:

- (a) The minimum net offer to the public in case of a public issue would either be 10% or 25% of the post-issue capital.
- (b) The normal requirement is that the net offer to the public must be 25% of the post-issue capital. However, a company is allowed to offer only 10% if the following conditions are satisfied:

- A minimum of 20 lakhs securities are offered to the public;
- The size of the offer to the public = Offer Price * number of securities offered to the public = Rs. 100 crores; and
- The issue was made only through the book building method with at least 60% being offered to Qualified Institutional Buyers.

(c) The company can make firm allotments or reservations for specified categories of persons.

Notes

Takeover Regulations: The provisions of the SEBI Takeover Regulations do not apply to an allotment made in a public issue. However, in case of an acquisition pursuant to a firm allotment in excess of the limits specified in the Regulations, certain conditions need to be fulfilled in order to avail of the exemption (see para 18.6.1).

Grading of IPOs: SEBI has made the grading of all IPOs mandatory. Grading must be carried out by a credit rating agency which is SEBI registered, e.g., CRISIL, CARE, ICRA, etc. The issuer must obtain a rating from at least one such agency. The issuer must disclose all grades obtained by it in the prospectus, advertisements, etc.

3.3.6 Prospectus

A prospectus is a formal document that is required by and filed with the Securities and Exchange Commission (SEC) that provides details about an investment offering to the public. A prospectus is filed for offerings of stocks, bonds, and mutual funds.

The prospectus can help investors make more informed investment decisions because it contains a host of relevant information about the investment or security.

- The Securities and Exchange Commission requires that security issuers file a prospectus when offering investment securities to the public.
- The prospectus provides details about the investment/security and the offering.
- A mutual fund prospectus contains details on investment objectives, strategies, performance, distribution policy, fees, and fund management.
- The risks of the investment are typically disclosed early in the prospectus and then explained in more detail later in the document.

Understanding Prospectus

Companies that wish to offer bonds or stock for sale to the public must file a prospectus with the Securities and Exchange Commission as part of the registration process. Companies must file a preliminary and final prospectus, and the SEC has specific guidelines as to what's listed in the prospectus for various securities.

The preliminary prospectus is the first offering document provided by a security issuer and includes most of the details of the business and transaction.

However, the preliminary prospectus doesn't contain the number of shares to be issued or price information. Typically, the preliminary prospectus is used to gauge interest in the market for the security being proposed.

The final prospectus contains the complete details of the investment offering to the public. The final prospectus includes any finalized background information, as well as the number of shares or certificates to be issued and the offering price.

A prospectus includes some of the following information:

- A brief summary of the company's background and financial information
- The name of the company issuing the stock
- The number of shares
- Type of securities being offered
- Whether an offering is public or private
- Names of the company's principals
- Names of the banks or financial companies performing the underwriting

Some companies are allowed to file an abridged prospectus, which is a document that contains some of the same information as the final prospectus.

Another reason a prospectus is issued is to inform investors of the risks involved with investing in the security or fund. Although a company might be raising capital through stock or bond issuance, investors should study the financials of the company to ensure the company is financially viable enough to honor its commitments.

Risks are typically disclosed early in the prospectus and described in more detail later. The age of the company, management experience, management's involvement in the business, and capitalization of the stock issuer are also described. The prospectus information also guards the issuing company against claims that pertinent information was not fully disclosed.

Prospectus Example

In the case of mutual funds, a prospectus contains details on the fund's objectives, investment strategies, risks, performance, distribution policy, fees, expenses, and fund management. Because the fees that mutual funds charge take away from investors' returns, the fees are listed in a table near the beginning of the prospectus. Fees for purchases, sales, and moving among funds are also included, which simplifies the process of comparing the costs of various mutual funds.

As an example of a prospectus for an offering, PNC Financial (PNC) filed a prospectus with the Securities and Exchange Commission in 2019 requesting a new issuance of debt. The senior note being offered to the public is a bond or a promissory note to pay a specific yield by maturity.

For review, senior notes are debt securities, or bonds, that take precedence over other unsecured notes in the event of bankruptcy. Senior notes must be paid

first-if assets are available in the event of company liquidation. A senior note pays a lower coupon rate of interest compared to junior unsecured bonds since the senior debt has a higher level of security and a reduced risk of default.

Below is a portion of the prospectus from the table of contents, which provides basic information about the offering. We can see the following information listed:

- Securities offered, which are senior notes that pay 3.50%
- The maturity date of the notes, which is Jan. 23, 2024.
- The issue date, which has yet to be determined
- How interest will be paid and denominations to be issued
- Use of proceeds or how the money raised will be spent, which might include financing operations, paying down debt, or buying back stock

Notes

Why Is a Prospectus Useful for Investors?

A prospectus is a formal document that is required by and filed with the Securities and Exchange Commission (SEC) that provides details about an investment offering to the public. It is very useful to investors as it informs them of the risks involved with investing in the security or fund. Risks are typically disclosed early in the prospectus and described in more detail later. Although a company might be raising capital through stock or bond issuance, investors should study the financials of the company to ensure the company is financially viable enough to honor its commitments.

What Information Is Normally in a Prospectus?

A prospectus includes pertinent information such as a brief summary of the company's background and financial information. The name of the company and its principals, age of the company, management experience, and management's involvement in the business. Furthermore, the number of shares being issued, the type of securities being offered, whether an offering is public or private, and the names of the banks or financial companies performing the underwriting are also listed.

What's the Difference Between a Preliminary and Final Prospectus?

The preliminary prospectus is the first offering document provided by a security issuer and includes most of the details of the business and transaction. However, the preliminary prospectus doesn't contain the number of shares to be issued or price information. Typically, the preliminary prospectus is used to gauge interest in the market for the security being proposed.

The final prospectus contains the complete details of the investment offering to the public. The final prospectus includes any finalized background information, as well as the number of shares or certificates to be issued and the offering price.

3.3.7 Allotment

The term allotment refers to the systematic distribution or assignment of resources in a business to various entities over time. Allotment generally

means the distribution of equity, particularly shares granted to a participating underwriting firm during an initial public offering (IPO).

There are several types of allotment that arise when new shares are issued and allocated to either new or existing shareholders. Companies allot shares and other resources when demand is much stronger than the available supply.

- An allotment is the systematic distribution of business resources across different entities and over time.
- It generally refers to the allocation of shares granted to a participating underwriting firm during an initial public offering.
- Allotments are commonly executed when demand is strong and exceeds demand.
- Companies can also execute allotments through stock splits, employee stock options, and rights offerings.
- The main reason that a company issues new shares for allotment is to raise money to finance business operations.

Understanding Allotments: In business, allotment describes the systematic distribution of resources across different entities and over time. In finance, the term typically relates to the allocation of shares during a public share issuance. When a private company wants to raise capital for any reason (to fund operations, make a large purchase, or acquire a rival), it may decide to issue shares by going public. Two or more financial institutions usually underwrite a public offering. Each underwriter receives a specific number of shares to sell.

The allotment process can get somewhat complicated during an IPO, even for individual investors. That's because stock markets are incredibly efficient mechanisms for matching prices and quantities, but the demand must be estimated before an IPO takes place. Investors must express interest in how many shares they would like to purchase at a specific price before the IPO.

If demand is too high, the actual allotment of shares received by an investor may be lower than the amount requested. If demand is too low, which means the IPO is undersubscribed, then the investor may be able to get the desired allotment at a lower price.

On the other hand, low demand often leads to the share price falling after the IPO takes place. This means that the allotment is oversubscribed.

It's a good idea for first-time IPO investors to start small because allotment can often be a tricky process.

Other Forms of Allotment: An IPO is not the only case of share allocation. Allotment can also occur when a company's directors earmark new shares to predetermined shareholders. These are investors who have either applied for new shares or earned them by owning existing shares. For example, the company allocates shares proportionately based on existing ownership in a stock split.

Companies allot shares to their employees through employee stock options (ESOs). This is a form of compensation that companies offer to attract new and

keep existing employees in addition to salaries and wages. ESOs incentivize employees to perform better by increasing the number of shares without diluting ownership.

Rights offerings or rights issues allocate shares to investors who wish to purchase more rather than doing so automatically. Thus, it gives investors the right but not the obligation to purchase additional shares in the company. Some companies may elect to do a rights issue to the shareholders of a company they want to acquire. This allows the acquiring company to raise capital by giving investors in the target firm an ownership stake in the newly formed company.

Reasons for Raising Shares: The number one reason a company issues new shares for allotment is to raise money to finance business operations. An IPO is also used to raise capital. In fact, there are very few other reasons why a company would issue and allocate new shares.

New shares can be issued to repay a public company's short- or long-term debt. Paying down debt helps a company with interest payments. It also changes critical financial ratios such as the debt-to-equity ratio and debt-to-asset ratio. There are times when a company may want to issue new shares, even if there is little or no debt. When companies face situations where current growth is outpacing sustainable growth, they may issue new shares to fund the continuation of organic growth.

Company directors may issue new shares to fund the acquisition or takeover of another business. In the case of a takeover, new shares can be allotted to existing shareholders of the acquired company, efficiently exchanging their shares for equity in the acquiring company.

As a form of reward to existing shareholders and stakeholders, companies issue and allot new shares. A scrip dividend, for example, is a dividend that gives equity holders some new shares proportional to the value of what they would have received had the dividend been cash.

Overallotment Options: There are options for underwriters where additional shares can be sold in an IPO or follow-on offering. This is called an overallotment or greenshoe option.

In an overallotment, underwriters have the option to issue more than 15% shares than the company originally intended to do. This option doesn't have to be exercised the day of the overallotment. Instead, companies can take as long as 30 days to do so. Companies do this when shares trade higher than the offering price and when demand is really high.

Overallotments allow companies to stabilize the price of their shares on the stock market while ensuring it floats below the offering price. If the price increases above this threshold, underwriters can purchase the additional shares at the offering price. Doing so ensures they don't have to deal with losses. But if the price falls below the offering price, underwriters can decrease the supply by purchasing some of the shares. This may push the price up.

