
UNIT 11 REGULATION OF CAPITAL MARKET

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11.0 OBJECTIVES

After studying this unit you should be able to :

- appreciate the need for regulating capital market operations;
- outline the regulatory framework for capital markets;
- describe SEBI guidelines for capital issues;
- outline the provisions of the Securities Contracts (Regulation) Act, 1956 for controlling stock market operations and the role of SEBI in respect thereof;
- identify the need for takeover code; and
- explain the main provisions of takeover code as modified by SEBI.

11.1 INTRODUCTION

You have learnt about the nature and significance of capital market and its two principal segments viz., the primary or new issue market and the secondary market predominantly comprising stock exchanges. Corporate securities issued in the primary market and held by investors are traded through the stock exchanges on a continuous basis. The capital market in India has experienced unprecedented growth during the last two decades both in terms of new issues as well as daily turnover in the major stock exchanges. The shareholding population in India now occupies the third place in the world, next only to U.S. and Japan. The equity cult has captured the imagination

of small investors who were earlier shy of investing in corporate securities. The number of stock brokers and sub-brokers has also increased about ten fold even though screen based electronic trading has largely replaced floor based dealings. However, along with the developments in terms of growth, there have emerged certain disquieting features for which more regulatory measures were called for.

In this unit, you will learn about the need for regulating capital market operations, and analyse the regulatory framework with respect to public issue of capital and stock market operations. In addition, you will have an idea about the regulation of corporate takeovers and the takeover code as modified by SEBI.

11.2 NEED FOR REGULATING CAPITAL MARKET OPERATIONS

Along with the phenomenal growth of Indian capital market, certain negative features have continued to plague the capital market operations. The necessity of capital market reforms and regulatory measures lay in those negative features which spread and intensified particularly after decontrol and deregulation of capital issues. Some of the major disquieting aspect have been as follows:

- 1 While dealing in securities consist mainly of equity shares, only a small proportion of the shares listed are actively traded in stock exchanges. Analysis of the frequency of transactions have revealed that about 90 per cent of the total transactions are confined to only 5 per cent of the scripts of listed companies. Thus, there is high volatility in respect of a small proportion of the scripts and poor liquidity in respect of a vast majority of scripts.
- 2 A practice of common occurrence in the context of issue of shares by companies is the manipulation of share prices called price rigging. It starts with charging a high premium on the first issue and continue with luring investors to the subsequent issues. Later, when allotments have been made, the prices slide down to their natural levels that are often below the offer prices. Attempt may also made at this stage by the speculators, or their rival groups, to depress the prices to the detriment of gullible investors.
- 3 Some companies which frequently enter the capital market with projects involving expansion, diversification and modernisation are known to delay allotments and do not return shares lodged for sub-division, consolidation and transfer on time. As a result, an artificial scarcity is created so as to manipulate the prices in the secondary market, seriously harming the genuine investors.
- 4 Another malpractice which has continued to vitiate the stock market operations is the insider trading. It refers to trading in the scrip of a company by a person having access to unpublished price sensitive information to make private gains or avoid losses. Directors, promoters and someone connected with the company may often have access to privileged information and make use of such information for private gain on the stock market.
- 5 Preferential allotment of shares to promoters/ associates has been another disturbing feature. There are instances of a number of companies which made preferential allotment of shares at a substantial discount to the prevailing market price and the allottees reaped windfall profits, while others suffered due to weakening of prices resulting from a surge in the supply of shares.
- 6 Problems posed by brokers and sub-brokers also assume serious proportions at times. Brokers indulge in what is known as 'front running' when they are advised

by institutions to execute bulk orders to buy or sell securities. Since the bulk orders have the potential to affect the market price, the brokers are known to make deals in advance of institutional orders to make profits for themselves. It is also observed that about 50 per cent of the complaints against stock brokers relate to sub-brokers acting with scant regard to investors' interest. Sub-brokers have proliferated all over the country and often issue contracts, bills memos, etc. in their own names to lend authenticity to their operations even though these are invalid and may not reflect the correct position. Gullible investors often fall a prey to such acts of the sub-brokers.

- 7 Small investors' interest had been adversely affected while dealing in odd lots as they would receive 10 to 15 per cent less than the market price when they sold and had to pay 5 to 10 per cent more when they would buy. However, this problem has been duly taken care of by the introduction of depository system which has literally done away with settlement through physical delivery of securities.
- 8 The system of carry forward (badla) has been responsible for excessive speculation, high price fluctuations and risk of loss. It is heartening to note that the have badla system has been abolished after the introduction of dealings in derivatives about which you have learnt in Unit 10.
- 9 A negative practice which affects the liquidity of investments is the inordinate delay in admitting securities for trading in stock exchanges. The delay is caused by the concerned companies as the collection of applications from different centres across the country, the processing of applications, the issue of allotment letters/share certificates, etc. often take a long time after the date of closure of the subscription list.

11.3 REGULATION OF CAPITAL MARKETS - AN OVERVIEW

Before the establishment of SEBI, the principal legislations governing the capital market in India were (a) the Capital Issues Control Act, 1956 for regulating the primary market, and (b) the Securities Contracts (Regulation) Act, 1956 for regulating the secondary market. The regulatory powers for the primary market were vested with the Controller of Capital Issues and those for the secondary market with the Stock Exchange Division in the Ministry of Finance.

In April 1988, the Securities Exchange Board of India (SEBI) was set up as a non-statutory body to regulate the capital market on the strength of the Government of India until January 30, 1992 when an Ordinance was promulgated to make it a statutory board. The Bill to replace the Ordinance was passed by both Houses of Parliament and it became an Act on April 4, 1992 when it received President's assent. Meanwhile, the **Capital Issue Control Act had been repealed and the Companies Act amended to make SEBI the Administrative authority for enforcement of the provisions of the Act relating to capital issues. As a result, the primary market became the preserve of the SEBI. Further, the Ministry of Finance transferred a number of its powers under the Securities Contracts (Regulation) Act also to SEBI. Thus, SEBI has also been entrusted with the main responsibility of adopting suitable measures for protecting the interests of investors in securities and promoting the development and regulation of stock market. Such measures include the following:**

- 1 Regulating the business in stock exchanges and any other securities market;
- 2 Registering and regulating the working of market intermediaries viz., registrars and transfer agents, portfolio managers, underwriters, etc;

- 3 Restricting and regulating the working of collective investment schemes including mutual funds;
- 4 Promoting and regulating self-regulatory organisations;
- 5 Prohibiting fraudulent and unfair trade practices in securities market;
- 6 Promoting investors education and training of intermediaries of securities markets;
- 7 Prohibiting insider trading in securities substantial acquisition of shares and takeover of companies;
- 8 Levying fees other charges for the above purposes and perform such other functions as may be prescribed.
- 9 Calling for information from, and undertaking inspection, conducting inquiries and audit of stock exchanges, intermediaries and self regulatory organisations in securities market. SEBI has been armed with some additional powers for ensuring the orderly development of capital markets and to enhance its ability to protect investors' interests.
- 10 Performing such functions and exercising such powers under the provisions of SCR Act as may be delegated to it by the Central Government.

Let us now take up the SEBI Guidelines for regulating capital issues, followed by the regulatory framework for controlling the stock market operations under the SCR Act including SEBI guidelines in respect thereof.

Check Your Progress A

- 1 What were the principal legislations governing the capital market in India before the establishment of SEBI?
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.....
- 2 List any three malpractices prevailing on the stock exchange in India.
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.....
- 3 Fill in the blanks
 - (a) Shareholding in India now occupies _____ place in the world.
 - (b) Analysis of frequency of transactions at the stock exchanges revealed that about 90 per cent of the total transactions are confined only to _____ per cent of the scripts of listed companies.
 - (c) Inside trading refers to trading in the scripts of a company by persons having access to _____ price sensitive information to make private gains or reduce losses.
 - (d) A negative practice which affects the of investments is the inordinate delay in admitting securities for trading in stock exchanges.
 - (e) The Act was amended to make SEBI, the administrative authority for enforcement of the provisions of the Act relating to capital issues.

