Regulatory Transition in Initial Public offers of Corporate Sector: An Indian Perspective

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ABSTRACT

Indian corporate securities market primary as well as secondary has grown in terms of financial products and volume of trading. A wide range of the financial products made regulators to bring several changes in the existing procedures. In the last decade several changes have been introduced by the Securities Exchange Board of India in the process of making initial public offers. The Company Act 1956 and 2013, Securities Contract (Regulation) Act 1956 and the Securities Exchange board of India induced several changes in context of eligibility requirement, process simplification, existing definition of products and parties. We observed that all these changes were introduced to make healthy philanthropic process. The relevant credentials of pertinent act as well recent reform substantiates it very well. It complements the extant literature by presenting recent reforms in systematic manner.

Keywords
Reforms, Companies Act 1956, Security Exchange Board of India, Initial Public Offer

1. INTRODUCTION

Securities Exchange Board of India (SEBI) became the principle regulator agency in the capital market when government of India on 25 Jan., 1995 promulgated an Ordinance to amend the Securities Exchange Board of India Act 1992. The motive behind the move of the government was to arm the SEBI with additional power for ensuring the orderly development of the Capital market and to enhance the ability to protect the interest of the investors. Since 1995, SEBI is working as the regulator of Industrial securities market. Liability of ‘New Issue Market’ was entrusted to SEBI after abolitions of CCI in 1992. Before 1992 Controller of capital issue (CCI) was the only body dealing with pricing of IPO. Earlier for filing of application to any initial public offer, there was a different physical setup and a heap of paper based application had to maintain by the appointed intermediaries. Now SEBI has made it possible to file the application for fresh industrial securities by using the physical infrastructure of stock exchanges. In India Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) now entertaining the application for fresh issues; by making their screen based system available for use of intermediaries to the issue. These major stock exchanges of India were established in 1992 and 1875 respectively; now fully demutualized. These exchanges are basically serving as platform for industrial securities and hybrid financial products. Beside NSE, BSE regional stock exchanges are also there. On regional stock exchange trading activities are minimal. Both Stock Exchange are functioning under the surveillance of Securities Exchange Board of India (SEBI). Both primary as well as secondary securities can be mobilized through major stock exchanges in India. Stock exchanges are not only providing marketability to the industrial securities in secondary market but also, proving help in procurement of funds through fresh industrial securities. Market for initial public offers (IPO) and stock market (secondary market) are economically an integral part of a single market i.e, industrial securities market. The IPO market and the secondary market act and react on each other. Public response is encouraging in the IPO market when there is boom in stock market. During slump period of secondary market (stock exchange) the response of the public tends to decline in IPO market. For better functioning of IPO market SEBI has streamlined the functioning of IPO market through various reforms. Any initial public offer is covered by the Provisions of the Companies Act, 1956; Securities Contracts (Regulations) Act, 1956, SEBI rules & regulations; Compliance of Listing Agreement with the concerned stock exchanges after the listing of securities and RBI regulations in case of foreign/NRI equity participation. There are a number of intermediaries that plays an important role in the process of making an public offer like merchant bankers, registrar & share transfer agents, bankers to the issue, underwriters, stock brokers and sub-brokers, depositories. The main concern of the Company Act 1956 is with the provisions relating to prospectus, Securities Contract (Regulation) Act 1956 is concerned with the provisions on minimum subscription, allotment, return of Allotment and Securities Exchange Board of India has power under section 55 A, to make rules relating to Issue & transfer of securities. Companies Act 2013 has widened the power of SEBI in context of listed companies. From prospectus preparation and filing, to till final allotment of shares several reformatory measures have been introduced to increase the transparency in the process.
2. OBJECTIVE OF THE STUDY

The objective of the study is to present a systematic layout of the reform that has been brought in by the regulator to enhance the better functioning in initial public offer market.

3. RESEARCH METHODOLOGY

The study is exploratory in nature. Hence to attain the objective of the study the research work is organised in three parts. The first part of the study deals with the identification of time horizon and source of data and the second part of the study document the major reforms that have been brought in by regulator of IPO market.