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What Is an IPO Greenshoe?

A greenshoe is an overallotment option that occurs during an IPO. A greenshoe or overallotment agreement allows underwriters to sell additional shares than the company originally intended. This generally occurs when investor demand is particularly high—higher than originally expected.

Greenshoe options allow underwriters to flatten out any fluctuations and stabilize prices. Underwriters are able to sell as much as 15% more shares up to 30 days after the initial public offering in case demand increases.

What Is Share Oversubscription and Undersubscription?

An oversubscription takes place when demand for shares is higher than anticipated. In this kind of scenario, prices can rise significantly. Investors end up receiving a lower amount of shares for a higher price.

An undersubscription occurs when demand for shares is lower than a company expects. This situation causes the stock price to drop. This means that an investor gets more shares than they expected at a lower price.

How Does an IPO Determine the Allotment of Shares?

Underwriters must determine how much they expect to sell before an initial public offering takes place by estimating demand. Once this is determined, they are granted a certain number of shares, which they must sell to the public in the IPO. Prices are determined by gauging demand from the market—higher demand means the company can command a higher price for the IPO. Lower demand, on the other hand, leads to a lower IPO price per share.

3.3.8 Preferential Allotment

Section 62 along with Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014 and Section 42 along with Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 prescribes the procedures and provisions for preferential allotment of shares.

Regulations 158 -170 deals with Preferential Issue as per SECURITIES AND EXCHANGE BOARD OF INDIA (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2018.

What is Preferential Allotment?

- A preferential issue is an issue of shares or convertible securities by listed or unlisted companies to a select group of investors, but it is neither a rights issue nor a public issue.
 - Why companies do preferential allotment?
- Companies go for preferential allotment as it is one of the fastest way to increase shares capital and bringing capital in company.
- Moreover, when a company raise capital in this way it becomes the asset of company as it leads to increase in existing shares capital. The allottee/(s) become members of the company and this fund is considered as owned fund.

APPLICABILITY OF PREFERENTIAL ISSUE AND MEANING OF SECURITIES AS PER SECTION 62 OF COMPANIES ACT, 2013.

Any company can for preferential allotment, whether it's a Public or private, listed or unlisted, Section 8 Companies, etc.

This Section specifically covers the "shares or other securities" means equity shares, fully convertible debentures, partly convertible debentures or any other securities, which would be convertible into or exchanged with equity shares at a later date.

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Conditions for Preferential Issue

A listed issuer making a preferential issue of specified securities shall ensure that:

- all equity shares allotted by way of preferential issue shall be made fully paid up at the time of the allotment; if a special resolution has been passed by its shareholders;
- all equity shares held by the proposed allottees in the issuer are in dematerialised form;
- the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the stock exchange where the equity shares of the issuer are listed and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements), 2015, as amended, and any circular or notification issued by the Board thereunder;
- the issuer has obtained the Permanent Account Numbers of the proposed allottees, except those allottees which may be exempt from specifying their Permanent Account Number for transacting in the securities market by the Board.

Procedure for Allotment of Preferential Issue of Shares

- Send notice to convene a Board Meeting at least seven days before the meeting.

Convene Board Meeting and consider below given matters:

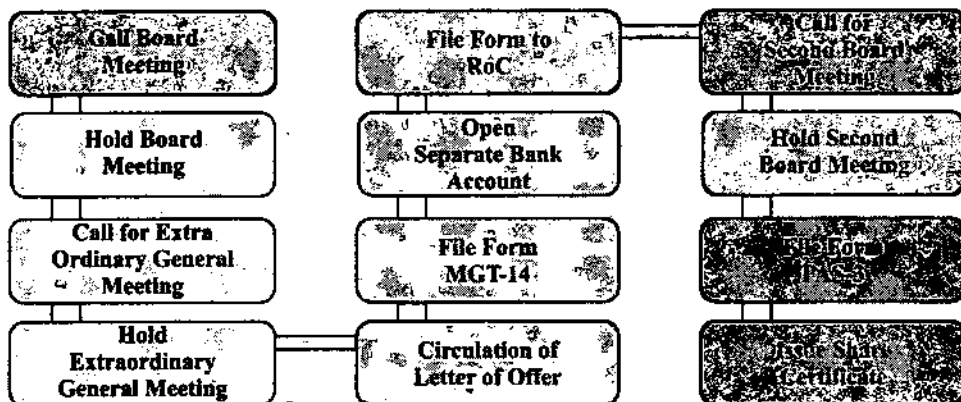
- Consider the valuation report as received.
- Deciding the list of allottees
- Fix day, date, venue and time of extraordinary general meeting
- Finalization of draft offer letter in the form PAS-4
- Finalization of notice for extraordinary general meeting along with the explanatory statement as required in the law.
- Decide the offer period
- Open a separate bank account in a scheduled bank to receive money
- Convene extraordinary general meeting and passing of resolution for allotment.

File MGT-14 and then the private placement offer letter i.e. PAS-4 cum application shall be dispatched to the proposed allottees with the following attachments:

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- Certified true copy of the special resolution.
- Explanatory statement.
- Dispatch private placement offer letter cum application to the proposed allottees within thirty days, either in writing or in electronic mode.
- Proposed Allottees shall subscribe to the shares in the private placement offer letter cum application along with the subscription money paid either by cheque or demand draft or other banking channel but not by cash whatsoever.
- The money as received shall be deposited in a separate bank account.
- Convene Board Meeting for the allotment of shares within 60 days of receipt of money.
- File PAS-3 within fifteen days of allotment of shares:

Procedure In Tabular Form



Part I: Issuers Ineligible to Make a Preferential Issue

(1) Preferential issue of specified securities shall not be made to any person who has sold or transferred any equity shares of the issuer during the six months preceding the relevant date: Provided that in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation in terms of sub-regulation (2) of regulation 11 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 to such a preferential allotment.

Explanation: Where any person belonging to promoter(s) or the promoter group has sold/ transferred their equity shares in the issuer during the six months preceding the relevant date, the promoter(s) and promoter group shall be ineligible for allotment of specified securities on preferential basis.

Provided that the above restriction shall not apply to any sale of equity shares by any person belonging to promoter(s) of the promoter group which qualifies for inter-se transfer amongst qualifying persons under clause (a) of sub-regulation (1) of regulation 10 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover Regulations), 2011 or in case of transfer of shares held by the promoters or promoter group on account of invocation of pledge by a scheduled commercial bank or public financial institution or a systemically important.

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Part 2: Issuers Ineligible to Make a Preferential Issue

- non-banking finance company or mutual fund or insurance company registered with the Insurance Regulatory and Development Authority.
- Where any person belonging to promoter(s) or the promoter group has previously subscribed to warrants of an issuer but has failed to exercise the warrants, the promoter(s) and promoter group shall be ineligible for issue of specified securities of such issuer on preferential basis for a period of one year from:
 - the date of expiry of the tenure of the warrants due to non-exercise of the option to convert; or
 - the date of cancellation of the warrants, as the case may be.
- An issuer shall not be eligible to make a preferential issue if any of its promoters or directors is a fugitive economic offender.

Conditions For Preferential Issue

A listed issuer making a preferential issue of specified securities shall ensure that:

- all equity shares allotted by way of preferential issue shall be made fully paid up at the time of the allotment;
- a special resolution has been passed by its shareholders;
- all equity shares held by the proposed allottees in the issuer are in dematerialised form;
- the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the stock exchange where the equity shares of the issuer are listed and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements), 2015, as amended, and any circular or notification issued by the Board thereunder;
- the issuer has obtained the Permanent Account Numbers of the proposed allottees, except those allottees which may be exempt from specifying their Permanent Account Number for transacting in the securities market by the Board.

Relevant Date

- For the purpose of this Chapter, "relevant date" means;
- in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue;
- Provided that in case of a preferential issue of specified securities pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India or a resolution;
 - plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code 2016,, the date of approval of the corporate debt restructuring package or resolution plan shall be the relevant date.
- in case of a preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.
- Explanation: Where the relevant date falls on a weekend or a holiday, the day preceding the weekend or the holiday will be reckoned to be the relevant date.

Valuation Required for Preferential Issue.

Listed Securities as per SEBI (ICDR)

1. The price of shares to be issued on a preferential basis by a listed company shall not be required to be determined by the valuation report of a registered valuer
2. Where the equity share or convertible securities are issued on a preferential basis by a listed entity for consideration other than cash, the valuation of the assets in consideration for which the equity shares are issued shall be done by an independent valuer, which shall be submitted to the stock exchanges where the equity shares of the issuer are listed .
3. If the stock exchange(s) is not satisfied with the appropriateness of the valuation, it may get the valuation done by any other valuer and for this purpose it may seek any information, as deemed necessary, from the issuer
4. Where the shares of an issuer are not frequently traded, the price determined by the issuer shall take into account the valuation parameters and the issuer shall submit a certificate stating that the issuer is in compliance of SEBI(ICDR)Regulations, obtained from an independent valuer to the stock exchange where the equity shares of the issuer are listed.

164(1)		164(2)	164A	164B	165	166
Frequently traded shares			Pricing in case of stressed assets	Optional pricing in preferential issue	Pricing of Infrequently traded shares	Adjustments in pricing - Frequently and Infrequently traded shares
Listed for more than 26 weeks	Listed for less than 26 weeks					
Higher of the Average of weekly high & low of the VWAP for 26 W/2W	Higher of • IPO Price or Scheme Price • Average of weekly high & low of the VWAP since listed • Average of weekly high & low of the VWAP for 2W	Higher of the Average of weekly high & low of the VWAP for 2 Weeks	Higher of the Average of weekly high & low of the VWAP for 12 W/2W *Was available till Pref Issue till December 31, 2020	Independent Valuer's Report	price determined for a preferential issue as per Reg 164 or Reg 165, shall be subject to appropriate adjustments, if the issuer makes Rights Issues, Split of Shares, Consolidate Shares, reclassify etc.	