11.4 REGULATORY FRAMEWORK FOR ISSUE OF CAPITAL – SEBI GUIDELINES

Till eighties, for raising capital from the public by issue of shares or debentures, a public company had to comply with the provisions of the Companies Act, the Capital Issues Control Act, 1947 including the Rules made thereunder, and the guidelines and instructions issued by the concerned government authorities and stock exchanges. As stated earlier, the Capital Issues Control Act was repealed in May 1992, and the capital issues came under the preview of SEBI set up under the SEBI Act, 1992. In June, 1992, SEBI released its guidelines for capital issues known as SEBI (Disclosure and Protection of Investors) Guidelines which lay stress on adequate disclosures, seek to safeguard the interest of investors, and emphasises prudent controls. These, along with provisions of the Companies Act, are applicable to all public issues of listed and unlisted companies, and all offers for and rights issues by listed companies except in case of rights issue where the aggregate value of securities offered does not exceed Rs. 50 lakh. The procedural requirements for public issue as per SEBI Guidelines, 2000 (as updated till September, 2005) are as follows :

11.4.1 Eligibility Norms

Every company making an initial public after (IPO), to start with, have to satisfy the following conditions.

Companies not barred from accessing the capital market : The Company planning to make a public issue of securities should not be the one which has been banned by SEBI from accessing the capital market.

Filing of offer document : To make an initial public offer of securities, the company has to prepare the draft offer document (prospectus) in accordance with the specified disclosure requirements and file it with SEBI through an eligible merchant banker at least 21 days prior to the filing the same with the Registrar of Companies. In the case of a rights issue by any listed company, if the aggregate value of securities including premium, if any, exceeds Rs. 50 lakh, a letter of offer is to be filed with the SEBI, through an eligible merchant banker, at least 21 days before filing it with the Regional Stock Exchange.

Application for listing : No company can make any public issue of securities unless it has made an application for listing of those securities in stock exchange (s).

Issue of securities in dematerialized form : To make a public or rights issue or an offer for sale of securities, the company has to enter into an agreement with a depository, registered with the Board, for dematerialization of securities. Further, the company must also give an option to subscribers/shareholders/investors to receive the security certificates or hold securities in dematerialized form with a depository.

Initial public offering by unlisted companies : An unlisted company can make an initial public offering (IPO) of equity shares or any other security which may be converted into, or exchanged with, equity shares at a later date, provided –

- (a) the company has net tangible assets of at least Rs. 3 crore in each of the preceding 3 full years, of which not more than 50% is held in monetary assets. However, if more than 50% of the net tangible assets are held in monetary assets, the company

must have made firm commitments to deploy such excess monetary assets in its business project;

- (b) the company has a track record of distributable profits for at least three out of immediately preceding five years;
- (c) the company has a net worth of at least Rs. 1 crore in each of the preceding 3 full years;
- (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of size does not exceed five times its pre-issue net worth as per the audited balance sheet of the last financial year; and
- (e) there are no outstanding financial instruments or any other right which would entitle the existing promoters or shareholders any option to receive equity share capital after the initial public offering.

An unlisted company not complying with any of the above conditions can make an IPO (i) if it is made through book building process with at least 50% of the net offer to the public is allotted to Qualified Institutional Buyers (QIBs) or the project has at least 15% participation of Financial Institutions / Scheduled Commercial Banks, of which at least 10% comes from the appraisers, and at least 10% of the issue size shall be allotted to QIBs; and (ii) the minimum post-issue face value of capital of the company shall be Rs. 10 crore or there shall be a compulsory market-making for at least 2 years from the date of listing of the shares.

No unlisted company can make a public issue or equity shares of any security convertible into equity share, if there are any outstanding financial instruments or any other right which would entitle the existing promoters or shareholders any option to receive equity share capital after the initial public offering.

Public Issue by listed companies : A listed company is eligible to make a public issue of equity shares or any other security which may be converted into or exchanged with equity shares at a later date provided the aggregate of the proposed issue and all previous issues made in the same financial year does not exceed 5 times its pre-issue net worth as per the audited balance sheet of the last financial year. In case it does not fulfil the aforesaid conditions, it may still be eligible to make a public issue provided it fulfils the conditions (i) and (ii) laid down with respect to unlisted companies making an IPO with similar limitations.

Exemption from eligibility norms : The provisions with respect to the eligibility of unlisted companies making an initial public offering and listed companies making public issue of equity shares and other securities are not applicable in the case of private and public sector banks, rights issue by a listed company and an infrastructure company whose project has been appraised by a Public Financial Institution (PFI) or Infrastructure Development Finance Corporation or Infrastructure Leasing and Financing Services Ltd. or a bank which was earlier a PFI, and if not less than 5% of the project cost is financed by any of the aforesaid institutions.

No existing partly paid-up shares : No company can make a public issue of equity share or any security convertible at a later date into equity share unless all the existing partly paid up shares have been made fully paid up or forfeited.

Firm arrangements of finance : To make a public or rights issue or securities, a company must have made firm arrangements of finance through verifiable means towards 75% of the stated means of finance, excluding the amount to be raised through the proposed public/rights issue.

11.4.2 Pricing of Securities

Every company, which is eligible to make a public issue, may freely price their equity shares or any securities convertible into equity at a later date.

Differential pricing : Any listed or unlisted company making public issue of equity shares or securities convertible into equity, may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made, provided the price at which securities are offered to the applicants in firm allotment category is higher than the price at which securities are offered to the public. Of course, justification for the price difference is to be given in the offer document. Similarly, a listed company making a composite issue of capital may issue securities at differential prices in its public and rights issues.

Price band : Any issuer company can mention a price band of 20% (cap in the price band should not be more than 20% of the floor price) in the offer documents filed with the Board, and actual price can be determined at a later date before filing offer document with ROCs. The final offer document is to contain only one price and one set of financial projections, if applicable.

Freedom to determine the denomination of shares : An eligible company has the freedom to make public or rights issue of equity shares in any denomination determined by it in accordance with the provisions of the Companies Act and in compliance with the norms as specified by SEBI. Companies which have already issued shares in the denomination of Rs. 10 or Rs. 100 may change the standard denomination of the shares by splitting or consolidating the existing shares. However, the denomination shall not be in decimal of a rupee in any case.

11.4.3 Promoters' Contribution / Shareholding

In a public issue by an unlisted company, the promoters have to contribute not less than 20% of the post-issue capital. The promoters' shareholding after offer for sale is not to be less than 20% of the post-issue capital. Similarly, in case of listed companies, the promoters may participate either to the extent of 20% of the proposed issue or ensure post-issue shareholding to the extent of 20% of the post-issue capital.

In case of composite issue of a listed company, the promoters' contribution may, at the option of the promoter(s), be either 20% of the proposed public issue or 20% of the post-issue capital. But the rights issue component of the composite issue must be excluded while calculating the post-issue capital.

In case the promoters' participation is in excess of the required minimum percentage of the post issue capital, it will be treated as preferential allotment and attract the pricing provisions of guidelines on preferential allotment, if the issue price is lower than the price determined on the basis of preferential allotment guidelines.

Promoters' contribution to be brought in before public issue opens : Promoters are to bring in the full amount of their contribution including premium at least one day prior to the issue opening date, and the amount must be kept in an escrow account with a scheduled commercial bank and the said amount is to be released to the company along with the public issue proceeds. Where the promoters' minimum contribution exceeds Rs. 100 crore, they have to bring in Rs. 100 crore before the opening of the issue and the balance may be brought in as advance on pro rata basis before the calls are made on public.

Exemption from requirement of promoters' contribution : The requirement of promoters' contribution is not applicable in case of public issue of securities which has been listed on a stock exchange for at least 3 years and the company has a track record of dividend payment for at least 3 immediately preceding years. However, the promoters must disclose their existing shareholding and the extent to which they are participating in the proposed issue in the offer document.

Lock-in requirements : In case of any public issue of capital, the minimum promoters' contribution is to be locked in for a period of three years. However, the promoters' contribution / participation in excess of the required minimum contribution / percentage is to be locked in for a period of one year only, and in the case of public issue by a company which has been listed on a stock exchange for at least three years and which has a track record of dividend payment for at least three immediately preceding years, excess promoters' contribution is not subject to lock-in requirements. In case of an unlisted company, the entire pre-issue share capital, other than that locked in as promoters' contribution, is to be locked in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later. The aforesaid lock-in requirements shall not be applicable to the pre-issue share capital held by venture capital funds and foreign ventures capital investors registered with SEBI. The same shall be locked in as per relevant SEBI (Venture Capital Fund) Guidelines of 1996 and SEBI (Foreign Venture Capital Investors), 2000 and any amendments thereto. The lock-in of pre-issue share capital shall also not be applicable to such capital held for a period of at least one year at the time of filing draft offer document with the SEBI and being offered to the public through offer for sale.

11.4.4 Pre-Issue Obligations

Due diligence exercise : The lead merchant banker must exercise due diligence. The standard of due diligence is to be such that the merchant banker satisfies himself about all aspects of offering and the veracity and adequacy of disclosure in the offer document.

Payment of fee : The lead merchant banker is to pay the requisite fee along with draft offer document to be filed with SEBI.