Data and source of Data

The study is based on qualitative data. As we know qualitative data can be obtained from in depth interview, direct observation, written document etc. In the study we are using various written document which are available on the website of SEBI (specifically from annual reports of SEBI) or Reserve Bank of India and other documents.

4. REGULATORY CHANGES & REFORMS IN PHASES OF INITIAL PUBLIC OFFER

We have tried to capture the reforms in IPO market in three dimensions and organized it accordingly. The first part converses the regulatory developments in IPO process by companies act 1956 or under companies act 2013. The second part is the accumulation of changes which brought in IPO process by Securities Contract (Regulation) Act 1956. The third part presents the regulatory measures adopted by SEBI to improve the growth, functioning and transparency in the IPO process as well as in IPO market. The process of making an IPO is tedious as well as time consuming. From Beginning to end a number of parties remain involved in the whole process.

But the whole process of making an IPO falls under the scope of Companies Act 1956 & 2013, Securities Contract (Regulation) Act 1956 and finally the Securities Exchange Board of India. Modification in the earlier provision and guidelines taking place from these sources in order to accelerate the growth in IPO market and to make the practices more fair reliable. The reforms which have been transmitted in IPO market by these controllers.

A. Initial public offers and Companies Act 1956 & 2013

Under sec (73) of companies act before issue of a prospectus document, company seeking funds through fresh equity instruments has to send an application to one or more stock exchanges. Company act basically deals with the prospectus related rules. SEBI has got the right to administer the issue and transfer and non-payment of dividend of those companies which are listed or intended to be listed on the stock exchange.

Now under sec (25) it is given that the any document by which offer for sale of equity or debenture to public is made will be considered prospectus and the person who is making offer for sale such offer for sale should be made on behalf of company. If a firm is making such offer for sale than it should be signed two directors, and if partnership firm is holder of the shares than offer for sale of the shares of a company can be made by partners of the firm having more than or equal to half share in the firm.

The section (26) is meant for the disclosures in the prospectus document. Now no statement of the expert can be part of the prospectus document. And registrar of company has to issue the prospectus with in the ninety days of its submission to the registrar of the company. In the prospectus document which is to be submitted with the registrar now it is not mandatory to disclose the rating given by rating agency and the details of the property purchased the amount of debenture redeemed and outstanding preference share. Now guideline for preparation of prospectus document has been made simple in comparison to earlier one.

In section 27 of the act there is a great change earlier as per this section a company was not allowed to vary from the terms of the contract or objects referred to in
accompanying a brief prospectus. The application form for the securities should be available for each type of companies. Under section 31 now only public financial institutions, public sector banks, scheduled bank are allowed to issue the self prospectus earlier the provision was equally applicable on all type of securities. The amount of share has been allotted by the company and the same is allotted (a document which tells to whom and how much share has been allotted by the company) and the same is prescripted by the SCRR.

In section 33, there is slight modification instead of equity shares now it is mandatory for all type of securities that the application form for the securities should be accompanied by a brief prospectus. In section 39 there is also slight modification now a company has to receive the minimum subscription with in the 30 days or as it will be prescribed by SEBI. Earlier there was a time frame was of 120 days. Now a company coming for the public issue has to file the return of the allotment (a document which tells to whom and how much share has been allotted by the company) and the same is equally applicable on all type of securities. The amount of the application can’t be less than 5 percent of the nominal value of the securities earlier the percent it was 10 percent. In the similar manner as per section 40 it was mandatory in context of equity share to mention the name of the stock exchange where the securities has to be dealt now each type of instrument falls in the scope of the section.

B. Initial public offers and Securities Contract (Regulation) Act 1956

The sections under the act the modification in any section made by SEBI in context of initial public offers has been identified and documented as under.