Notes

Companies Act Compliances- Roc Filing

1. MGT- 14 within 30 days of passing Board resolution in which Preferential allotment is approved
2. MGT-14 within 30 days of passing Special Resolution
3. PAS -3 within fifteen days of allotment along with a complete list of all the allottees containing-
 - the full name, address, permanent Account Number and E-mail ID of such security holder;
 - the class of security held;
 - the date of allotment of security ;
 - the number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.

Relaxation By SEBI To Stress Entities Due To Covid 19

- SEBI introduces optional pricing in preferential issue SEBI has regulation 164B to SEBI ICDR to provide an additional option to the existing pricing framework for preferential issues of frequently traded shares. The new regulation allows the issuer to reckon the preferential issue price based on an average of 12 week price of equity shares as against the existing 26 week price. Specified securities allotted on a preferential basis using the optional pricing method determined shall be locked-in for a period of three years. The optional pricing may be availed for preferential issues made between 1 July 2020 and 31st December 2020.

- Lock-in requirements: The allotment made shall be locked-in for a period of three years from the last date of trading approval.
- Restriction on use of proceeds: The proceeds of such preferential issue shall not be used for any repayment of loans taken from promoters/promoter group/ group companies. The proposed use of proceeds shall be disclosed in the explanatory statement sent for the purpose of the shareholder resolution.

Relaxation By SEBI To Promoters Due To Covid 19 Pandemic

- Capital market regulator, Securities and Exchange Board of India (SEBI) on June 17 relaxed the preferential allotment norms till March 2021.
- SEBI has allowed promoters to increase their stake in the company by up to 10 percent through a preferential allotment, against the limit of 5 percent earlier.
- The move comes at a time when a lot of companies are in need of funds to start operations following the countrywide lockdown. It can help the companies to raise funds faster via promoters.

3.3.9 Private Placement

Private Placement, the section defines the term "Private Placement" so as to mean any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in this section. A company may make an offer or invitation of securities through issue of a private placement offer letter in Form PAS-4.

The section provides that the offer of securities or invitation to subscribe securities, shall be made to such number of persons not exceeding fifty or such higher number as may be prescribed, (excluding qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option).

"qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 as amended from time to time. Further the explanation provides that if a company whether listed or unlisted, makes an offer of securities to more than prescribed number of persons whether the payment for the securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to public and shall be dealt accordingly.

According to Companies (Prospectus and Allotment of Securities) Rules, 2014 a private placement offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the names of such persons. No person other than the person so addressed in the application form shall be allowed to apply

through such application form and any application not so received shall be treated as invalid. Sub rule(2) provides that a company shall not make private placement unless:

- (a) the proposed offer of securities or invitation to subscribe securities has been previously approved by the shareholders of the company, by a Special Resolution, for each of the Offers or Invitations: The explanatory statement annexed to the notice for the general meeting the basis or justification for the price (including premium, if any) at which the offer or invitation is being made shall be disclosed. In case of offer or invitation for non-convertible debentures, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitation for such debentures during the year.
- (b) such offer or invitation shall be made to not more than two hundred persons in the aggregate in a financial year: Any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons; Explanation.— For the purposes of this sub-rule, it is hereby clarified that –
 - (i) the restrictions under sub-clause (b) would be reckoned individually for each kind of security that is equity share, preference share or debenture;
 - (ii) the requirement of provisions of sub-section (3) of section 42 shall apply in respect of offer or invitation of each kind of security and no offer or invitation of another kind of security shall be made unless allotments with respect to offer or invitation made earlier in respect of any other kind of security is completed;
- (c) the value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities;
- (d) the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the Bank account from where such payments for subscriptions have been received. Monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.

Notes

The company shall maintain a complete record of private placement offers in Form PAS-5: Provided that a copy of such record along with the private placement offer letter in Form PAS-4 shall be filed with the Registrar with fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the Securities and Exchange Board within a period of thirty days of circulation of the private placement offer letter.

Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be required to be complied with.

Private Placement shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such person shall receive the offer by name, and that a complete record of such offers shall be kept by the company in such manner as may be prescribed and complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

The company shall maintain a complete record of private placement offers in Form PAS-5. A copy of such record along with the private placement offer letter in Form PAS-4 shall be filed with the Registrar with fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the Securities and Exchange Board within a period of thirty days of circulation of the private placement offer letter.

A company shall allot securities within 60 days from the date of receipt of application money, if it does not allot within 60 days then application money shall be repaid within 15 days after expiry of 60 days and if the company does not pay money after the aforesaid period the company is liable to repay the money with interest at the rate of 12 percent per annum from the expiry of 60th day. The monies received shall be kept in separate bank account with a scheduled bank and shall not be utilised for any purpose other than—

- (a) for adjustment against allotment of securities; or
- (b) for the repayment of monies where the company is unable to allot securities.

A company shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed. Under the rules, a return of allotment of securities shall be filed with the Registrar in Form PAS-3 and with the fee as provided in Annexure 'B' along with a complete list of all security holders containing-

- (i) the full name, address, Permanent Account Number and Email ID of such security holder;
- (ii) the class of security held;
- (iii) the date of allotment of security;
- (iv) the number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.

The section provides for certain restrictions on the private placement which are as under:

1. No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.
2. No monies payable on subscription of securities not to be made in cash, all monies shall be made through cheque or demand draft or other banking channels but not by cash.
3. No company offering securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

Notes

The provisions of clauses (b) and (c) of sub-rule (2) shall not be applicable to - (a) non-banking financial companies which are registered with the Reserve Bank of India under Reserve Bank of India Act, 1934; and (b) housing finance companies which are registered with the National Housing Bank under National Housing Bank Act, 1987, if they are complying with regulations made by Reserve Bank of India or National Housing Bank in respect of offer or invitation to be issued on private placement basis. Such companies shall comply with sub-clauses (b) and (c) of sub-rule (2) in case the Reserve Bank of India or the National Housing Bank have not specified similar regulations.

3.3.10 Book Building Process

Book building is a price discovery mechanism that is used in the stock markets while pricing securities for the first time. When shares are being offered for sale in an IPO, it can either be done at a fixed price. However, if the company is not sure about the exact price at which to market its shares, it can decide a price range instead of an exact figure. This process of discovering the price by providing the investors with a price range and then asking them to bid on it is called the book building process. It is considered to be one of the most efficient mechanisms of pricing securities in the primary market. This is the preferred method which is recommended by all major stock exchanges and as a result is followed in all major developed countries in the world.

Meaning of Book Building

Book building is a process used for marketing a public offer of equity shares of a company. Book building is called so because it refers to the collection of bids from investors, which is based on an indicative price range. The issue price is fixed after the bid closing date. The issuer company engages a lead merchant banker to act as a book runner, who prepares and obtains a green signal for the draft of offer document (without mentioning price) to SEBI. A syndicate, comprising of capital market intermediaries (eligible brokers, merchant bankers or even mutual funds) is appointed to underwrite issue who approaches investors and collects bids from them. They collect demand for securities at different price levels and consolidate information which is passed on to syndicate. It in turn,

passes it on to the book runner. The book runner builds an order book, that is, collects the bids from various investors which shows the demand for the shares of the company at various prices there after price of issue is fixed.

The detailed process of book building is as follows:

1. **Appointment of Investment Banker:** The first step starts with appointing the lead investment banker. The lead investment banker conducts due diligence. They propose the size of the capital issue that must be conducted by the company. Then they also propose a price band for the shares to be sold. If the management agrees with the propositions of the investment banker, the prospectus is issued with the price range as suggested by the investment banker. The lower end of the price range is known as the floor price whereas the higher end is known as the ceiling price. The final price at which securities are indeed offered for sale after the entire book building process is called the cut-off price.
2. **Collecting Bids:** Investors in the market are requested to bid to buy the shares. They are requested to bid the number of shares that they are willing to buy at varying price levels. These bids along with the application money are supposed to be submitted to the investment bankers. It must be noted that it is not a single investment banker who is engaged in the collection of bids. Rather, the lead investment banker can appoint sub-agents to tap into their network especially for receiving the bids from a larger group of individuals.
3. **Price Discovery:** Once all the bids have been aggregated by the lead investment banker, they begin the process of price discovery. The final price chosen is simply the weighted average of all the bids that have been received by the investment banker. This price is declared as the cut-off price. For any issue which has received substantial publicity and which is being anticipated by the public, the ceiling price is usually the cut-off price.
4. **Publicizing:** In the interest of transparency, stock exchanges all over the world require that companies make public the details of the bids that were received by them. It is the lead investment banker's duty to run advertisements containing the details of the bids received for the purchase of shares for a given period of time (let's say a week). The regulators in many markets are also entitled to physically verify the bid applications if they wish to.
5. **Settlement:** Lastly, the application amount received from the various bidders has to be adjusted and shares have to be allotted. For instance, if a bidder has bid a lower price than the cut-off price then a call letter has to be sent asking for the balance money to be paid. On the other hand, if a bidder has bid a higher price than the cut-off, a refund cheque needs to be processed for them. The settlement process ensures that only the cut-off amount is collected from the investors in lieu of the shares sold to them.

Partial Book Building

Partial book building is another variation of the book building process. In this process, instead of inviting bids from the general population, investment bankers invite bids from certain leading institutions. Based on their bids, a weighted average of the prices is created and cut-off price is decided. This cut-off price is then offered to the retail investors as a fixed price. Therefore, the bidding only happens at an institutional level and not at a retail level.

This is also an efficient mechanism to discover prices. Also the cost and complications involved in conducting a partial book building are substantially low.

How is Book Building Better Than the Fixed Price Mechanism ?

First of all, the book building process brings flexibility to the pricing of IPO's. Prior to the introduction of book building, a lot of IPO's were either underpriced or overpriced. This created problems because if the issue was underpriced, the company was losing possible capital. On the other hand, if the issue was overpriced it would not be fully subscribed. In fact, if it was subscribed below a given percentage, the issue of securities had to be cancelled and the substantial costs incurred over the issue would simply have to be written off. With the introduction of book building process, such events no longer happen and the primary market functions more efficiently.