Documents to be submitted : The following documents are required to be submitted along with the offer document by the Lead Manager.

- (a) Memorandum of Understanding (MOU) entered into between the lead merchant banker and the issuer company specifying their mutual rights, liabilities and obligations relating to the issue.
- (b) Inter-se allocation of responsibilities must be demarcated as specified in Schedule II of SEBI Guidelines in case the public or rights issue is managed by more than one merchant banker.
- (c) Due Diligence Certificate as specified in Scheduled III of SEBI Guidelines is to be furnished to the Board by the lead merchant banker along with the draft prospectus.
- (d) Certificates signed by the company secretary or chartered accountant regarding timely despatch of refund orders of the previous issue, security certificates, and the listing of securities.
- (e) An undertaking by the user to the effect that transactions in securities by the promoters and their immediate relatives during the period between the date of filing the offer documents and the date of closure of the issue, shall be reported to the stock exchanges concerned within 24 hours of the transaction(s).

- (f) A list of the persons who constitute the Promoters' Group and their individual shareholding and some personal details to be submitted by the Board.

Appointment of lead merchant banker : An eligible merchant banker must be appointed to lead and manage the issue, and he is to ensure that registrars bankers to the issue and the other intermediaries are duly appointed, and registered with the Board, wherever applicable.

Underwriting : The lead merchant banker is to satisfy himself about the ability of the underwriters to discharge their underwriting obligations, incorporate a statement in the offer document to the effect that, in their opinion, the underwriters' assets are adequate to meet their underwriting obligations. In respect of an underwritten issue, the lead merchant banker is also to ensure that the relevant details of underwriters are included in the offer document. Moreover, in respect of every underwritten issue, the lead merchant banker(s) have to undertake a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lakh, whichever is less.

Draft Offer Document to be made public : The draft offer document filed with SEBI is required to be made public for a period of 21 days from the date of filing the offer document with the Board and make its copies available to the public.

While filing the draft offer document with the Board, the lead merchant banker is also to file the document with the stock exchanges where the securities are proposed to be listed, and obtain and furnish to the Board, an in-principle approval of the stock exchanges for listing of the securities within 15 days of filing of the draft offer documents with the stock exchanges.

Pre-issue advertisement : Soon after receiving the final observations, if any, on the draft prospectus from the Board, the issuer company has to make an advertisement in an English national daily, one Hindi national newspaper and a regional language newspaper at the place where the registered office of the issuer is situated. This has to be in the format and contain the minimum disclosures as given in Part A of Schedule XXA of the SEBI Guidelines, both in case of fixed price issues as well as book built issues.

Despatch of issue material : The lead merchant banker must ensure that for all public issues, offer documents and other issues materials are despatched to the various stock exchanges, brokers, underwriters, bankers to the issue, investors associations etc. in advance. In the case of rights issue, the lead merchant banker must ensure that the letters of offer are despatched to all shareholders at least one week before the date of opening of the issue.

No complaints certificate : After 21 days from the date the draft offer document was made public, the lead merchant banker must file a statement with the Board giving a list of complaints received by it, along with a statement whether it is proposed to amend the draft offer document or not, and also highlight those amendments.

Collection centres / Agents : The issuer company may appoint as many collection centres as it deems fit. However, the minimum requirement of collection centres for an issue of capital is four metropolitan centers, (b) all such centres where the stock exchanges are located in the region in which the registered office of the company is situated, and (c) the regional division of collection centres as indicated in Schedule VII of the Guidelines. The Company can also appoint authorised collection agents in

consultation with the lead merchant banker subject to necessary disclosures including the names and addresses of such agents in the offer document.

Advertisement for rights post issues : In the case of a rights issue, the lead merchant banker must ensure that an advertisement giving the date of completion of despatch of letters of offer are released at least 7 days before the date of opening of the issue. The advertisement must indicate the centres other than registered office of the company where the shareholders or the persons entitled to rights may obtain duplicate copies of composite application forms.

Appointment of compliance officer : An issuer company is to appoint a compliance officer who shall directly liaise with the Board with regard to the compliance with various laws, rules, regulations and other directives issued by the Board and investor complaint related matters. The name of the compliance officer must be intimated to the Board.

Abridged Prospectus : The lead merchant banker must ensure that every application form distributed by the issuer company is accompanied by a copy of the abridged prospectus, of which the application form may be stapled to form a part, or may be a stapled part.

11.4.5 Post-Issue Obligations

Post-issue monitoring reports : Irrespective of the level of subscription, the post-issue lead merchant banker is to ensure submission of the post-issue monitoring reports as per format specified in Schedule XVI of the Guidelines. These reports must be submitted within 3 working days from the due dates specified.

Redressal of investor grievances : The post-issue lead merchant banker is to actively associate himself with post-issue activities, viz., allotment, refund and despatch, and has to regularly monitor redressal of investor grievances arising therefrom.

Coordination with intermediaries : The post-issue lead merchant banker is to 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, etc. till the basis of allotment is finalised, despatch of security certificates and refund orders completed and securities listed. Any act of omission or commission on the part of any of the intermediaries must be duly reported to the Board.

Underwriters : In case there is a devolvement on underwriters, the lead merchant banker is to ensure that the underwriters honour their commitments within 60 days from the date of closure of the issue. In case of undersubscribed issues, the lead merchant banker is to furnish information in respect of underwriters who have failed to meet their underwriting developments to the Board in the format specified at Schedule XVII of the Guidelines.

Bankers to an issue : The post-issue lead merchant banker has to ensure that money received pursuant to the issue are kept in a separate bank and are released by the said bank only after the listing permission under the said section has been obtained from the stock exchanges where the securities were proposed to be listed as per the offer document.

Post-issue advertisements : The post-issue lead merchant banker must ensure that in case of all issues, advertisement giving details relating to (i) over subscription, (ii) basis of allotment, (iii) number, value and percentage of applications, (iv) number, value and percentage of successful allottees, (v) date of completion of despatch of refund orders, (vi) date of despatch of certificates, and (vii) date of filing of listing application, is released within 10 days from the date of completion of the various activities.

Basis of allotment : In a public issue of securities, the executive director / managing director of the designated stock exchange along with the post-issue lead merchant banker and the registrars to the issue are to be responsible to ensure that the basis of allotment is finalised in a fair and proper manner as specified in the SEBI Guidelines. As per guidelines, if the issue is oversubscribed, the allotment must be made in marketable lots on proportionate basis within the specified categories subject to reservation for retail individual investors which is 50% of the net offer to the public. Draw of lots, if required, can be made to finalise the basis of allotment.

Other responsibilities : The lead merchant banker is to ensure that (i) the despatch of share certificates/ refund orders and demat credit is completed and the allotment and listing documents submitted to the stock exchanges within 2 working days of finalization of the basis of allotment, and (ii) all steps for completion of the necessary formalities for listing and commencement of trading at all stock exchanges where the securities are to be listed are taken within 7 working days of finalization of the basis of allotment.

The post-issue lead merchant banker is to continue to be responsible for post issue activities till the subscribers have received the shares/debenture certificates or refund of application money, and the listing agreement is entered into by the issuer company with the stock exchange and listing / trading permission is obtained.

11.4.6 Other Requirements

Public issue of NCDS / DSCE : The lead merchant banker is to ensure compliance with the guidelines relating to public issue and listing of non-convertible debt securities (NCDS) and debt securities convertible into equity after allotment (DSCE). An unlisted company making a public issue of NCDS / DSCE can make a public issue and make an application for listing its NCDS in the stock exchange/s without making a prior public issue of equity and listing thereof, subject to the conditions specified in the guidelines.

The lead merchant banker can mention a price band of 20% in the offer document filed with the Board and the specific coupon rate/price can be determined by an issuer in consultation with the lead manager at a later date before filing of the offer document with the ROC. The issuer may, subject to the relevant provisions of the guidelines, make the issue through book building process to ascertain and determine the coupon rate and price /conversion price of the NCDS / DSCE.

Rule 19 (2) (b) of Securities Contracts (Regulation) Rules, 1957 : It specifies that

- 1 In case of a public issue by an unlisted company, the net offer to public must be at least 10% or 25% as the case may be, of the post-issue capital;
- 2 In case of a public issue by a listed company, the net offer to public must be at least 10% or 25% as the case may be, of the issue size.

- 3 An infrastructure company inviting subscription from the public shall not attract the provisions of the above two clauses.
- 4 The issuer company is free to make reservations and/or firm allotments to various categories of persons such as employees, shareholders, mutual funds, FIIs, development institutions, and scheduled banks for the remaining part of the issue subject to other relevant provisions of the guidelines.