Prior to September 1993, Rule 19 (2) (b) of the SCRR required a minimum public offer of 60% of the issued capital of a company for getting listed on a recognized stock exchange. The securities taken or agreed to be taken by the Governments or select financial institutions, up to a maximum of 11%, could form part of 60% of the public offer. It empowered the stock exchanges to relax this requirement, with the previous approval of the Central Government, on being satisfied that the securities sought to be listed were not unduly concentrated in a few hands. It also empowered the Central Government to waive or relax the strict enforcement of any or all of the requirements with respect to listing prescribed by the SCRR. Depending on the circumstances, the minimum size of the public offer was being relaxed frequently by means of administrative guidelines. A variety of relaxations was granted to FERA companies, new companies with foreign/NRI equity participation, etc., while a variety of further requirements such as minimum issued capital, minimum public offer in terms of face value, minimum number of public shareholders, etc., were prescribed. Relaxations were granted for individual companies on a case-by-case basis as well as for classes of companies. A major relaxation was granted by permitting non-FERA companies incorporated in India. Rule 19 (2) (b) was amended on September 20, 1993 by which the minimum public offer by a company for getting listed on a stock exchange was brought down to 25% from the earlier norm of 60% or such other percentage as was admissible under the guidelines of the Government. This was done to encourage the listing of a large number of companies to broaden the market. The securities taken or agreed to be taken by the Governments or select financial institutions did not form part of the 25% of the public offer. It restricted the power of the stock exchanges to relax this requirement only in respect of a Government company with the previous approval of the Central Government (SEBI from December 1996). It also empowered the Central Government (SEBI from December 1996) to waive or relax the strict enforcement of any or all of the requirements with respect to listing prescribed by the SCRR.

SCRR-Amendment dated 4.6.2010

The minimum threshold level of public holding is 25% for all listed companies. Existing listed companies having less than 25% public holding have to reach the minimum 25% level by an annual addition of not less than 5% to public holding. For new listing, if the post issue capital of the company calculated at offer price is more than Rs. 4000 crore, the company may be allowed to go public with 10% public shareholding and comply with the 25% public...
shareholding requirement by increasing its public shareholding by at least 5% per annum.

SCRR-Amendment dated 4.6.2010

For companies whose draft offer document is pending with Securities and Exchange Board of India on or before these amendments are required to comply with 25% public shareholding requirement by increasing its public shareholding by at least 5% per annum, irrespective of the amount of post issue capital of the company calculated at offer price. A company may increase its public shareholding by less than 5% in a year if such increase brings its public shareholding to the level of 25% in that year.

Every listed company shall maintain public shareholding of at least 25%. If the public shareholding in a listed company falls below 25% at any time, such company shall bring the public shareholding to 25% within a maximum period of 12 months from the date of such fall.

C. Issue of capital and disclosure (requirements) regulations, 2009

Promoter related disclosures and requirement

Before making the public issue it is to be disclosed that the Issuer, its promoter group or directors or persons in control of the issuer is not debarred from accessing capital market and promoters, directors or persons in control of the issuer are not promoters, directors or person in control of any other company which is debarred from accessing capital market.

Free pricing and price band:

SEBI allows free pricing of equity shares in an IPO. It is discretion of the issuer to mention the floor price or price band of the share in read hearing prospectus. Issuer can open floor price of the price band at least 2 working days before the opening of the bid in case of initial public offer in case of FPO the price can be disclosed at least one day before the opening of the bid. Under the regulation to retail investors share can be issued at a discount of 10 percent in comparison to other categories of the investors. Now differential pricing is permissible in a public issue to retail investors and retail individual holder.

Promoter’s Contribution & Lock In

- Shares acquired for consideration other than cash and revaluation of assets or capitalization of intangible assets.
- Shares allotted on account of bonus issue, out of revaluation reserves or reserves without accrual of cash resources.
- Shares allotted at a price lower than the price at which equity is being offered to public during the preceding one year.
- Applications received for less than Rs. 25000 per applicant in case of each individual and Rs. 1 lakh from firms and companies.

Promoters Contribution to be brought in before the issue

Promoters are required to bring the full amount of promoters’ contribution at least one day prior to the opening of public issue and should be kept in an escrow account with a scheduled bank. The said amount shall be released after the finalization of the basis of allotment with the proceeds of public issue. However, if the promoters’ contribution has been brought prior to the public issue and has been utilized by the Company, the Company is required to insert cash flow statement in the prospectus in this regard disclosing the use of such fund received from the promoters. If the minimum promoters’ contribution exceed Rs. 100 crores, the promoters are required to bring at least Rs. 100 crores before the opening date of public issue and the balance contribution can be bought by the promoters in advance on pro rata before calls are made to the public.

