What are the Chief Functions of the New Issue Market?

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

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

It, therefore, becomes imperative at this stage to classify new issues. One classification suggested by R.F. Henderson (c.f. The New Issue Market & Finance for Industry, 1951), categorises new issues into those by:

(a) New companies also called ‘initial issues’ and

(b) Old companies also called ‘further issues’.

These bear no relation to the age of the company, but are based on the fact whether the company already has stock exchange listing. This classification is thus concerned only with the flow of ‘new money’. Another classification (c.f. Merrett, Howe & New bould “Equity Issues and the London Capital Market” 1967) distinguishes between flow of funds into the market and flow of “new money” hence we have ‘new money issues’ or issues of capital involving newly created share and ‘no new money issues’ i.e. sale of securities already in existence and sold by their holders.

This is more an “exclusive” classification in that two types of issues are excluded from the category of new issues.

(a) Bonus/capitalisation issues which represent only book keeping entries.

(b) Exchange issues: by which shares in one company are/exchanged for securities of another.

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

(a) Origination

(b) Underwriting

(c) Distribution

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

(a) Origination:

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

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

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

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

(b) Underwriting:

The idea of underwriting originated on account of uncertainties prevailing in the capital market as a result of which the success of the issue becomes unpredictable. If the issue remains undersubscribed, the directors cannot proceed to allot the shares, and have to return money to the applicants if the subscription is below a minimum amount fixed under the Companies Act. Consequently, the issue and hence the project will fail.

Underwriting entails an agreement whereby a person/organisation agrees to take a specified number of shares or debentures or a specified amount of stock offered to the public in the event of the public not subscribing to it, in consideration of a commission the underwriting commission.

If the issue is fully subscribed by the public, there is no liability attaching to the underwriters; else they have to come forth to meet the shortfall to the extent of the under-subscription. The underwriters in India may broadly be classified into the following two types:

(i) Institutional Underwriters;

(ii) Non-Institutional Underwriting.

Institutional Underwriting in our country has been development oriented. It stands as a major support to those projects which often fail to catch the eye of investing public. These projects rank high from the points of view of national importance e.g. steel, fertilizer, and generally receive higher priority by such underwriters.

Thus institutional underwriting may be broadly recognised, in the context of development credit, as playing a decisive role in directing the economic resources of the country towards desired activities.

This does not mean that they are barred entrance in the issue market from so called glamorous issues to which public can be expected to readily subscribe. They may be underwriting in such cases, but what is expected of them is their support to projects in the priority sector.

One of the principal advantages they offer is that resource-wise they are undoubted. They are in a position to fulfill their underwriting commitments even in the worst foreseeable situations.

The public financial institutions namely IDBI, IFCI, ICICI, LIC and UTI, underwrite a portion of the issued capital. Usually, the underwriting is done in addition to granting term finance by way of loans on debentures. These institutions are usually approached when one or more of the following situations prevail:
(i) The issue is so large that broker-underwriting may not be able to cover the entire issue.

(ii) The gestation period is long enough to act as distinctive

(iii) The project is weak, inasmuch as it is being located in a backward area.

(iv) The project is in the priority sector which may not be able to provide an attractive return on investment.

(v) The project is promoted by technicians.

(vi) The project is new to the market.

The quantum of underwriting assistance varies from institution to institution according to the commitments of each of them for a particular industry.

However, institutional underwriting suffers from the following two drawbacks:

1. The institutional handling involves procedural delays which sometimes dampen the initiative of the corporate managers or promoters.

2. The other disadvantage is that the institutions prefer to wait and watch the results to fulfill their obligations only where they are called upon to meet the deficit caused by under subscription.

(c) Distribution:

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

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**Methods of Floating New Issues in the Primary Market**

by Priyanka Anand • January 28, 2013 • Comments Off on Methods of Floating New Issues in the Primary Market

The term capital Market refers to facilities and institutions arrangements through which long-term funds; both debt and equity are raised and invested. The Capital Market consists of development banks, commercial Banks and stock exchanges. The Capital market can be divided into two parts (a) Primary Market (b) Secondary Market

**Methods of Floating New Issues in the Primary Market**

Public issue: When a company raises funds by selling (issuing) its shares (or debenture / bonds) to the public through issue of offer document (prospectus), it is called a public issue. Initial Public Offer (IPO): When a (unlisted) company makes a public issue for the first time and gets its shares listed on stock exchange, the public issue is called as initial public offer (IPO).Follow-on public offer (FPO): When a listed company makes another public issue to raise capital, it is called follow-on offer (FPO).

Offer for sale: Institutional investors like venture funds, private equity funds etc., invest in
unlisted company when it is very small or at an early stage. Subsequently, when the company becomes large, these investors sell their shares to the public, through issue of offer document and the company’s shares are listed in stock exchange. This is called as offer for sale. The proceeds of this issue go to the existing investors and not to the company.

Private Placement: The sale of securities to a relatively small number of select investors for raising capital. Investors involved in private placements are usually large banks, mutual funds, insurance companies and pension funds. Private placement is the opposite of a public issue, in which securities are made available for sale on the open market.

Issue of Indian Depository Receipts (IDR): A foreign company which is listed in stock exchange abroad can raise money from Indian investors by selling (issuing) shares. These shares are held in trust by a foreign custodian bank against which a domestic custodian bank issues an instrument called Indian depository receipts (IDR). IDR can be traded in stock exchange like any other shares and the holder is entitled to rights of ownership including receiving dividend.

Rights issue (RI): When a company raises funds from its existing shareholders by selling (issuing) them new shares / debentures, it is called as rights issue. The offer document for a rights issue is called as the Letter of Offer and the issue is kept open for 30-60 days. Existing shareholders are entitled to apply for new shares in proportion to the number of shares already held.