An unlisted company may make an application to the Board for relaxation from applicability of Rule 19(2) (b) of SCR Rules, 1957, and for listing of its shares without making an initial public offer, if it satisfies the prescribed conditions.

New financial instruments : SEBI in its guidelines of June, 1992 also permitted companies to issue new financial instruments subject to certain conditions. Such instruments include zero coupon debentures/ bonds, warrants, deep discount bonds, PCD/NCD with buy back arrangement, secured premium notes, etc. The main condition relates to adequate disclosures regarding the terms and conditions of redemption, security, conversion and any other relevant features of the instruments.

Terms of the issue : The SEBI guidelines also provide for detailed requirements relating to the following terms for the public issue.

- 1 Minimum application value to be within the range of Rs. 5,000 to Rs. 7,000.
- 2 If the subscription money is to be received in calls, the entire subscription must be called within 12 months from the date of allotment.
- 3 No further capital issue in any manner during the period commencing from submission of offer document to the Board till the securities offered in the said offer document have been listed or application money refunded on account of non-listing.
- 4 Minimum and maximum period for subscription to be kept open to be 3 to 12 working days. Rights issue shall be kept open for at least 30 days and not more than 60 days.
- 5 The particulars as per audited statements contained in the offer document not to be more than 6 months old from issue opening date
- 6 Minimum subscription to be 90% of the total offer amount.
- 7 Over subscription to the extent of 10% of the net offer to public permitted for purpose of rounding off to the nearest multiple of 100 while finalizing the allotment.
- 8 No incentive to be offered to the prospective investors.
- 9 Compliance officer to be appointed to ensure that all rules, regulations, guidelines, notifications, etc. issued by the Board, the Government of India and other regulatory organisation are complied with.
- 10 Arrangement for monitoring the use of the proceeds of the issue by one of the financial institutions.
- 11 Any safety net for buy back arrangement of the shares to be strictly in accordance with the provisions in the guidelines.
- 12 In case of change in denomination of shares, the compliance with the provision shall be ensured while making disclosure in the offer document.

The important procedural requirements for issue of capital as laid down in the SEBI (Disclosure and Investor Protection) Guidelines, 2000, updated till September 2005

have been duly outlined above. However, SEBI guidelines cover many other aspects of regulatory framework for capital issues which have been kept in view. These include those on green shoe options for stabilising the post listing price of its shares, employees stock option scheme (ESOP), sweat equity shares to promoters advertisements and research reports, issue of debt instruments, book building, IPO through the Stock Exchange, On-line system (e-IPO), issue of capital by designated financial institutions, shelf prospectus, preferential issues, OTCEI issues, bonus issues, contents of offer documents, prospectus, abridged prospectus and letter of offer, etc.

Check Your Progress B

- 1 Who are exempted from eligibility norms ?

- 2 State the lock-in requirements in respect of promoters' contribution to public issue.

- 3 What is the minimum requirement of collection centres in case of public issue of capital ?

- 4 State which of the following statement are True or False.
 - (a) No company can make any public issue of securities unless it has made an application for listing of those securities in a stock exchange.
 - (b) The eligibility norms for public issue of capital do not apply to an infrastructure company whose project has been appraised by a public financial institution.
 - (c) No Company can make a public issue of capital unless all the existing partly paid shares have been made fully paid or forfeited.
 - (d) Every company which is eligible to make a public issue cannot freely price its equity shares.
 - (e) In case the promoters' participation is in excess of the required minimum percentage of the post issue capital, it will be treated as preferential allotment.
 - (f) In case of the rights issue, the lead merchant banker must ensure that the letters of offer are despatched to all shareholders 21 days before the date of opening of the issue.

11.5 REGULATORY FRAMEWORK FOR CONTROLLING STOCK MARKET OPERATIONS

The attention of the government was drawn from time to time to the ills of stock exchanges as a result of which the Securities Contracts (Regulation) Act was passed in 1956 to regulate and control stock market operations in the wider interest of the financial market institutions and the investors. The Act came into effect from February 20, 1957. It provides, inter alia, for : (a) recognition of stock exchanges, (b) general control over their trading methods and practices, (c) regulation of contracts and options in securities, and (d) listing of securities.

The Securities Contracts (Regulation) Rules were also framed in 1957. Among other things, the Rules provide for the procedure to be followed for recognition of stock exchanges, submission of periodical returns and annual reports, inquiry into the affairs of recognized stock exchanges and their members, and requirements for listing of securities. The rules are statutory and constitute a code of standardized regulations uniformly applicable to all recognised stock exchanges.

11.5.1 Powers of Central Government

The Securities Contracts (Regulation) Act empowers the Central Government to take appropriate measures to achieve the objectives of the Act. These powers are :

- 1 Grant and withdrawal of recognition to any stock exchange;
- 2 Approval of rules and bye-laws of stock exchanges;
- 3 Direct stock exchange to make or amend rules and bye-laws in certain cases;
- 4 Call for periodical returns and specific information from stock exchanges;
- 5 Conduct inquiry on the members or on the stock exchange;
- 6 Suspend business of stock exchange;
- 7 Supersede the governing body of the stock exchange; and
- 8 Regulation of listing of securities.

After the constitution of SEBI, all powers under the SRC Act had been transferred by the Government to SEBI so as to make it the sole regulator of capital market in India. However, certain power are concurrently exercised by the Central Government and SEBI. These are summarized as follows:

Recognition of Stock Exchanges

For grant of recognition, a stock exchange is required to make an application to the SEBI in the prescribed manner. Every application for recognition must contain such particulars as may be prescribed and must be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts. It must also attach a copy of the rules relating, in general, to the constitution of the stock exchange and, in particular, to (a) the composition and powers of the governing body and the manner in which its business is to be conducted; (b) the powers and duties of the office bearers of the stock exchanges; (c) the eligibility admission, expulsion, etc. of various classes of members; (d) the procedure for the registration of partnerships as members of the stock exchange in cases where the rules provide for such membership, and (e) the nomination and appointment of authorized representatives and clerks.

Grant of recognition is subject to the conditions that (i) the rules and bye-laws of the stock exchange are in conformity with such conditions as may have been prescribed with a view to ensure fair dealing and protect the investors; (ii) the stock exchange is willing to comply with any other conditions (including condition as to the number of members) which SEBI may impose; and (iii) it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange.

The conditions which may be prescribed for the grant of recognition may include, among other matters, conditions relating to : (a) qualifications for membership of stock exchange; (b) the manner in which contracts shall be entered into and enforced as between members; (c) representation of the Central Government on each of the stock exchanges by such number of persons not exceeding three as the Central Government may nominate in this behalf; and (d) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Central Government.

Where recognition is refused, an opportunity must be given to the applicant stock exchange to be heard in the matter. The reasons for such refusal must also be communicated to the stock exchange in writing.

Rules of Stock Exchanges

Every stock exchange must have rules which provide for all or any of the following :

- (a) restriction of voting rights of members in respect of any matter placed before the stock exchange at any meeting;
- (b) regulation of voting right in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange;
- (c) restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange; and
- (d) such incidental, consequential and supplementary matters as may be necessary to give effect to any of the matters specified above in clauses (1), (2) and (3).

Rules made and amended as above have to be approved by the Central Government /SEBI and then published in the Official Gazette

Bye-Laws of Stock Exchanges

Any recognized stock exchange may, subject to previous approval of SEBI, make bye-laws for the regulation and control of contracts. Some of the important provisions which may be contained in the bye-laws are those relating to

- (a) opening and closing of markets and regulation of the hours of trade;
- (b) a clearing house for the periodical settlement of contracts and differences thereunder, delivery and payment for securities, passing on of delivery orders, and regulation and maintenance of such clearing house;
- (c) the number and classes of contracts in respect of which settlements shall made or differences paid through the clearing house;
- (d) regulation or prohibition of bank transfers;
- (e) method and procedure for the settlement of claims or disputes, including settlement by arbitration;
- (f) levy and recovery of fee, fines and penalties;

- (g) fixing of scale of brokerage and other charges; and
- (h) regulation of dealings by members on their own account.

The SEBI is empowered to on the basis of a request received from the governing body of a stock exchange, or on its own motion, to make or amend any bye-laws in accordance with the SCR Act.

Furnishing of Information and Conduct of Enquiry

Every stock exchange shall furnish the Central Government with a copy of the annual report containing all the particulars prescribed. Further, it shall furnish to the SEBI such periodical returns relating to its affairs as may be prescribed.

It is also laid down that every recognised stock exchange and every member shall maintain and preserve, for such period not exceeding five years, such books of accounts and other documents as may be prescribed by the Central Government. These books of account and other documents shall be available for inspection by SEBI at all reasonable time.