Lock in Requirements

The eligible promoters’ contribution is locked in for 3 years. The entire pre-issue share capital, other than that locked-in as promoters’ contribution, shall be locked-in for a period of one year. The shares held by promoters and are locked-in may be pledged with banks or financial institutions for loans, provided the pledge of shares is one of the terms of the sanction of loan. The locked-in shares held by promoters can be transferred between promoters provided they are disclosed as promoters in the prospectus and there would be no change in the period of lock-in. But there is exemption from the lock in requirements. In case of public issue of securities by a company which has been listed on a stock exchange for at least 3 years and has a track record of dividend payment for at least 3 immediately preceding years Or in case of companies where no identifiable promoter or promoter group exists; or in case of right issues.

D. Initial public offer market and Securities Exchange Board of India

SEBI brought several changes in the procedures of public issue in order to make the public issue transparent and a worthy investment. It has been tried to document the
regulatory changes that have been introduced by the regulator from 1999 till June 2014.

In May 1999 the criteria of minimum net worth was introduced besides provision of free pricing introduced to have premium issue. In the 1999-2000 major regulatory changes brought in by the regulator in the context of public issue to increase the investors base. Before 1999-2000 the standard denomination for the share was rs. 10 and rs 100 SEBI permitted to companies with dematerialized shares to issue their share at any denomination of any natural number, but the face value of the shares has to be disclosed with market quotation. one set of entry norms and disclosures made for the companies irrespective of the issue price. Before it there was a separate set of rules for the public issues at par, at discount and at premium. In the same year it was permitted to make use of the secondary market’s infrastructure (eg. Terminal, broker, computers etc.) to facilitate the process of public issue, before it the primary issue process was burdened with printing of a large number of application forms and dispatching of refund orders and, therefore, was leading to increase in cost and time required for the public issues. It leads to reduce the cost and time involved in a public issue process and does away with the blocking of funds of the investors. It became necessary for issuing company to keep securities in de materialized form, but investors were allowed to exercise option of either subscribing to securities in physical form or de materialized form. In the same year it was decided to lock the entire pre – issue capital, if any allotment was made to the investors who had the shares below the public issue price. In the same year disclosure and investor protection guidelines were also amended. Appointment of registrar for the rights issue was a major step in the dimension. Promoter contribution has been made uniform at 20 percent with an acceptable lock-in period, irrespective of the issue size. In the year 2013 the regulation changed and increased the promoters holding stake up to 25 percent. The companies belongs to information technology were instructed to express the same through their names, these company were restricted to make a follow on public issue up to 10 percent of post issue capital while other firms can float, up to 25 percent of the post issue capital. It was stipulated that unlisted companies in the information technology industry should have a track record of distributable profits in three out of five years from the information technology activities. October 1999 first time book building mechanism got approval and issuer has been given the option to book build either 90 per cent of the net offer to the public or 75 per cent of the net offer to the public. At that time to follow book building price mechanism for price discovery was optional. At present 90 per cent book building is mandatory. In the same year In order to harmonize the disclosure requirements under the Listing Agreement and the Accounting Standards issued by Institute of Chartered Accountants of India (ICAI), it has been prescribed that the Cash Flow Statement being disclosed by the companies in terms of Listing Agreement be prepared in accordance with the relevant Accounting Standard. Simultaneously, in order to avoid the volatility in the stock prices it was prescribed to made announcement of dividends, right, bonus issue outside the market hours. SEBI issued guidelines on employee stock options in 1992 and modified it in the year 1995 and 1999.