Book Building Procedure: The Lead manager is responsible for coordination of all the activities amongst various intermediaries connected in the issue/system. The names of brokers appointed by the issuer company along with names of the other intermediaries namely Lead managers to the issue and Registrars to the Issue shall be disclosed in the prospectus and application form. The company shall make an issue advertisement wide circulation. The advertisement shall contain the salient features of the offer document.

During the period the issue is open to the public for subscription, the applicants may approach the brokers of the stock exchanges through which the securities are offered under on-line system, to place an order for subscribing to the securities. Every broker shall accept orders from all clients who place order through him directly and send the application form along with the cheque, demand draft for the sum payable towards application money to the Registrar to the Issue or place the order to subscribe through a stock broker under the on-line system.

The broker shall collect the client registration form duly filled up and signed from the applicants before placing an order in the system. The broker shall, thereafter, enter the buy order in the system, on behalf of the clients and enter their details and give an order number/order confirmation slip to the applicant. The applicant may withdraw application terms of the Companies Act, 1956.

The broker collects an amount to the extent of 100% of the application money as margin money from the clients before he places an order on their

Notes

behalf. The broker shall open a separate, bank account Escrow Account with the clearing house bank for primary market issues and the amount collected by the broker from his clients as margin money shall be deposited in this account. The broker shall, at the end of each day while the issue is open for subscription, download/forward the order data to the Registrar to the Issue on a daily basis.

This data shall contain only valid orders (including those that are cancelled). On the date of closure of the issue, the final status of orders received shall be sent to the Registrar to the issue/company. On the closure of the issue the Regional Stock Exchange, along with the Lead merchant banker and Registrars to the Issue shall ensure that the basis of allocation is finalised in fair and proper manner on the lines of the norms with respect to basis of allotment as may be modified from time to time. After finalisation of basis of Issue Management allocation, the Registrar to the Issue company shall send the computer file containing the allocation details i.e. the allocation numbers, allocated quantity, etc., of successful applicants to the Exchange.

The Exchange shall process and generate the brokerwise funds pay-in obligation and shall send the file containing the allocation details to member brokers. On receipt of the basis of allocation data, the brokers shall immediately intimate the fact of allocation to their client/ applicant. The broker shall refund the margin money collected earlier, within 3 days of receipt on basis of allocation, to the applicants who did not receive allocation.

The brokers shall give details of the amount received from each client and the names of clients who have not paid the application money to the exchange. On the pay-in day, the broker should deposit the amount collected from the clients in the separate bank account opened for primary issues with the clearing house/bank. The clearing house shall debit the primary issue account of each broker and credit the amount so collected from each broker to the "Issue Account". On payment and receipt of the sum payable on application for the amount towards minimum subscription, the company shall allot the shares to the applicants.

Allotment of securities shall be made not later than 15 days from the closure of the issue failing which interest at the rate of 15% shall be paid to the investors. In cases of applicants who have applied directly or by post to the Registrar to the issue, and have not received allocation, the Registrar to the issue shall arrange to refund the application money paid by them within the time prescribed.

Safety Net Scheme or Buy Back Arrangement

Under this scheme, the merchant bankers provide a buy-back facility to the individual investor in case the price of the share goes below the issue price after listing. During the past we have seen several shares issued at a premium declining below the issue price on the market. In such circumstances if the investor is given a buy back option or a safety net by the merchant banker, he can exercise it to reduce his losses.

Any safety net scheme or buy-back arrangements of the shares proposed in any public issue shall be finalised by issuer company with the lead merchant banker in advance and disclosed in the prospectus. Such buy back or safety net arrangements shall be made available only to original resident individual allottees. Such buy back or safety net facility shall be limited up to a maximum of 1000 shares per allottee and the offer shall be valid at least for a period of 6 months from the last date of dispatch of securities.

Notes

The financial capacity of the person making available buy back or safety net facility shall be disclosed in the draft prospectus. For investor protection a safety net scheme has been floated by some companies making public issues at a premium.

For the purpose of illustration, two instances of public issues with safety net are presented hereunder. Godrej Soaps Ltd.: For the first time, a public issue was offered with a safety net to the investing public against possible loss from a decline in market prices of a share at premium. Godrej Soaps Ltd. made a public issue of Rs. 99.12 crores in April, 1993 at a premium of Rs. 130 per Rs. 10 share. The offer was not open to institutional investors. The Godrej Soaps issue was made to finance the company's working capital requirements and capital expenditure needs. The merchant bankers to the issue, Kotak Mahindra Finance Ltd., made an innovative offer to buy-back share from individual investors if they opt out of the issue after the allotment is made.

The salient feature of the safety-net scheme were:

The cap on total number of shares to be bought back was 10 lakh shares or around 15 per cent of the public issue.

The buy back option was open for six months after the date of listing.

Ballarpur Industries Ltd.: Another issue which came up in April, 1993 with a safety net was from Ballarpur Industries Ltd. a company of the Thaper Group. The company came up with an issue of 61,50,000 equity shares of Rs. 10 each with a premium of Rs. 165 per share. One of the lead managers to the issue M/s. HB Portfolio Leasing Ltd. had offered a safety-net for the investors.

The salient features of the safety-net scheme were:

The scheme was open to all resident Indian individual original allottees.

It was restricted to individual investors only, and institutional investors were excluded. Under this scheme, HB Portfolio Leasing Ltd. purchased from individual investors fully paid equity shares allotted at a price of Rs. 175 per share.

Issue of Debt Instruments

A company can also raise funds through debt instruments making public issue or rights issue. Primarily the arrangements to be made and procedures involved are same as in case of issue of equity. Still some peculiar provisions are specified by SEBI (Disclosure and Investor Protection) Guidelines 2000. Some of its important provisions are mentioned here.

(a) The offer document of such issue should contain:

- The interest rate for debentures which can be freely determined by the issuer company,
- Premium amount on conversion, time of conversion,
- In case of PCDs/NCDs, redemption amount, period of maturity, yield on redemption of the PCDs/NCDs,
- Full information relating to the terms of offer or purchase, including the name(s) of the party offering to purchase, the khokhas (non-convertible portion of PCDs),
- The discount at which such an offer is made and the effective price for the investor as a result of such discount,
- The existing and future equity and long-term debt ratio,
- Servicing behaviour on existing debentures, payment of due interest on due dates on term loans and debentures.

(b) Such public or rights issue of debt instruments (including convertible instruments) irrespective of their maturity or conversion period can be made only if the credit rating has been obtained and disclosed in the offer document.

All issues of Rs 100 crore or more is to obtain ratings from two different credit rating agencies. All credit rating(s), whether accepted or not, should be disclosed in the offer document. Further, all the credit ratings obtained during the three years preceding the issue for any listed security of the issuer company should also be disclosed.

(c) If issue is of debt with maturity of more than 18 months, the issuer has to appoint debenture trustees holders irrespective of whether or not the debentures/bonds are secured. Their names must be stated in the offer document. A trust deed has to be executed by the issuer company in favour of the debenture trustees within six months of the closure of the issue. The trustees should be vested with the requisite powers for protecting the interest of debenture holders. They also have a right to appoint a nominee director on the board of the company in consultation with the institutional debenture holders.

(d) The offer document should state assets on which the security would be created and also their ranking of the charge(s). The security/asset cover to be maintained, the basis for its computation, the valuation methods and periodicity of such valuation should be disclosed. The security should be created within six months from the date of issue of debentures. If the issuing company proposes to create a charge for debentures of maturity of less than 18 months, it should file with the ROCs the particulars of the charge under the Companies Act. Where no charge is to be created on such debentures, the issuer company should ensure compliance with the provisions of the Companies (Acceptance of Deposits) Rules, 1975, as unsecured debentures/bonds are treated as "deposits" for purposes of these rules.

(e) While filing the draft offer document the merchant banker should file with SEBI certificates from their bankers that the assets on which security is to

be created are free from any encumbrances and the necessary permissions to mortgage the assets have been obtained from the financial institutions or banks in cases such assets are encumbered.

(f) A letter of option containing disclosures with regard to credit rating, debenture holders resolution, option for conversion, justification for conversion price and such other terms which SEBI may prescribe from time to time should be filed with SEBI through an eligible merchant banker, in the following cases:

Notes

In the case of a roll-over of non-convertible portions of partly convertible debentures (PCDs)/non-convertible debentures (NCDs), the non-convertible portions of PCDs/NCDs issued by a listed company, the value of which exceeds Rs 50 lakh, can be rolled over without change in the interest rate subject to the following conditions:

- An option is compulsorily given to the debenture holders to redeem the debentures as per the terms of the offer document;
- A roll-over is done only in cases where debenture holders have sent their positive consent and not on the basis of the non-receipt of their negative reply;
- Before a roll-over, a fresh credit rating is obtained within six months prior to the due date of redemption and communicated to debenture holders before the rollover;
- A fresh trust deed is executed at the time of such a roll-over; and a fresh security is created in respect of such debentures to be rolled over. If, however, the existing trust deed or the security documents provide for continuance of the security till redemption of debentures, fresh security may not be created. In the case of conversion of PCDs/FCDs into equity capital;
- If the convertible portion of any instrument such as PCDs, FCDs, etc. issued by a listed company, value of which exceeds Rs 50 lakh, and whose conversion price was not fixed at the time of issue, holders of such instruments should be given a compulsory option of not converting into equity capital;
- Conversion should be done only in cases where instrument holders have sent their positive consent and not on the basis of the non-receipt of their negative reply. Where issues are made and cap price with justification, thereon, is fixed beforehand in respect of any instruments by the issuer and disclosed to the investors before issue, It should not be necessary to give the option to the instrument holder for converting the instruments into equity capital within the cap price;

In cases where an option is to be given to such instrument holders and if any instrument holder does not exercise the option to convert the debentures into equity at a price determined in the general meeting of the shareholders, the company should redeem that part of the debenture at a price not less than its face value, within one month from the last date by which the option is to

be exercised; the provision of sub-clause (c) above would not apply if such redemption is to be made in accordance with the terms of the issue originally stated. 12.6 Rollover of debentures/bonds.