The SEBI can also call upon any recognised stock exchange or any member of such stock exchange for explanation relating to the affairs of the stock exchange or the member in relation to stock exchange. It can also order an inquiry in relation to the affairs of the governing body of a stock exchange or the affairs of any member of the exchange in relation to the stock exchange.

Power to Supersede Governing Body

If the Central Government has sufficient reasons to feel that the governing body of any stock exchange should be superseded, it may do so after serving a written notice on the governing body and giving it an opportunity to be heard in this matter. When the governing body is superseded, the Government may appoint any person or persons to exercise and perform all the powers and duties of the governing body for such period as may be specified. The Government may call upon the stock exchange to reconstitute the governing body before the termination of this period.

Power to Suspend Business of Stock Exchange

The Act empowers the Central Government to suspend the business of any stock exchange, under certain circumstances, for a period not exceeding seven days in the interest of trade or public interest. The period of suspension may be extended from time to time but only after the governing body has been given an opportunity of being heard in the matter.

Listing of Securities by Public Companies

Power of SEBI to compel listing : You know there is no obligation that every public company should get its shares listed on a stock exchange unless it is seeking public subscription to shares or debentures by issue of a prospectus. However, notwithstanding anything contained in any other law for the time being in force, if SEBI is of opinion, having regard to the nature of securities issued by any public company or to the dealings in them, that it is necessary or expedient in the interest of the trade or in the public interest so to do, it may require the company to comply with such requirements as may be prescribed with respect to listing of its securities on any

recognised stock exchange. But, before making the order, SEBI shall be required to give an opportunity to the company to make its representation.

Right of appeal against refusal of stock exchanges to list security : When a public company has applied for listing on a stock exchange and the stock exchange refuses to list its securities of the company is entitled to be furnished with reasons for such refusal and appeal to the Central Government / SEBI against such refusal. The appeal should, however, be preferred within 15 days from the date on which the reasons for such refusal are furnished to it. The Central Government /SEBI, after giving the stock exchange an opportunity of being heard, may (a) vary or set aside the decision of the stock exchange, or (b) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission.

Every listed company has to specify in each annual report the name and address of each stock exchange at which the company's securities are listed and whether the company has paid the annual listing fees to each such exchange.

Delisting of securities : Shares of a company may be delisted for non-payment of the annual listing fees or for its failure or refusal to abide by the listing agreement. In case the securities of a company have been delisted, directors in their report have to make a disclosure to this effect. SEBI has also provided for voluntary delisting of securities which is permitted by the stock exchange at the request of the companies. In such a case, the Directors' Report of the company is to disclose the fact of delisting, together with a statement of reasons and the justification for voluntary delisting. The re-instatement of delisted securities may be permitted by the stock exchange within a period of one year after the date of delisting, without requiring the company to make application as if it were a case of fresh listing. However, if the listing of delisted securities is sought after one year, it should be considered as a case of fresh listing.

11.5.2 Powers of SEBI in relation to Stock Exchanges

As indicated earlier, almost all powers which were earlier exercised by the Central Government under the SCR Act have been transferred to SEBI and that, while certain powers are to be exercised concurrently the Central Government and SEBI, the others are to be exercised by SEBI itself. These are summarized hereunder :

Registration of stock brokers, sub-brokers, share transfer agents and other market intermediaries : Under Section 12 of the Act, provision has been made for the registration of market intermediaries with the Board (SEBI). Since the commencement of the Act the stock brokers, sub-brokers, registrars, share transfer agents, bankers to the issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries can deal in securities only if they obtain a certificate of registration from the Board and the dealings are in accordance with the terms and conditions of such certificate. All such persons who are already functioning as above before the establishment of the Board were required to make an application for registration within three months from the date of establishment of the Board. The application for registration is required to be made on payment of the prescribed fees as determined by regulation made by SEBI in this behalf.

Under Section 28 of the Act, however, the Central Government is empowered to exempt any person or class of persons buying or selling securities or otherwise dealing with the securities market from the operation of the provisions of sub-section (1) or

Section 12. In other words, any such persons may be allowed to trade or deal with securities without registration with SEBI if the Central Government so directs.

Licensing of dealers in securities : Any person dealing in securities in areas other than notified areas (whether on his own behalf or on behalf of any other person) is required to obtain a licence from SEBI in this behalf. Dealings in securities by or on behalf of a member of any recognised stock exchange do not come within the purview of the restriction. Even though the provision relating to licensing does not normally apply to spot delivery contracts, the Central Government may, by notification, make the said provision applicable to specific securities.

According to SEBI (Stock Brokers and Sub-brokers) Rules, 1992, no person can act as a stockbroker unless he holds a certificate granted by SEBI subject to fulfilment of the conditions laid down in the Rules. The regulations issued in October 1992, inter alia, cover registration of brokers and sub-brokers, their general obligations and responsibilities, procedures for inspection of their operations and action to be initiated in case of default.

Inspection of stock exchange : SEBI has drawn up a programme for inspecting stock exchanges to improve their functioning. Inspections have already been carried out on some of the exchanges.

Measures aided at strengthening investor interest and confidence in the secondary market : These measures include rationalization and refining of margin system, relaxation of listing requirement in respect of securities in the IT sector by reducing the stipulated minimum offering from 25% to 10% , incorporation of derivative instruments in the definition of securities under relevant laws enacted by Parliament, and introduction of rolling settlement for selected scripts.

Regulations pertaining to insider trading : SEBI issued regulations in 1992 prohibiting dealings, communications or counselling in matters relating to 'insider trading'. These regulations were expected to help protection and preservation of market integrity, and inspire investor confidence in the market over time.

Setting up clearing house or clearing corporations and providing trade guarantee by stock exchanges : SEBI has directed all stock exchanges to set up clearing houses or clearing corporations so as to reduce counter-party risks and enable investors to take advantage of settlement of transactions through a depository. SEBI has also prescribed uniform norms and procedures for timely resolution or bad deliveries.

Compulsory settlement of trades in depositories : Effective from January 1998, SEBI decided that settlement of trades in the depository would be compulsory for domestic financial institutions, banks, mutual funds, and foreign institutional investors (FIIs) having a minimum portfolio of securities of Rs. 10 crore as on their latest balance sheets. This measure was considered necessary for expediting the process of dematerialisation of securities and settlement of transactions in the depository..

Inspection of mutual funds : Having been authorized to inspect mutual funds, SEBI has undertaken inspection of some mutual funds, pointed out deficiencies of individual funds in the inspection reports, and corrective actions have been taken to set them right.

Regulation of merchant banking : Since merchant banking is statutorily under the regulatory framework of SEBI, they are not only to be authorized by SEBI, but also to

adhere to the capital adequacy norms and to abide by a code of conduct specifying responsibility towards inspectors in respect of pricing and premium fixation of issues.

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Guidelines for entry norms and for companies accessing capital market : In April, 1996, SEBI issued guidelines for entry norms for companies accessing capital market to the effect that such companies should have a track record of dividend payment for a minimum of 3 years out of the immediate preceding 5 years. In case a manufacturing company does not have such a track record, it can access the public issue market provided the projects have been approved by public financial institutions or any scheduled commercial bank, and such appraising entity is also participating in the project fund.

Buyback of shares : The provisions of the Companies Amendment Act under Section 77 and 77B allowing companies to buy back their shares and the conditions stipulated are also subject to regulations and guidelines laid down by SEBI.

Collective Investment Schemes (CIS) : In October 1999, SEBI notified regulations for collective Investment Schemes (CIS) including any scheme or arrangement with respect to property of any description which may enable investors to participate in the scheme by way of subscriptions and to receive profits or income or produce arising from the management of such property. Under the SEBI regulations, no person can carry on any CIS unless he obtains a certificate of registration from SEBI.

Compulsorily rolling settlement and derivatives trading : In 2000, keeping in line with international best practices, SEBI introduced compulsory rolling settlement in scrips and trading in derivatives.

Centralised internet based filing system : In 2002, SEBI launched the Electronic Data Information Filing and Retrieval System (EDIFRS) website at the same time as they submit it to the exchange. The system is aimed at providing investors simultaneous, one-point access to key information on all listed companies.

Posting all orders against errant companies and others on website : From July 2002, SEBI decided to post all orders passed by its Chairman against errant companies and market intermediaries on its website so as to provide such useful information to the investors.

Takeover code and amendments thereto : Several amendments have since been made in the takeover code, such as bringing preferential allotment under the ambit of takeover code. So as to stop the practice of promoters making preferential allotments to avoid making an open offer to other shareholders Acquirers are also required to disclose their holdings more frequently which may increase transparency.