In July 2001 minimum dilution reduced from 25 percent to 10 percent at the time of IPO and minimum number of 1000 shareholders should be there in a public issue. In the year 2006, securities and exchange board of India (Merchant Bankers) rules, 1992 was amended. Since then it has become necessary for a person or an entity to have a certificate of registration to work as a merchant banker. The person or entity without registration certificate cannot act as a merchant banker to the issue. The certificate remains valid for a period of three years from the date of the issue of a certificate to the person or entity acting as a merchant banker. In case of any grievance to investors a investment banker has to take necessary step within the one month of the receipt of the complain and has to inform SEBI about the number, nature and other particulars of the complaints received.

In 2007 SEBI made it mandatory for every initial public offer which came after April 2007 to have grading by a certified rating agency. The step was taken to disclose the quality of the financials at the time of public issue.

Sept 2008 SEBI introduced a new mode of payment in public issues through book building called Applications Supported by Blocked Amount (ASBA). The application money under ASBA system remains blocked in the bank account of the applicant till finalization of allotment which was supplementary to the existing process of applying in public issues through cheque/draft. Shares which were held by shareholders for a period of at least one year at the time of filing of draft offer document for a public issue were eligible, to be included for computing promoters contribution or to be offered for sale. Prior to year 2008-09 for every initial public offer through book building mechanism it is mandatory to disclose the floor price or price band in the Red Herring Prospectus (RHP). In the year 2008-09 an initial public offer were permitted to announce the floor price or price band at least two working days before the issue opening date subject to fulfillment of certain disclosure requirements. In April 2008 regulator reduced filing fees for offer documents by amending SEBI (Buy back of Securities) Regulations, SEBI (Merchant Bankers) Regulation, 1992 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

To ensure the certain minimum level of subscription from qualified institutional buyers (QIBs) despite bullish
phase of the market in July 2009 SEBI introduced the concept of ‘Anchor Investors. An Anchor investor allowed to make application of minimum Rs. 10 crore for a lock in period of 30 days.

In the year 2010-11 minimum promoters contribution guidelines were removed in context of follow on public issue of a corporate entity if it has a track record of dividend payment for 3 years and equity shares of the company were frequently traded on a recognized stock exchange. On 6 April 2010 ASB facility made available for Qualified Institutional Buyers (QIBs) in all public issue that were floated after 2010. Before April 2010 the time lag between closing of a issue and its listing was around 22 days. SEBI decided to reduce the time between issue closure and listing to 12 working days. May 2010 In order to lay down the framework for recognition and supervision of stock exchanges/platforms for issue, listing and trading of the securities issued by the SMEs, necessary amendments have been made in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, SEBI (Merchant Bankers) Regulations, 1992, SEBI (Foreign Institutional Investors) Regulations, 1995, SEBI (Venture Capital Funds) Regulations, 1996, SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 and SEBI (Stock Brokers and Sub-brokers) Regulations, 1992. October 2010 In order to increase retail investor participation and to keep pace with inflation, monetary limit on the retail individual investor application was increased from Rs. one lakh to Rs. two lakh.

Corporate entity that floats their IPOs through the profitability track, from 2011-12 it became mandatory for such corporate entity to comply the track record of their distributable for at least three out of the immediate preceding five years on a consolidated basis as well as on stand-alone basis. 2011-12 To comply with the amended rule 19(2) (b) of Securities Contracts (Regulation) Rules, 1957, which requires the listed companies to achieve and maintain a minimum public shareholding at 25 percent (10 percent for public sector companies), 2 additional methods viz. Institutional Placement Programme (IPP) and Offer for Sale of Shares (OFS) through the stock exchange mechanism were introduced. IPP may be used by way of fresh issue capital or by dilution by promoters through an offer for sale. But the provision of offer through IPP was permitted in favor of qualified institutional buyers (QIBs) only. IPP, the issuer is required to announce a floor price or price band at least one day prior to the opening of the offer. The allotment of shares may be made on price priority basis, proportionate basis or on pre-specified criteria as disclosed in the offer document. Since 27 sept, 2011 each merchant banker to the issue has to disclose the information of past issue handled by them along with their prices. 16 may 2011 Investors eligible for discount in public issues permitted to make payment, net of discount, if any, at the time of bidding. Feb 2012 SEBI has notified the standardised lot sizes for SMEs in case of initial public offer and secondary market trading on SME exchange. In the same year a separate trading platform for small and medium sized enterprises were opened up at Bombay stock exchange (BSE) and at National Stock Exchange (NSE).