(g) In case non-convertible portion of PCDs or Non-Convertible Bonds/ Debentures are to be rolled over with or without change in the interest rate(s), an option shall be given to those debenture/bond holders, who desire to withdraw from the scheme. Roll over may be given only in cases, where debenture/bond holders have sent their positive consent and not on the basis of the non-receipt of their negative reply.

Before roll over of any non-convertible bonds or debentures or nonconvertible portion of the PCDs, fresh credit rating shall be obtained within a period of six months prior to the due date for redemption and communicated to the bond/debenture holders before roll over. The letter of option regarding roll over shall be filed containing disclosure with regard to the credit rating, bond/debenture holder resolution, option for conversion and such other terms which the Board may stipulate from time to time.

(h) No company should issue fully convertible debentures (FCDs) having a conversion period of more than 36 months, unless conversion is made optional with "put" and "call" option. If the conversion takes place at or after 18 months from the date of allotment, but before 36 months, any conversion, in part or whole, of the debenture should be optional at the hands of the debenture holder.

(i) Issue of debentures cannot be made for acquisition of shares or providing loan to any group company. This requirement would not apply to the issue of fully convertible debentures providing conversion within a period of 18 months. The premium amount and time of conversion should be determined by the issuer company and disclosed. The interest rate for debentures can be freely determined by the issuer company.

Impact of Information Technology

Revolution in the area of Information Technology has influenced Issue Management also to a great extent. It has added value in the system by increased accuracy, transparency, efficiency and promptness. It has proved to be more investor friendly. The quality to investors has improved many fold. Time gap between making application and getting allotment or refund has reduced substantially. Investors get full value of money they deploy in this activity. Even at pre issue stage a lot of time is saved.

The SEBI requirement of submitting soft copy of draft prospectus enables it to put the red herring prospectus on the web site of SEBI. Investors find themselves more comfortable having access to detailed prospectus on site instead of waiting for long for response of lead manager.

e-IPO: The most significant development has been the emergence of Electronic Initial Public Issue (e-IPO). A company proposing to issue capital to public now can provide an opportunity to investors to avail benefits of IT

revolution. Through the on-line system of the stock exchange SEBI now permits companies to offer e-IPO for offer of securities. Such issuers shall comply with the following requirements of SEBI in this regards:

The company shall enter into an agreement with the Stock Exchange(s) which have the requisite system of on-line offer of securities. Where the Regional Stock Exchange has the requisite system of online offer of securities, the company shall also, enter into an agreement with the regional stock exchange for offering securities to public through on-line system. The agreement mentioned in the above clause shall specify inter alia the rights, duties, responsibilities and obligations of the company and stock exchange(s) inter se.

The agreement may also provide for a dispute resolution mechanism between the company and the stock exchange. Subject to the requirement of listing on the Regional Stock Exchange, the company may apply for listing of its securities on an exchange other than the exchange through which it offers its securities to public through the on-line system. The stock exchange, shall appoint brokers of the exchange, who are registered with SEBI, for the purpose of accepting applications and placing orders with the company.

The brokers, so appointed accepting applications and application money, shall be considered as 'collection centres'. These brokers shall collect the money from his/ their client for every order placed by him/them and in case the client fails to pay for shares allocated as per the Guidelines, the broker shall pay such amount. The company/lead manager shall ensure that the brokers having terminals are appointed in compliance with the requirement of mandatory collection centres.

The company/lead manager shall ensure that the brokers so appointed are financially capable of honouring their commitments arising out of defaults of their clients. The company shall pay to the broker/s a commission/fee for the services rendered by him/ them. The exchange shall ensure that the broker does not levy a service fee on his clients in lieu of his services. The company shall also appoint a Registrar to the Issue having electronic connectivity with the Stock Exchange/s through which the securities are offered under the system.

Regulatory Environment: In the present unit we have briefly discussed Issue Management in the context of SEBI Guidelines for Disclosure and Investors Protection and SEBI (Merchant bankers) Regulations 1992, but while raising funds through capital issues due regard is also to be given to the following:

1. Provisions of the Companies Act, 1956
 - (a) Prospectus (Sec. 55 to 68A and Schedule II)
 - (b) Share Allotment (Sec. 69 to 75)
 - (c) Commissions and discounts (Sec. 76 and 77)
 - (d) Issue of shares at premium and at discount (Sec. 78 and 79)
 - (e) Issue and redemption of preference shares (Sec. 80 and 80A)
 - (f) Further issues of capital (Sec. 81).

Notes

- (g) Nature, numbering and certificate of shares (Sec. 82 to 84)
- (h) Kinds of share capital and prohibition on issue of any other kind of shares (Sec. 85 and 86)

2. The Securities Contracts (Regulations) Act, 1957 regarding transactions in securities.

Underwriting: In respect of every issue under his management, the lead manager shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lacs whichever is less. The outstanding underwriting commitments of a merchant banker shall not exceed 5 times his net worth at any point of time. The lead manager shall ensure that the issue to the public is fully underwritten and details of underwriters included in the prospectus. He shall also satisfy himself about the worth of the underwriters to fulfill their respective underwriting commitments.

The lead manager shall satisfy himself that the issue is fully subscribed before announcing closure of the issue. In case, there is no definite information about subscription figures, the issue should be kept open for the required number of days to take care of the underwriters interests and to avoid any dispute, at a later date, by the underwriters over their liability.

In case there is a devolvement on underwriters, the lead manager shall ensure that the underwriters give a letter of acceptance for the amount of devolvement within 60 days from the date of closure of the issue and pay the amount of devolvement within 90 days from the date of closure of the issue. Any dispute relating to acceptance of underwriting commitment shall immediately be brought to the notice of SEBI. The lead manager shall exercise due caution while finalising the underwriting arrangement keeping in view the track record of underwriters in meeting their commitments in the devolved issues managed by them.

While selecting underwriters and finalising underwriting arrangements, lead managers may ensure that the underwriters do not overexpose themselves so that it may become difficult for them to fulfill underwriting commitments. In this context, the overall exposure of underwriter(s) belonging to the, same group or management in an issue may be viewed carefully.

There were complaints that the OTC Dealers are not treated on par with brokers of other exchanges while finalising underwriting arrangements. SEBI desires that other things being equal, lead managers may not exclude OTC Dealers registered with SEBI under SEBI (Stock Brokers and SubBrokers) Rules and Regulations, 1992 from underwriting.

Due Dillgence Certificate: On the basis of such examination and the discussions with the company, its directors and other officers, other agencies, independent verification of the statements concerning the objects of the issue, projected profitability, price justification and the contents of the documents mentioned in the Annexure and other papers furnished by the company the lead managers issue a certificate stating that: WE CONFIRM that: the draft

prospectus/letter of offer forwarded to SEBI is in conformity with the documents, materials and papers relevant to the issue; all the legal requirements connected with the said issue as also the guidelines, instructions, etc. issued by SEBI, the Government and any other competent authority in this behalf have been duly complied with; and the disclosures made in the draft prospectus/letter of offer are true, fair and adequate to enable the investors to make a well informed decision as to the investment in the proposed issue.

We confirm that besides ourselves, all the intermediaries named in the prospectus/letter of offer are registered with SEBI and that till date such registration is valid. We have satisfied ourselves about the worth of the underwriters to fulfill their underwriting commitments.

Notes

Annexure to the Due Diligence Certificate for the issue of by Limited

- Memorandum and Articles of Association of the Company.
- Letter of Intent/SIA Registration/Foreign Collaboration Approval/ Approval for import of plant and machinery, if applicable.
- Necessary clearance from governmental, statutory, municipal authorities, etc. for implementation of the project, wherever applicable.
- Documents in support of the track record and experience of the promoters and their professional competence.
- Listing agreement of the company for existing securities on the Stock Exchanges.
- Consent letter from Company's auditors, Bankers to issue, bankers to the Company, Lead Managers, Brokers and where applicable, Proposed Trustees.
- Applications made by the company to the financial institutions/banks for financial assistance as per object of the Issue and copies of relative sanction letters.
- Underwriting letters from the proposed underwriters to the issue. 1 Audited Balance Sheets of the Company/Promoter companies for relevant periods.
- Auditors certificate regarding tax-benefits available to the Company, Shareholders and Debenture holders.
- Certificate from Architects or any other competent authority on project implementation schedule furnished by the company, if applicable.
- Reports from Government agencies/expert agencies/consultants/ company regarding market demand and supply for the product, industry scenario, standing of the foreign collaborators, etc.
- Documents in support of the infrastructural facilities, raw material availability, etc.
- Auditor's Report indicating summary of audited accounts for the period including that of subsidiaries of the company.

Stock Exchange quotations of the last 3 years duly certified by regional stock exchange in case of an existing company.

- Applications to RBI and approval thereof for allotment of shares to non-residents, if any, as also for collaboration terms and conditions.
- Minutes of Board and General Body of the company for matters which are in the prospectus.
- Declaration in Form 32 from Directors (for particulars of Directorship) or the Company Secretary's certificate in this regard.
- Revaluation certificate of company's assets given by Government Valuer or any other approved valuer.
- Environmental clearance as given by Pollution Control Board of the State Government or the Central Government as applicable.
- Certificates from company's solicitors in regard to compliance of legal provisions of the prospectus as also applicability of ERA/MRTP provisions to the company.
- Other documents, reports, etc. as are relevant, necessary fortune, fair and adequate disclosures in the draft prospectus/letter of offer (to give details).
- True copy of the Board resolution passed by the issuer authorising a representative of the Registrar to act on its behalf in relation to handling of Stock invests.

Inter-se Allocation of Responsibilities

Inter se allocation of the activities/ sub-activities will be for the lead managers to make who must however ensure that activity wise allocation is properly delineated and that SEBI is advised the name of the lead manager responsible for each set of activities/ sub-activities, well before opening of issue.