11.5.3 Amendment of SEBI Act in 2002

Certain key changes have been made in the SEBI Act, 1992 so as to provide adequate powers to SEBI to perform its regulatory role more effectively.

- 1 **Power of search and seizure :** Under the amended provisions of the SEBI Act, the Board's officers may be armed with a search warrant from a judicial magistrate, and they can search any market player's premises and also seize documents. Earlier, a SEBI officer could only ask an entity for specific documents which allowed concealment of incriminating documents.

- 2 **Power to freeze bank accounts :** In course of investigating transactions, SEBI is now empowered to impound cash proceeds and securities connected with any transaction. With authorization from a judicial magistrate, SEBI can also freeze bank accounts for duration of one month of any person or entity involved in market violation.
- 3 **Power to impose higher penalties :** The limit of fine which can be imposed by SEBI has been substantially raised. Earlier, it was only Rs. 5 lakh. Now, for market manipulation and insider trading, the maximum fine which can be imposed is Rs. 25 crore or three times the profits made by the entity concerned. For other violations like non-disclosure, the maximum monetary penalty can be upto Rs. 1 crore.
- 4 **Increase in board membership :** The strength of the SEBI Board has been increased from six to nine including three whole-time directors (excluding the chairman). The number of members of the Securities Appellate Tribunal (SAT) has also been increased from one to three. The objective of strengthening the Board and SAT is to reduce the possibility of error or bias of an individual or a small group.

Check Your Progress C

- 1 State a few important items to which the provisions contained in the bye laws may relate to .
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- 2 Is registration for brokers, sub-brokers etc with SEBI compulsory for deal in securities at the stock exchange ? If so, are there any exceptions to it?
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- 3 Enumerate the key changes made in the SEBI Act in 2002.
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11.6 REGULATION OF CORPORATE TAKEOVERS

Combination or merger of enterprises in which one acquires the assets and liabilities of another in exchange for cash or shares and/or debentures is generally known as merger through acquisition, absorption or takeover. This is widely regarded as a strategy of external growth. It may involve a cooperative friendly approach on the part of the combining firms, or take place through a bid to take over of one firm by another with a hostile approach. Thus, a friendly merger results in a negotiated acquisition of one firm by another, while a hostile merger or takeover involves one firm acquiring control over another against the will of its management generally by way of purchasing a sizable number of shares of the target company in the open market.

In 1983, some instances of takeover bids in India made headlines due to the technical and legal issues involved. For example, an attempt was made by a London based industrialist, Swaraj Paul, to buy shares in DCM and Escorts, making a bid for takeover of the management of the two companies. The purchase of shares was apparently encouraged by the Non-resident Investment Scheme announced by the Union Ministry of Finance, of which one implication was the possible destabilization of the existing management of corporate enterprises, and the other possibility being that of foreign multinationals making inroads in the Indian market. The Company Law Board stepped in to prevent this takeover bid. Another case of a takeover bid came to light in 1985 when R. G. Shaw & Co., UK, which held shares in Shaw Wallace & Co. in India, was sold to a Hong Kong based company (Carrasco) controlled by a non-resident Indian, Manu Chahabria. There was again apprehension that the management of Shaw Wallace & Co. would be destabilised. However, in this case, the Company Law Board held that shares of Shaw Wallace had not actually been transferred, and there was no case of intervention.

Usually it is expected that profitable growth companies would mainly attract takeover bids. But, quite often, various other considerations underlie the decision of company to go in for takeover of other companies. The benefits expected to be derived are : (a) economies of large scale operation; (b) diversification of activities for stability and higher profits; (c) securing necessary working plant and equipment more quickly than building up capacity internally and also to secure access to scarce raw materials and distribution network; (d) possibility of easy market in the context of competition involving product differentiation and the operating efficiency and financial resources of competitors; and (e) acquiring requisite managerial competence to implement the growth process.

11.6.1 Prevention of Secret Takeover Bids

The Government of India amended Clause 40 of the Listing Agreement of companies with stock exchanges in May 1990 so as to prevent clandestine takeover bids by any company as also to protect the interest of minority shareholders. The amended clause stipulated under Clause 40A that if any person acquired or agreed to acquire shares of a company while the nominal value of shares already held by such persons exceeded the aggregate 5 per cent of the voting capital of the company, the stock exchange must be notified within two days of such acquisition or agreement for acquisition by the company, by the authorised intermediary and also by the acquirer. It was also stipulated that when any person held shares which, in the aggregate, carried less than 10 per cent of the voting rights in the company, he should not acquire any share which, when aggregated with the shares already held by him, would carry 10 per cent or more of the voting rights unless he notifies the stock exchange and fulfilled the conditions specified in Clause 40B. Further, the company must notify the stock exchange within 7 days any information which had an effect on its assets and liabilities or financial position or on the general course of its business leading to substantial movements in the price of the shares and in particular information about transactions mentioned above.

Under Clause 40B of the amendment, it was provided that whenever a takeover bid was made to a company, or by a company, whether voluntarily or compulsorily, a public announcement to that effect must be made both by the offeror company and the offeree company. If the offer was made by a person other than the ultimate offeror, the identity of such other person must be disclosed at the outset in the public announcement as also in the notification to the stock exchange. The offer with all

particulars in detail should be placed in the first instance before the Board of Directors of the offeror company. All information relating to the offer must be made available to all the shareholders of the offeror company and the offeree company at the same time, and also lodged with the SEBI.

Another stipulation was that the offeror company should, either before or immediately after making the offer to the offeree company, make an offer to the remaining members of the offeree company to purchase their shares at a price not lower than the highest price during the immediately preceding six months or the negotiated price. The offer to the remaining shareholders should be to acquire them an aggregate minimum of 20 per cent of the total shares of that company. However, such offer must not result in the public shareholding being reduced to less than 20 per cent of the voting capital of the company, subject to the condition that from each of the shareholders accepting such offer, the acquirer must acquire his full holding up to 100 shares of Rs. 10 each or upto 10 shares of Rs. 100 each.

11.6.2 Takeover Code as Modified by SEBI

Takeover of companies was regulated by listing agreements with stock exchanges under the amended Clause 40, as discussed above, till 1994 when SEBI was empowered to regulate takeovers under the SEBI (Substantial Acquisition of Shares and Debentures) Regulations. The primary objectives of the regulation were to make the takeover process transparent and to protect the interest of minority shareholders. In February 1997, SEBI adopted a modified takeover code to strengthen the regulations, based on the recommendations of a Committee with former Justice P. N. Bhagwati as Chairman (Bhagwati Committee). Under the modified Takeover Code, the “acquirer” and persons “acting in concert” have been defined to cover direct as well as indirect acquisitions i.e., acquisitions by mutual funds, their sponsored asset management companies and trustees, foreign institutional investors and banks, financial advisors and stock brokers.

The major provisions of the Takeover Code are as follows :

- 1 Any acquirer holding more than 5 per cent of the shares in a company must disclose the shareholding to the company and all stock exchanges where the scrip is listed.
- 2 It is mandatory for the acquirer to make a public offer when the holding of 10 percent of equity is crossed and there is change in control.
- 3 For the purpose of consolidation of holdings, acquirers holding not less than 10 per cent but not more than 51 per cent equity are allowed ‘creeping acquisition’ upto 2 per cent in any period of 12 months. Any purchase for a holding of more than 51 per cent will have to be in a transparent manner through a public tender offer.
- 4 An acquirer, including persons presently in control of the company, should make a public offer to acquire a minimum of 20 per cent in case the conditions for mandatory public offer are valid.
- 5 SEBI is not to be involved in the pricing of the offer. Pricing will be based on parameters such as the negotiated price, average of the high and low prices for 26 weeks before the date of average of the high and low prices for 26 weeks before the date of the public announcement, highest price paid by the acquirer for any acquisition during 26 weeks period before the date of public announcement, and the price of preferential offers, if any.

- 6 The 'Chain Principle' will be applicable requiring a public offer to be made to shareholders of each company when several companies are acquired through the acquisition of one company.
- 7 Disclosure requirement would include disclosure of additional details on financial arrangement for implementing the offer, future plans of the acquirer of the target company, etc. Misleading information will be deemed to be a violation of disclosure requirement and attract penal action.
- 8 Conditional offer is allowed subject to either a mandatory acceptance of 20 per cent equity with differential pricing, or with a deposit of 50 per cent of the value of the offer in cash to be deposited in an escrow account, in cases where the bidder does not want to be saddled with the 20 per cent acquisition.
- 9 During the offer period, the board of the target company is precluded from inducing any person belonging to the acquirer, or transfer shares in his name until all formalities relating to the offer have been duly completed.