In 2012 it was held that application form for any public issue will contain the information which are mandatory for bidding and for resolution of post-issue complaints. Some redundant provisions were weeded from the prospectus document and regulator made the abridge prospectus more investor friendly.

2012-13 In accordance with the provisions of the Securities Contracts (Regulation) Rules, 1957, SEBI had specified certain means for the listed companies to achieve minimum public shareholding requirements like rights or bonus issues to public shareholders, with promoters/promoter group shareholders forgoing their entitlement for the purpose of achieving compliance. Further, it has also been prescribed that listed entities desirous of achieving the minimum public shareholding requirement through other means / relaxation from the available methods may approach SEBI with appropriate details. In the same year To provide flexibility to issuers on qualified institutional placement (QIPs), a maximum discount of 5 percent can be given on issue price but subject to shareholders permission. The minimum application size for all investors has also been increased to `10,000 - 15,000 as against ` 5,000 - 7,000 prescribed earlier.

In the year 2014 in order to attract the retail investors large-scale changes to rules governing the primary market have been made by the Securities Exchange Board of India (SEBI). From 2014 every retail investor will get the allotment in IPOs irrespective of the size of the application. Before June 2014 allotment to applicants of IPOs were executed firstly, on a proportionate basis, then on a lottery basis. As a result allotment is now guaranteed to retail investors. Besides, it the minimum application size of all retail investors doubled from the current Rs 5,000-Rs7,000 to Rs 10,000 and Rs 15,000. In order to bring down the time line of the public issue, SEBI encouraged the broker by giving more incentives so that they can encourage the use of application supported by blocked amount (ASBA) among retail investors. To widen the distribution network of IPOs, the framework of electronic IPOs (E-IPOs) introduced in the same year. Since 2014 it is necessary for every company to have a minimum 25 percent of the shareholding from retail investors, which can be achieved by a company through bonus issue or right issue, but promoters and promoters group will not be benefited by the provision due to clear restriction by the SEBI on their participation in the
mentioned issue provision. From 2014 SEBI issuer and banker bring 20 percent variation in the issue size earlier they were allowed to bring 10 percent variation in the issue size. From June 2014 price band of the issue will be disclosed 5 days before the issue opened earlier it was to be disclosed 2 days before. Since 2014 it is not optional to withdraw or to lower the bids from public issues. SEBI allowed to get listed only the companies with pre-tax operating profit of `15 crore. If the company fails to meet the requirement then a company can use the SME platform to float its issue or has to float its issue through the book building route with 75 percent participation from institutional investors as against existing 50 percent.

All these changes in the regulatory environment are either motivated by investor protection, growth in primary market activities or brought in with an objective of procedural simplification and transparency in every activity related to public issues. Analysis of trend of initial public offers can really exhibit the impact of these regulatory changes on activities of initial public offers.

5. CONCLUSION

After in-depth study of the concerned law and SEBI annual report it is concluded that the reform measures were introduce to make rules to bring new financial instruments in scope of the related act. To make IPO market lucrative for retail buyers' special provisions have been introduced by the regulator for reservation and allotment of shares of shares. In order to channelize the savings toward small and medium scale enterprises special trading platforms made at NSE and BSE. To reduce the rate of failure of new public issues; subscription from side of qualified institutional buyers (QIBs) is now mandatory for every public issues. In company act 2013 the listed companies now will be under regulation of SEBI only whereas non listed corporate entity will follow the provisions of Company Act 1956 & 2013. For discovery of fair price book building mechanism strictly implement by the regulators. Grading of equity instruments introduced to disseminate qualitative aspect of the financials reported in the prospectus document. Indian industrial securities market is secure for initial public offers, effort on part of SEBI and amendment in law substantiate it.

whose native language is other than English to enlist the services of a native language speaking colleague or associate to review and edit your submission.

REFERENCES