This advice must be signed by all lead managers to issue. Where the circumstances warrant joint and several responsibility of lead managers for a particular activity, a coordinator designated from amongst the lead managers shall furnish to SEBI, when called for, with information, report, comments, etc. on matters relating to the activity (of joint and several responsibility).

The activity/sub-activities may be grouped on the following lines: Capital structuring with the relative components and formalities such as composition of debt and equity, type of instruments. Drafting and Design of the offer document and of advertisement/publicity material including newspaper advertisements and brochure/memorandum containing salient features of the offer document.

The designated lead manager shall ensure compliance with the Guidelines for Disclosure and Investor Protection and other stipulated requirements and completion of prescribed formalities with Stock Exchange Registrar of Companies and SEBI.

Marketing of the issue, which will cover, inter-alia, formulating marketing strategies, preparation of publicity budget, arrangements for selection of (i) ad-media, (ii) centres of holding conferences of brokers, investors, etc.,

(iii) bankers to issue; (iv) collection centres. (v) brokers to issue, and (vi) underwriters and the underwriting arrangement, distribution of publicity and issue material including application form, prospectus and brochure, and deciding on the quantum of issue material.

Selection of various agencies connected with issue, namely Registrars to issue, printers and advertising agencies. Follow-up with bankers to the issue to get quick estimates of collection and advising the issuer about closure of the issue, based on the correct figures. The post-issue activities will involve essential follow-up steps, which must include finalisation of basis of allotment/weeding out of multiple applications, listing of instruments and despatch of certificates and refunds, with the various agencies connected with the work such as registrars to the issue, bankers to the issue, and the bank handling refund business.

Even if many of these activities would be handled by other intermediaries, the designated lead manager shall be responsible for ensuring that these agencies fulfill their functions and enable him to discharge this responsibility through suitable agreements with the issuer company. Ordinarily, one lead manager will be responsible for post-issue activities".

Proportionate Allotment Procedure

The allotment shall be subject to allotment in marketable lots, on a proportionate basis as explained below:

- (a) Applicants shall be categorised according to the number of shares applied for
- (b) The total number of shares to be allotted to each category as a whole shall be arrived at on a proportionate basis i.e., the total number of shares applied for in that category (number of applicants in the category x number of shares applied for) multiplied by the inverse of the over subscription ratio as illustrated below:

Total number of applicants in category of 100s

Total number of shares applied for 1,500

1,50,000

Number of times allotments to category 3

Proportionate allotments to category $1,50,000 \times 1/3 = 50,000$

- (c) Number of shares to be allotted to the successful allottees shall be arrived at on a proportionate basis i.e., total number of shares applied for by each applicant in that category multiplied by the inverse of the over subscription ratio. Schedule XVIII of basis of allotment procedure may be referred to.

Number of shares applied for by each applicant 100

Number of times oversubscribed 3

Proportionate allotment to each successful applicant $100 \times 1/3 = 33$

(to be round off to 100)

Notes

All the applications where the proportionate allotment works out to less than 100 shares per applicant, the allotment shall be made as follows:

- (i) Each Successful applicant shall be allotted a minimum of 100 securities; and
- (ii) The successful applicants out of the total applicants for that category shall be determined by drawl of lots in such a manner that the total number of shares allotted in that category is equal to the number of shares worked out as per (c) above.

If the proportionate allotment to an applicant works out to a number that is more than 100 but is not a multiple of 100 (which is the marketable lot), the number in excess of the multiple of 100 shall be rounded off to the higher multiple of 100 if that number is 50 or higher.

If such number is lower than 50, it shall be rounded off to the lower multiple of 100. As an illustration, if the proportionate allotment works out to 250, the applicant would be allotted 300 shares. If however the proportionate allotment works out to 240, the applicant shall be allotted 200 shares.

All applicants in such categories shall be allotted shares arrived at after such rounding off. If the shares allocated on a proportionate basis to any category is more than the shares allotted to the applicants in that category, the balance available shares for allotment shall be first adjusted against any other category, where the allocated shares are not sufficient for proportionate to the successful applicants in that category. The balance shares if any, remaining after such adjustment shall be added to the category comprising applicants applying for minimum number of shares.

As the process of rounding off to the nearer multiple of 100 may result in the actual allocation being higher than the shares offered, it may be necessary to allow a 10% margin. The final allotment may be higher by 10% of the net offer to public.

Reservation for Small Individual Applicants

The above proportionate allotments of securities in an issue that is oversubscribed shall be subject to the reservation for small individual applicants as described below:

- (a) A minimum 50% of the net offer of securities to the public shall initially be made available for allotment to individual applicants who have applied for allotment equal to or less than 10 marketable lots of shares or debentures or the securities offered, as the case may be.
- (b) The balance net offer of securities to the public shall be made available for allotment to individual applicants who have applied for allotment of more than to marketable lots of shares or debentures or the securities offered; and other investors including Corporate bodies/institutions irrespective of the number of shares, debentures etc. applied for.

- (c) The unsubscribed portion of the net offer to anyone of the categories specified in (a) or (b), shall/may be made available for allotment to applicants in the other category, if so required.

The drawl of lots (where required) to finalise the basis of allotment, shall be done in the presence of a public representative on the Governing Board of the Regional Stock Exchange. The basis of allotment shall be, signed as correct by the Executive Director/Managing Director of the stock exchange and the public nominee (where applicable) in addition to the lead merchant banker responsible for post issue activities and the Registrar to the Issue.

Notes

The stock exchange shall invite the public representative on a rotation based from out of the various public representatives on its governing board. The expression "reservation" shall mean reservation on Competitive Basis wherein allotment of shares is made in proportion to the shares applied for by the concern of reserved categories. Reservation on competitive basis can be made in a public issue to the following categories: Permanent employees (including working directors) of the company and in the case of a new company the permanent employees of the promoting companies.

Shareholders of the promoting companies in the case of a new company and shareholders of group companies in the case of an existing company.

Indian Mutual Funds

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

1. Adjusted earning per share

(a) 2001-02	₹ 0.41
(b) 2002-03	₹ 8.39
(c) 2003-04	₹ 13.82
(d) Weighted average	₹ 10.9

2. Price/Earning Ratio (P/E) in relation to issue price

(a) Based on 2003-2004 EPS	37.63
(b) Industry P/E	
(i) Highest	61.2
(ii) Lowest	0.8
(iii) Average	25.3

3. Returned on Net Worth

(a) 2001-02	27.36%
(b) 2002-03	28.77%
(c) 2003-04	33.45%
(d) Weighted average	30.88%

4. Minimum return on total network after issue needed to maintain EPS at ₹ 13.82

14.65%

5. Net asset value (NAV)

(a) As on 31-3-2004	₹ 46.40
(b) After issue	₹ 94.29
(c) Issue price	₹ 520.00

Book Building Guidelines

(Some important provisions)

There are two categories of provisions, one is for the issues where only 75% of the issue are book build and the other is when 100% of the issue is book build.

(A) 75 % Book Building process: In an issue of securities to the public through a prospectus, the option of 75 percent building is available to all body corporate which are otherwise eligible to make an issue of capital to the public. The book building facility shall be available as an alternative to, and to the extent of the percentage of the issue which can be reserved for firm allotment.

The issue of securities through book-building process shall be separately identified/ indicated as 'placement portion category' in the issued prospectus. The draft prospectus containing all the information except the information regarding the price at which the securities are offered shall be filed with the Board. It shall, of course, indicate the price band within which the securities are being offered for subscription.

One of the lead merchant banker to the issue shall be nominated by the issuer company as a Book Runner and his name shall be mentioned in the prospectus. The copy of the draft prospectus filed with the Board may be circulated by the Book Runner to the institutional buyers who are eligible for firm allotment and to the intermediaries eligible to act as underwriters inviting offers for subscribing to the securities. The securities available to the public shall be separately identified as 'net offer to the public and the requirement of minimum 25% of the securities to be offered to the public shall also be applicable.

In case the book-building option is availed of, underwriting shall be mandatory to the extent of the net offer to the public. The Book Runner on receipt of the offers shall maintain a record of the names and number of securities ordered and the price at which the institutional buyer or underwriter is willing to subscribe to securities under the placement portion. The underwriter(s) shall maintain a record of the orders received by him for subscribing to the issue out of the placement portion.

The underwriter(s) shall aggregate the offers so received for subscribing to the issue and intimate to the Book Runner the aggregate amount of the orders received by him. The institutional investor shall also forward its orders, if any, to the book runner. On receipt of the information, the Book Runner and the issuer company shall determine the price at which the securities shall be offered to the public. The issue price for the placement portion and offer to the public shall be the same.

On determination of the price of the underwriter shall enter into an underwriting agreement with the issuer indicating the number of securities as well as the price at which the underwriter shall subscribe to the securities. Book Runner can require the underwriters to the net offer to the public to pay in advance all money required to be paid in respect of their underwriting commitment.

On determination of the issue price within two days, thereafter the prospectus shall be filed with the Registrar of Company. The issuer company shall open two different accounts for collection of application money, one for the private placement portion and the other for the public subscription.

One day prior to the opening of the issue to the public, Book Runner shall collect from the institutional buyers and the underwriters the application forms along with the application money to the extent or the securities proposed to be allotted to them/subscribed by them.

Allotments for the private placement portion shall be made on Issue Management the second day from the closure of the issue. It is to be ensured that the securities allotted under placement portion and , public portion are pari passu in all respects. The issuer company may have one date of allotment which shall be the deemed date of allotment- for the issue of securities through book building process. Allotment of securities under the public category shall be made as per SEBI guidelines and such securities shall be eligible to be listed.

(B) 100% Book Building Process: An issuer company can make 100% issue of securities to the public through book building either as

- (a) 100% of the net offer to the public through book building process, or
- (b) 75% of the net offer to the public through book building process and 25% at the price determined through book building.