The above provisions to a great extent, ensured the necessary transparency and protection of investors in case of takeover bids.

11.7 LET US SUM UP

Along with the growth of Indian capital market in terms of the number and size of security issues and the daily turnover and market capitalization of stock exchanges, certain negative features have also continued to plague the capital market operations. Some of the major disquieting aspects have been, high volatility in respect of a small proportion of scrips and poor liquidity in respect of a vast majority of scrips, manipulation of share prices to the detriment of gullible investors, delay in allotment of shares creating an artificial scarcity in the market, insider trading, preferential allotment of shares to promoters/associates at a substantial discount to the prevailing market price, 'front running' by brokers and sub-brokers acting with scant regard to investors' interest, and inordinate delay in admitting securities for trading in stock exchanges, and so on.

Before establishment of SEBI, the main laws governing the capital market were the Capital Issues Control Act, 1956 for regulating the primary market and Securities Contracts (Regulation) Act for regulating the secondary market. In April 1988, however, SEBI was set up to look after the investors' interest in both the markets. Meanwhile, the Capital Issues Control Act had been repealed and the Companies Act amended to make SEBI the administrative authority for regulating capital issues, and the government transferred its power under SCR Act to SEBI to regulate the stock market. Thus, SEBI was entrusted with the main responsibility of adopting suitable measures for protecting investors' interests in securities.

Regulation of Public Issue of Capital

SEBI released its Guidelines for Capital Issues of June 1992, which are applicable to all public issues of capital by listed and unlisted companies including offers for sale and the rights issues. These guidelines (as amended till September, 2005) are as follows:

Eligibility norms : The companies issuing securities through an offer document shall ensure that a draft prospectus is filed with SEBI through an eligible merchant banker at least 21 days prior to its filing with ROCs. The same thing applies to a letter of offer in case of rights issue. The company is also to make an application for listing of the

securities to be issued, and enter into an agreement with a depository for dematerialisation of the securities.

An unlisted company can make an initial public offer (IPO) of securities subject to certain conditions such as having net tangible of Rs. 3 crore and track record of distributable profits, and a minimum net worth as specified, and so on. Similarly, for a listed company to make public issue, the size of the proposed and previous issues must not exceed 5 times of its pre-issue net worth, otherwise the company must meet the two conditions of minimum tangible assets and distributable profits as laid down with respect to unlisted companies making an IPO. However, these norms are not applicable to banks and rights issue by a listed company and an infrastructure company if certain conditions are met.

Unlisted companies cannot make a public issue of equity shares or convertible debentures if there are outstanding financial instruments or any other right whereby promoters may be entitled to receive equity shares after the IPO; and no public issue can be made of equity shares unless the existing partly paid-up shares are fully paid up or forfeited

Pricing of Securities : Both listed and unlisted companies may freely price the securities while making a public issue, and such securities may be issued to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made provided the former is higher than the latter. Companies have also the freedom to determine the denomination of equity shares issued subject to the provisions of the Companies Act and in compliance with the norms as specified by SEBI and so also of splitting or consolidating the existing shares.

Promoters' Contribution/Shareholding : In a public issue by an unlisted company, the promoters have to contribute not less than 20 per cent of the post-issue capital. For listed companies, the promoters may either participate to the extent of 20 per cent of the proposed issue or ensure post-issue shareholding to the extent of 20 per cent. If the promoters' participation is in excess of the required minimum contribution, it will be treated as preferential allotment and attract the pricing provisions of the guidelines on preferential allotment. There is also a lock-in requirement of 3 years for their share. However, the requirement of promoters' contribution is not applicable in case of public issue of securities listed on a stock exchange for at least 3 years and the company has a track record of dividend payment for at least 3 preceding years.

Pre-Issue Obligations : The lead merchant banker must exercise due diligence, pay the requisite fee and submit (i) MOU entered into between the lead merchant banker and the issuer company, (ii) Inter-se allocation of responsibilities demarcated as per schedule II of SEBI Guidelines, and (iii) Due Diligence Certificate along with the offer document filed with SEBI. In addition, the lead merchant banker is also to furnish certificates as per Schedule IV, V and VI. The issuer company has also to submit a list to the Board of the persons who constitute the promoters' group and their individual shareholding etc. Lead merchant banker is also to ensure compliance with all regulations as regards appointment of other intermediaries, satisfy itself about the ability of the underwriters to discharge their obligations, and ensure inclusion of relevant details in the offer document.

The draft offer document is required to be made public for a period of 21 days, and the lead merchant banker is also to file the document with the concerned stock exchanges and make its copies available to the public. The issuer company has to make an

advertisement in English, Hindi and regional language newspapers containing disclosures as given in Part A of Schedule XXA of the SEBI Guidelines.

The lead merchant banker must ensure that offer document and other issue materials are despatched in advance to stock exchanges, brokers, underwriters, bankers to the issue and investors associations. A statement is required to be filed with the Board by the lead merchant banker after 21 days from the date the offer document was made public giving a list of complaints received and amendment, if any, proposed to be made in the document.

The issuer company may appoint any number of centres as it may deem fit subject, however, to the minimum requirement in this regard. It may also appoint authorised collection agents in consultation with and at the discretion of lead merchant banker subject to necessary disclosures in the offer document. In addition, it is to appoint a compliance officer who will directly liaise with the Board on all matters regarding compliance with various laws, rules and regulations, etc. Every application form must be accompanied by a copy of the abridged prospectus.

Post-issue Obligations : Post-issue monitoring reports must be submitted as per format specified in Schedule XVI of the Guidelines. This is to be ensured by the post-issue lead merchant banker irrespective of the level of subscription and in accordance with the due dates specified. The post-issue lead merchant banker is to actively associate with post-issue activities, viz., allotment, refund and despatch, regularly monitor redressal of investor grievances arising therefrom, and maintain close coordination with the registrars of the issue. He has to satisfy himself that the public issue is fully subscribed before its closure is announced, and ensure that the underwriters honour their commitments in case of devolvement, and that the money collected on the issue is released only after the listing permission has been obtained from the relevant stock exchanges.

A post-issue advertisement must be released giving details regarding oversubscription, basis of allotment, number, value and percentage of successful allottees, dates of despatch of refund orders and certificates, and date of filing of listing application. It must be ensured that the basis of allotment is finalised in a fair and proper manner as specified in the SEBI Guidelines, and that despatch of share certificates / refund orders and demat credit as also submission of allotment and listing documents to the stock exchanges are completed within two working days of the finalisation of the basis of allotment.

Other requirements : In case of public issue of non-convertible and convertible debt securities, the lead merchant banker is to ensure compliance with the SEBI Guidelines 2000 (as revised from time to time, relating to NCDS and DSCE including conditions specified under Rule 19(2) (b) of Securities Contracts (Regulation) Rules, 1957 which provides for minimum net offer to the public and the limits of reservations and firm allotments to various categories of persons. However, the unlisted company can make an application to the Board for relaxation from applicability of this Rule and for listing of its shares without making an initial offer provided it satisfies the prescribed conditions. The companies are also permitted to issue new financial instruments such as zero coupon bonds, warrants, deep discount bonds, etc. subject to certain conditions.

SEBI guidelines also provide for detailed requirements related to minimum application value, total period within which the calls are to fall due, minimum period of

subscription to be kept open, the period to which audited statements contained in the offer document should relate, appointment of the compliance officer, the limit of minimum subscription arrangement, monitoring the use of the proceeds of the issue, safety for buy back arrangement, etc.

In additions, detailed guidelines are laid down by SEBI on green shoe option, employee stock option scheme, book building, issue of debt instruments, e-IPO, preferential issues, bonus, issue, etc.

Regulatory Framework for Controlling Stock Market Operations

To regulate and control stock market operations in wider interest of investors, the SCR Act was passed in 1956. It provides for recognition of stock exchanges, general control over their trading methods and practices, regulation of contracts and options in securities, and listing of securities by public companies. In 1957, when the Act came into effect, detailed rules were also framed for the purpose. Originally, the powers of its administration vested with the Central Governments. But after SEBI was constituted, most of these powers were transferred to SEBI.

For grant of recognition, a stock exchange is to make an application to SEBI accompanied by a copy of bye-laws of the exchange and a copy of the rules relating to its constitution. The grant of recognition is subject to a number of conditions prescribed for the grant of recognition.

Every stock exchange must have rules regulating the voting rights of members in respect of matters to be placed before the stock exchange. These rules must have the approval of the Central Government / SEBI and then published in the official Gazette. Similarly, subject to previous approval of SEBI, the recognised stock exchange can make necessary bye-laws for the regulation and control of contracts.