Bonus Issue, the company issues new shares to its existing shareholders. As the new shares are issued out of the company’s reserves (accumulated profits), shareholders need not pay any money to the company for receiving the new shares.

IPO Process in India

The IPO process in India consists of the following steps:

- Appointment of merchant banker and other intermediaries
- Registration of offer document
- Marketing of the issue
- Post-issue activities

Appointment of Merchant Banker and Other Intermediaries

One of the crucial steps for successful implementation of the IPO is the appointment of a merchant banker. A merchant banker should have a valid SEBI registration to be eligible for appointment.

A merchant banker can be any of the following – lead manager, co-manager, underwriter or advisor to the issue.

Certain guidelines are laid down in Section 30 of the SEBI Act, 1992 on the maximum limits of intermediaries associated with the issue:

Size of the Issue

No. Of lead Managers

50 cr.
50 – 100 cr.

3

100 – 200 cr.

4

200 – 400 cr.

5

Above 400 cr.

5 or more as agreed by the board

The number of co-managers should not exceed the number of lead managers.

There can only be one advisor/consultant to the issue.

There is no limit on the number of underwriters.

Other Intermediaries

Registrar to the Issue: Registration with SEBI is mandatory to take on responsibilities as a registrar and share transfer agent. The registrar provides administrative support to the issue process. The registrar of the issue assists in everything from helping the lead manager in the selection of Bankers to the Issue and the Collection Centres to preparing the allotment and application forms, collection of application and allotment money, reconciliation of bank accounts with application money, listing of issues and grievance handling.

Bankers to the Issue: Any scheduled bank registered with SEBI can be appointed as the banker to the issue. There are no restrictions on the number of bankers to the issue. The main functions of bankers involve collection of application forms with money, maintaining a daily report, transferring the proceeds to the share application money account maintained by the controlling branch, and forwarding the money collected with the application forms to the registrar.

Underwriters to the Issue: Underwriting involves a commitment from the underwriter to subscribe to the shares of a particular company to the extent it is under subscribed by the public or existing shareholders of the corporate. An underwriter should have a minimum net worth of 20 lakhs, and his total obligation at any time should not exceed 20 times the underwriter’s net worth. A commission is paid to the writers on the issue price for undertaking the risk of under subscription. The maximum rate of underwriting commission paid is as follows:
Nature of Issue

On amount Devolving On Underwriters

On amounts subscribed by public

Equity shares, preference shares and debentures

2.5%

2.5%

Issue amount upto Rs.5 lakhs

2.5%

1.5%

Issue amount exceeding %

2.0%

1.0%

Broker To the Issue: Any member of a recognised stock exchange can become a broker to the issue. A broker offers marketing support, underwriting support, disseminates information to investors about the issue and distributes issue stationery at retail investor level.

Registration Of The Offer Document

For registration, 10 copies of the draft prospectus should be filed with SEBI. The draft prospectus filed is treated as a public document. The lead manager also files the document with all listed stock exchanges. Similarly, SEBI uploads the document on its website www.sebi.com. Any amendments to be made in the prospectus should be done within 21 days of filing the offer document. Thereafter the offer document is deemed to have been cleared by SEBI.

Promoters Contribution: In the public issue of an unlisted company, the promoters shall contribute not less than 20% of the post issue capital as given in Chapter- IV of the SEBI Act, 1992. The entire contribution should have been made before the opening of the issue.
Lock-in Requirement

The minimum promoters contribution will be locked in for a period of 3 years. The lock-in period commences from the date of allotment or from the date of commencement of commercial production, whichever is earlier.

Marketing of the Issue

Timing of the Issue
Retail distribution
Reservation of the Issue
Advertising Campaign

Timing of the Issue

An appropriate decision regarding the timing of the IPO should be made, keeping in mind the general sentiments prevailing in the investor market. For example, if recession is prevailing in the economy (the investors are pessimistic in their approach), then the firm will not be able to get a good pricing for its IPO, as investors may not be willing to put their money in stocks.

Retail distribution:

Retail distribution is the process through which an attempt is made to increase the subscription. Normally, a network of brokers undertakes retail distribution. The issuer company organises road shows in which conferences are held, which are attended by high networth investors, brokers and sub-brokers. The company makes presentations and solves queries raised by participants. This is one of the best ways to raise subscription.

Reservation in the Issue

Sometimes reservations are tailored to a specific class of investors. This reduces the amount to be issued to the general public. The following are the classes of investors for whom reservations are made:

- Mutual Funds
  - Banks and Financial Institutions; Non-resident Indians (NRI) and Overseas Corporate Bodies (OCB) The total reservation for NRI/OCB should not exceed 10% of the post-issue capital, and individually it should not exceed 5% of the post issue capital.
  - Foreign Institutional Investors (FII): The total reservation for FII cannot exceed 10% of the post-issue capital, and individually it should not exceed 5% of the post issue capital.
- Employees: Reservation under this category should not exceed 10% of the post issue capital.
- Group Shareholders: Reservation in this category should not exceed 10% of the post issue capital.

The net offer made to the public should not be less than the 25% of the total issue at any point of time.

Post-Issue Activities

Principles of Allotment: After the closure of the subscription list, the merchant banker should inform, within 3 days of the closure, whether 90% of the amount has been subscribed or not. If it is
not subscribed up to 90%, then the underwriters should bring the shortfall amount within 60 days. In case of over subscription, the shares should be allotted on a pro-rata basis, and the excess amount should be refunded with interest to the shares holders within 30 days from the date of closure.

Formalities Associated With Listing: The SEBI lists certain rules and regulations to be followed by the issuing company. These rules and regulations are laid down to protect the interests of investors. The issuing company should disclose to the public its profit and loss account, balance sheet, information relating to bonus and rights issue and any other relevant information.