Book Building shall be for the portion other than the promoters contribution and the allocation is made to:

- (a) permanent employees of the issuer company and in the case of a new company the permanent employees of the promoting companies;
- (b) Shareholders of the promoting companies in the case of a new company and shareholders of group companies in the case of an existing company either on a competitive basis or on a firm allotment basis.

The primary responsibility of building the book shall be that of the Lead Book Runner. The Lead Merchant Banker shall act as the Lead Book Runner and the other eligible Merchant Banker(s) , so appointed by the issuer, shall be termed as Co-Book Runner(s). In case the issuer company appoints more than one book runner, the names of all such book runners who have submitted the due diligence certificate to SEBI, may be mentioned on the front cover page of the prospectus. A disclosure to the effect that the "investors may contact any of such book runners, for any complaint pertaining to the issues" shall be made in the prospectus, after the "risk factors". In case of appointment of more than one Lead Merchant Banker or Book Runner for book building, the rights, obligations and responsibilities of each should be delineated.

Notes

The Book Runner(s) may appoint those intermediaries who are registered with the Board and who are permitted to carry on activity as an Underwriter as syndicate members. The draft prospectus containing all the disclosures required except that of price and the number of securities to be offered to the public shall be filed by the Lead Merchant Banker with the Board but the total size of the issue shall be mentioned in the draft prospectus.

Such prospectus is called Red herring prospectus. The red herring prospectus shall disclose, only the floor price of the security offered through it and shall not mention the maximum price or the indicative price band. The Board within 21 days of the receipt of the draft prospectus may suggest modifications to it. The Lead Merchant Banker shall be responsible, for ensuring that modifications/final observations made by the Board are incorporated in the prospectus.

In case of an under subscription in an issue, the shortfall shall have to be made good by the Book Runner(s) to the issue and the same shall be incorporated in the inter se allocation of responsibility. The issuer company shall after receiving the final observations if any on the offer document from the Board make an advertisement in an English National daily with wide circulation, one Hindi National newspaper and a Regional language newspaper with wide circulation at the place where the registered office of the Issuer company is situated.

The advertisement so issued shall contain the salient features of the final offer document. The pre-issue obligations and disclosure requirements of SEBI Guidelines, shall also be applicable to issue of securities through book building. The Book Runner(s) and the issuer company shall determine the issue price based on the bids received through the syndicate members.

On determination of the price, the number of securities to be offered shall be determined (issue size divided by the price which has been determined). All those bidders whose bids have been found to be successful (i.e., at and above the final price or cut-off price) shall become entitled for allotment of securities.

On determination of the entitlement under sub-clause (xvi), the information regarding the same (i.e. the number of securities which the investor becomes entitled) shall be intimated immediately to the investors. The final prospectus containing all disclosures including the price and the number of securities proposed to be issued shall be filed with the Registrar of Companies.

Arrangement shall be made by the issuer for collection of the applications by appointing mandatory collection centres. The online real time graphical display of demand and bid prices at the bidding terminals, shall be made.

Additional Disclosures

Apart from meeting the already discussed disclosure requirements, the following disclosures shall also be suitably made:

- (i) The particulars of syndicate members along with the details of registrars, bankers to the issue, etc.

- (ii) The following statement shall be given under the basis for issue price:
 "The issue price has been determined by the Issuer in consultation with the Book Runner(s), on the basis of assessment of market demand for the offered securities by way of Book-building".

The following accounting ratios shall be given under the basis for issue price for each of the accounting periods to which the financial information is given:

Notes

1. EPS, pre-issue, for the last three years (as adjusted for changes in capital).
2. P/E, pre-issue and comparison thereof with industry P/E where available (giving the source from which industry P/E has been taken).
3. Average return on net-worth in the last three years.
4. Net-Asset value per share based on last balance sheet.
5. The accounting ratios disclosed in the offer document shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital shall be exercised.

Underwriting: In case the issuer company is making an issue of securities (100% of the net offer to them public or the book built portion - 75% of the net offer to the public) it shall be compulsorily underwritten by the syndicate members/book runner(s) and this shall apply to 60% of the net offer to the public, mandatorily to be allotted to the Qualified Institutional Buyers. The syndicate members shall enter into an underwriting agreement.

Procedure for bidding

An advertisement to the fact that 100% book building issue is to be made which shall contain the following:

- (a) the date of opening and closing of the bidding (not less than 5 days);
Issue Management
- (b) the names and addresses of the syndicate, members as well as the bidding terminals for accepting the bids;
- (c) the method and process of bidding. Bidding shall be permitted only if an electronically linked transparent facility is used.

The syndicate members shall be present at the bidding centres so that at least one electronically linked computer terminal at all the bidding centres is available for the purpose of bidding. The number of bidding centres, in case 75% of the net offer to the public is offered through the book building process shall not be less than the number of mandatory collection centres as specified in these regulations.

In case 100% of the net offer to the public is made through book building process, the bidding centres shall be at all the places, where the recognised stock exchanges are situated. Individual as well as qualified institutional buyers shall

place their bids only through the syndicate members who shall have the right to vet the bids. The investors shall have the right to revise their bids.

Notes

Bidding Form

- (a) Shall be a standard bidding form to ensure uniformity in bidding and accuracy.
- (b) Shall contain information about the investor, the price and the number of securities that the investor wishes to bid.
- (c) Before being issued to the bidder shall be serially numbered at the bidding centres and date and time stamped.
- (d) Shall be issued in duplicate signed by the investor and countersigned by the syndicate member, with one form for the investor and the other for the syndicate member(s)/Book Runner(s). At the end of each day of the bidding period the demand shall be shown graphically on the terminals for information of the syndicate members as well as the investors.

Allocational Allotment Procedure

- I. In case an Issuer company makes an issue of 100% of the net offer to public through 100% book building process:
 - (a) not less than 25% of the net offer to the public shall be available for allocation to retail individual investors i.e. investors applying for up to 1000 securities;
 - (b) not less than 15% of the net offer to the public shall be available for allocation to non-institutional investors i.e. investors applying for more than 1000 securities;
 - (c) not more than 60% of the net offer to the public shall be available for allocation to Qualified Institutional Buyers.
- II. In case an issuer company makes an issue of 75% of the net offer to public through book building, process and 25% at the price determined through book building:
 - (a) in the book built portion, not less than 15% of the net offer to the public, shall be available for allocation to non-institutional investors.
 - (b) the balance 25% of the net offer to the public, offered at a price determined through book building, shall be available only to retail individual investors who have either not participated or have not received any allocation, in the book built portion. 60% of the issue size shall be allotted to the Qualified Institutional Buyers.

Allotment to retail individual investors and non institutional investors, shall be made on the basis of the proportionate allotment system. The allocation to the Qualified Institutional Buyers, shall be determined by the Book Runner(s) based on prior commitment, investor quality, price aggression, earliness bids, etc. Allotment shall be made not later than 15 days from the closure of the issue failing which interest at the rate of 15% shall be paid to the investors.

Model Time

Frame for Book Building specified by SEBI shall be followed. In case the issuer company has made an issue of 75% of the net offer to public through book building process and 25% at the price determined through book building

- (a) the offer of 25% of the net offer to the public, made at a price determined through book building, shall open within 15 days from the date of closure of bidding;
- (b) the offer for subscription to the public, shall remain open for a period of atleast 3 working days after completing all the requirements of advertisement and dispatch of issue material to all the stock exchanges,
- (c) during the time when the offer is open, the investors who have whether received or not an intimation of entitlement of securities shall submit the application forms alongwith the application money.

Notes

Model Timeframe

After, the final observation from SEBI has been received on the offer document, the minimum number of application forms accompanied with Form 2A and offer document containing the final price, shall be dispatched to the members of the Stock Exchange. However, the issue opening and closing date shall be mentioned in the application form.

A minimum of 200 application forms per active member of the Stock Exchange where the securities of the issuer company are proposed to be listed and 10,000 forms each to other Stock Exchanges shall be dispatched. Further, minimum 1,000 offer document, containing the final observation received from SEBI, to each Stock exchange where the securities of the issuer company are proposed to be listed and minimum 200 offer documents, containing the final observation received from SEBI each to other Stock Exchange would also have to be dispatched.

These shall be dispatched subject to the condition that a minimum gap of 14 days is maintained between the receipt of these application and the issue opening date. After, the price has been determined on the basis of bidding the statutory public advertisement containing, inter-alia, the price as well as a table showing the number of securities and the amount payable by an investor, based on the price determined, shall be issued.

The statutory advertisement may be issued before the ROC filing. There shall be a minimum time gap of five (5) days between the statutory public advertisement and the issue opening date. The statutory public advertisement shall be issued for a continuous period of three days in an English National daily with wide circulation, one Hindi National paper and a Regional language newspaper with daily circulation at the place where the registered office of the issuer company is situated.

3.3.11 Designing and Pricing

Price is the sacrifice made by the consumers to get an item. They are very sensitive to what they sacrifice for a product. In price setting, marketers should consider consumers' ability to pay, demand of the product that exists, cost involved in producing the item, as well as the costs, prices, and offers of their competitors. **The Meaning and Role of Price** The price is what the consumer must give up in order to get the product. It is a representation of value placed on the product for purposes of exchange. Partially, this value is established by the marketing executive. Marketers incur certain costs in making, handling, storing, and selling the product.

These costs are usually covered in the selling price except certain expectations. Marketers seek some extra compensation over the actual costs so some profits are made by them. Costs and profit expectations, then, become the value the marketing executive places on the product. The value of the product is not always set by the marketer.

Buyers as well help determine value through their purchasing patterns. Buyers allocate their funds to the goods and services that maximize their short and/or long-run benefits. Buyers thus, place a trade-off value on the company's product by weighing the benefits of having the item against the cost of foregoing the purchase of other products or retaining their money. The price of the product, then, will be balanced between the seller's value and the buyer's trade-off value. Where these two are similar, the price will be appropriate. If they do not match, some change in values must occur or the product will fail in the marketplace, i.e. it will not sell well.