Every stock exchange is required to furnish the Central Government with a copy of its annual report and prescribed periodical returns, and make its books account and documents available for inspection by SEBI. SEBI can also order an enquiry in relation to the affairs of the governing body or any member of the exchange. The Government has the power to supersede the governing body for a specific period and also to suspend the business of a stock exchange for a short period, if need be.

Normally a company is not obliged to get its shares listed unless it is making public issue. However, a company may be compelled by SEBI for listing of its securities on a recognised stock exchange if it is necessary and expedient to do so in the interest of trade or in the public interest. Where a company applies for listing and the stock exchange refuses to list the securities, the company is entitled to be furnished with reasons for such refusal, and it may appeal to the Central Government /SEBI against such refusal. The shares of a company can also be delisted for various reasons, and when it happens, this fact must be disclosed in Director's Report with a statement of reasons for the same. There is also a provision for reinstatement of delisted securities with a period of one year after of delisting.

The role of SEBI as regulator of capital market operations may be stated in the light of the various measures adopted over time, viz., registration of intermediaries; inspection of stock exchanges to improve their functioning; measures aimed at strengthening investor interest and confidence in the secondary market; enforcing regulations prohibiting 'insider trading'; setting up clearing houses or clearing corporations and

providing trade guarantee by stock exchanges; compulsory settlement of trades through depositories; inspection of mutual funds; regulation of merchant banking; issue of guidelines for entry norms for companies accessing capital market; regulating buy back of shares and collective investment schemes; introducing compulsory rolling settlement and derivatives trading; launching centralised internet based filing system; posting all orders against errant companies and others on website; adopting a takeover code to regulate corporate takeovers; etc.

Certain key changes had been made in 2002 in the SEBI Act so as to provide adequate powers to SEBI to perform its regulatory role more effectively. These include power of search and seizure, power to freeze bank accounts, power to impose higher penalties, and increase in Board's membership.

Regulation of Corporate Takeover

Corporate mergers through acquisition, absorption or takeover is widely regarded as a strategy of external growth. It may involve a friendly approach or take place through a bid to takeover with a hostile approach. Usually, the profitable growth companies are expected to attract takeover bids. But, various other considerations and the benefits to be derived from merger also underlie the decision of companies to go in for takeover of other companies.

The Government of India amended Clause 40 of the Listing Agreement of companies with stock exchanges in May 1990 to prevent clandestine takeover bids by any company as also to protect the interest of minority shareholders. The amended clause inter alia, provided for a public announcement of the takeover bid and making all information relating to offer available to shareholders of both offeror and offeree companies and also lodged with SEBI. Another stipulation related to the offeror company making an offer to the members of the offeree company to purchase their shares at a negotiated price. In 1994, SEBI was empowered to regulate takeover under SEBI (Substantial Acquisition of Shares and Debentures) Regulations. In February 1997, SEBI adopted a modified takeover code to strengthen the existing regulations. Its major provisions include : anyone holding more than 5 per cent of the shares of a company must disclose the shareholding to the company and all stock exchanges concerned; the acquirer must make public offer when the holding of 10 per cent equity is crossed and there is change in control; any purchase for a holding of more than 51 per cent will have to be in a transparent manner through a public tender offer; disclosure requirements as specified must be implemented; the board of the target company is precluded from inducting any person belonging to the acquirer of transfer shares in his name until all formalities related to the offer have been duly completed. These provisions have ensured, to some extent, the transparency and protection of investors' interest in case of takeover bids.

11.8 KEY WORDS

Buy-Back Arrangement : A company buying its own shares and other specified securities out of its free reserves, securities premium account or the proceeds of any shares or other specified securities as per the provisions of Section 77A of the Companies Act.

Composite issue : An issue of securities by a listed company on a public cum rights basis offered through a single offer document wherein the allotment for both public and rights components of the issue is proposed to be made simultaneously.

Coupon Rate : The stated rate of interest on a bond or debenture.

Deep Discount Bonds : Bonds issued at low values with a long maturity period when, on account of compound interest, they fetch an extremely high amount. ICICI and IDBI had issued such bond at Rs. 5100 /5300 to become Rs. 2,00,000 after 28/25 years respectively with a call option exercisable on the expiry of 5 years.

Due Diligence : It is an exercise carried out generally by an expert to assess benefits and problems of a proposed project, issue or acquisition based on enquiries documents and other verifiable procedures to avoid bad buys.

Employees Stock Options : The options given to the whole-time directors, officers or employees of a company to purchase or subscribe at a future date the securities offered by the company at a pre-determined price.

E-IPO : Initial public offer through online system of the stock exchange for offer of securities.

Green Shoe Option : An option of allocating shares in excess of the shares included in the public issue and operating a price listing price stabilizing mechanism (an option to retain over-subscription).

Lock-in Period : The period within which shares and other securities cannot be transferred by sale or otherwise.

Near Banks : These refer to financial institutions like that offer more specialised services.

Retail Individual Investor : An investor who applies or bids for securities of a value of not more than Rs. 1,00,000.

Reverse Merger : A situation wherein a small firm acquires a larger firm although the former may be loss making while the later is the profit maker. May be it is motivated for exploiting tax benefits.

Sweat Equity Shares : Equity shares issued by a company to its promoters, directors or employees at a discount or for consideration other than cash. They may be issued for providing know-how or making available intellectual property right or value additions by whatever name called.

Takeover Bid : A bid to takeover which involves acquiring the control over another company against the will of its management generally by way of purchasing a sizable number of shares of the target company.

Warrants : A warrant is an option to the investor to buy a specified number of equity shares at a specified price over a specified period of time.

Zero Coupon Debentures / Bonds : These are bonds sold at a large discount on the nominal value. Their maturity period varies from 5 to 12 years when they are redeemed at par. They were first issued by Mahindra and Mahindra Ltd. Since the investor is not entitled to any interest on these bonds, the conversion price is suitably adjusted to take care of interest loss to investors.

11.9 ANSWERS TO CHECK YOUR PROGRESS

- A 3 (a) third (b) 5 (c) unpublished (d) liquidity (e) Companies
 B 4 (a) True (b) True (c) True (d) False (e) True (f) False

11.10 TERMINAL QUESTIONS

- 1 Why has it been necessary for Government of India to initiate capital market reforms and regulatory measures in the recent past ? Discuss.
- 2 “SEBI has been entrusted with the main responsibility to adopt suitable measures for protecting the interest of investors in securities and promoting the development and regulation of stock market”. Discuss.
- 3 What are the conditions required to be fulfilled by (a) a listed company and (b) an unlisted company to be eligible to make a public issue of shares as per SEBI Guidelines?
- 4 State SEBI Guidelines in respect of following
 - (a) Underwriting
 - (b) Pre-issue advertisement
 - (c) Differential pricing
 - (d) Basis of allotment
- 5 State the SEBI Guidelines with respect to promoters’ contribution in a public issue of securities by (i) a listed company, and (ii) and unlisted company. Also state the lock-in requirement in respect thereof.
- 6 List and state the nature of documents required to be filed by the lead manager with SEBI alongwith the offer document for a proposed public issue of securities.
- 7 Discuss the post-issue obligations of the lead merchant banker to the public issue of shares
- 8 (a) Explain briefly the provisions of Rule 19(2) (b) of Securities Contracts (Regulation) Rules, 1957).
 (b) Outline the requirements related to the terms of issue under other issue requirements relating to public issue of securities.
- 9 State the objectives underlying the Securities Contracts (Regulation) Act, 1956, and the powers granted to Central Government to achieve these objectives.
- 10 What is the procedure laid down in the Securities Contract (Regulation) Act for recognition of stock exchanges ? State the main requirements to be fulfilled for grant of recognition.
- 11 Can SEBI compel a public company to get its securities listed on stock exchanges while making a public issue ? On what grounds can the listed securities be delisted by a stock exchange ? Explain the rules in this regard.
- 12 State the measures adopted by SEBI at strengthening investors’ interest and confidence in the stock market.
- 13 Discuss the role of SEBI in controlling stock market operations as reflected in the measures adopted by it towards that end.
- 14 Write an explanatory note on regulations governing takeover bids by companies, and state the main features of the Modified Takeover Code adopted by SEBI.

- 15 Write short notes on
- (a) Rules of Stock exchanges
 - (b) Bye-laws of Stock Exchanges
 - (c) Licensing of Dealers in securities
 - (d) New Debt Instruments

Note : These questions will help you to understand the unit better. Try to write answers for them, but do not submit your answers to the university for assessment. These are for your practice only.