The nature of the value of the product determines the price related problems. In addition to the costs, the seller's expectations of profit and the buyer's trade-off values are variables. Not all sellers have the same profit expectations and not all buyers have the same perception of the benefits of having the product versus holding money or purchasing another product. Generally speaking, a product's price reflects the personal values of the seller and buyer.

Specifically, price has a somewhat different role, acting as a technical mechanisms for negotiations between individuals and groups of individuals who have goods, services, or money to trade. Truly speaking, price is the common denominator allowing sellers and buyers to make evaluations and complete their exchanges. You as a marketer should be in mind that, price is a means for allocating the nation's scarce resources. Raw materials, products, and services in relatively short supply tend to be more highly valued than those readily available.

Through the pricing system, sellers and buyers can better arrange their priorities and better utilize the resources of the economy. Price is a highly significant marketing variable directly affecting company's sales and profits. Price also has considerable symbolic value, conveying information about the company to potential buyers. A marketer should realize that his sales and profits

are heavily influenced by the prices of his products. An increase or decrease in price can mean higher or lower revenues. This assumption is not always realistic since price changes alter buyer's cost-benefit trade-off.

Generally, when the price increases, consumer demand falls and vice versa. But total taka sales can increase even though demand declines. Similarly, total taka sales can rise when prices decline and consumer demand greatly increases. Though consumers are sensitive to price changes, but the degree of sensitivity depends on many factors such as consumer's financial status, availability of new products and so on.

The price set by marketing executive is also important as consumers relate a product's price to such factors as quality, progressiveness, and social status, psychological satisfaction and so on. They usually equate higher prices with better quality, modern, and more fashionable products. This image carries over to a company's other products as well as to the company itself affecting the future of the company. Stages for Establishing Prices We have already examined the nature and importance of price. It is now time to move on to the stages followed in price setting.

Setting price for the first time is a real challenge to a firm and it faces this situation when it plans to launch a new product, or introduce an existing one into a new distribution channel, or area, or participates in a bid. In setting its pricing policy, a firm has to consider quite a number of factors and proceed following a logical process consisting of seven steps. They are: selection of pricing objective; assessment of target market's evaluation of price and its ability to purchase; determination of demand; analysis of costs; analysis of competitors' costs, prices, and offers; selection of a pricing method; and, determination of a specific price. Following figure shows the stages involved in price setting.

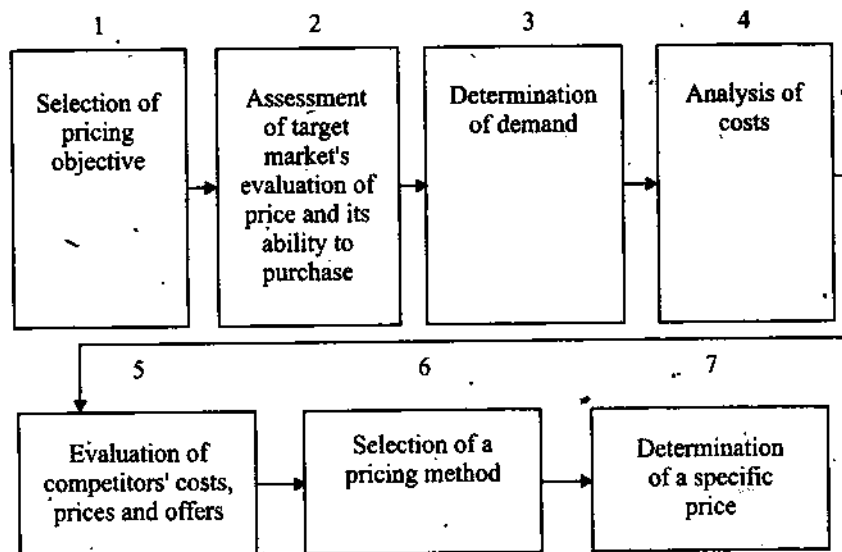


Figure 1: Stages Involved in Price Setting

We shall discuss each of them in turn:

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Pricing objectives

Pricing of goods and services is often a critical factor in the successful operation of business organizations. Although the basic pricing ingredients (costs, competition, demand, and profit) are the same for all firms, the optimum mix of these factors varies according to the nature of products, markets, and corporate objectives. The manager's job is to develop and implement a pricing strategy that meets the needs of a particular company at a certain point in time.

Many different ways of handling prices are observed. Prices are often set by top management rather than by marketing or salespeople in smaller companies, while, division and product-line managers handle prices in larger companies following the general pricing policies and objectives set by the top management.

Selecting the pricing objective means deciding in advance what the company wants to achieve through offering its product. The marketing mix strategy of a firm including price becomes easier if the company is able to select its target market and position the product correctly. A firm can easily set price of its product if it can clearly set its objectives. Pricing objectives are overall goals that describe the role of price in an organization's long-range plans. Pricing objectives will influence decisions in most functional areas. The objectives must be consistent with the organization's overall objectives.

Because of the many areas involved, a marketer often uses multiple pricing objectives. Here we shall look at some of the typical pricing objectives pursued by the marketing executives. One of the six major objectives can be pursued by a firm through its pricing, such as survival, maximum current profit, maximum sales growth, product quality leadership, maximize current revenue, or maximum market skimming. We shall now discuss in turn each of these objectives:

- **Survival:** A fundamental pricing objective is to survive. Most organizations will not tolerate short-run losses, internal upheaval, and almost any other difficulties if they are necessary for survival. Since price is such a flexible and convenient variable to adjust, it sometimes is used to increase sales volume to levels that match the organization's expenses. If a company is plagued with over-capacity, intense competition, or changing consumer wants, it can pursue the survival objective. It is a short run objective pursued by different companies to ensure survival. Companies here cut prices without considering profit margin in such a way that covers variable costs and some fixed costs in order to sustain.
- **Maximum Current Profit:** It is another pricing objective being pursued by many companies; and they set a price that guarantees maximum current profit. This objective does not always guarantee maximum profit particularly in the long run because the company overlooks the effects of other marketing mix variables, legal restraints on price, and competitors' reactions. The other problem associated

with it is that a company set price here taking into account the demand and cost functions which can hardly be estimated accurately.

- **Maximum Sales Growth:** Pursuing this objective means setting price at the lowest level to ensure maximum sales in order to lower unit cost thus maximizing long-run profit. This can also be termed as market-penetration pricing, and consumers are here thought of as highly sensitive to prices. In order to pursue this strategy three conditions must prevail. They are: the market is price sensitive, and market growth is stimulated by low price; accumulated production experience reduces production and distribution costs; actual and potential competitions are discouraged by low price.
 - **Product-Quality Leadership:** A company might have the objective of product quality leadership in the market. If a company aims to be the product-quality leader in the market it can pursue this pricing objective. Here the company sets prices at a higher level (compared to competitors) to give the market an idea that its product is superior in terms of quality, durability, functional performance and so on (it obviously produces a high quality product). The price is also charged high here to cover high product quality and the high cost of research and development.
 - **Maximise Current Revenue:** Here the price is set based on demand function with the aim of maximizing sales revenue. It is hoped that market share growth and profit maximization will be achieved in the long-run if this objective is pursued.
 - **Maximum Market Skimming:** In this objective, price is set at a high level. This objective is pursued particularly in case of new or innovative product with the hope that some segments will buy the product because of the newness even paying a higher price. When these segments become sour, the company will lower price to attract new segments and continues to follow the same method as long as the product is sold and thus skims the market. Under the following conditions, market skimming strategy works:
 - If a sufficient number of buyers have a high current demand
 - If the unit costs of producing a small volume are not so high that they cancel the advantage of charging what the traffic will bear
 - If the high initial price does not attract more competitors to the market
 - If the high price communicates the image of a superior product.
- Other Pricing Objectives** There are some other pricing objectives some of which are followed by business organizations, and others by nonprofit, social, or public organizations. They are: achieve a target market share; achieve a target return on investment, maximize cash flow, meet or prevent competition, stabilize prices, support other products, partial cost recovery (may be pursued by an educational institution), full cost

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recovery (may be pursued by a non profit maternity clinic), and social price geared to the varying income situations of different clients (may be pursued by a nonprofit theatre company):

Let us now have a short discussion on them:

- **Achieve a Target Market Share:** Here, the marketing executive will estimate the total market potential and determine what share the product should obtain given the competition. The executive will then estimate how high (or low) the price should be set to achieve that market share.
- **Achieve a Target Return on Investment:** A more realistic pricing objective is achieving a target return on investment. Here, the marketer first determines the total costs of making and selling a certain number of units, including both the variable costs and the fixed costs. Thereafter, he decides on desired return on that investment. From that point, the executive will calculate a price that will yield that level of profitability.

For example:

Total cost to produce and sell 1,000,000 units	=	₹ 10,00,000
Desired return on investment	=	15%
Target profits	=	₹ 1,50,000
Selling price per unit (for 1,000,000 units)	=	₹ 1.15

- **Maximize Cash Flow:** Under this objective, the marketing executive may decide to price the product in a manner that maximizes the cash flow. It is assumed that sales are synonymous with cash. But in many instances, purchases are made on credit. If a company must pay its supplier before its customers pay, cash inflows will be slower than outflows of cash. In order to get rid of this problem, the marketing executive may have to induce consumers to either pay in cash or pay sooner than they would otherwise. Here, a marketer can make the cash price more attractive to buyer than a credit price or what is available from other sellers.
- **Meet or Prevent Competition:** There are situation where a marketer may be more concerned about the competition in the marketplace than with the actual performance of the product. In such situations he may simply price the product in a manner that nullifies price as a marketing variable, or discourages potential competition from entering the marketplace.
- **Stabilize Prices:** Here a marketer tries to create a consistent price for the product so that both the executive and potential buyers will know what price to expect and plan for. To stabilize prices, the marketing executive will generally meet competitive price changes as they occur, reducing the benefits to price modification, and resulting in a more stabilized price, which may help him to retain his customers.

Support Other Products: There are situations where a marketer will use a product as a loss leader in which a loss is taken on the product in order to enhance sales and profits of other products within the mix of the company's