Raising of Resources from Capital Market in India

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Resources can be mobilized either for short term or for long term. Economy consists of huge number of enterprises and individuals, requirements of all of them differ. Some have surplus cash to save, while some other needs cash. Some firms/individuals wants to make good there short term liquidity requirements, some wants money for long term capital investment. So distinction can be made as to period for which one intends to lend or borrow. In this sense financial market is categorized into **money market and capital markets**. In Money market, period involved (for funds movement) is 1 year or less, while in capital markets period is generally more than 1 year.

In this paper, we'll be specifically looking at the different ways in which resources can be raised from the **capital market** in India.

That India's capital markets are among the most developed and efficient in the world is an accepted notion, especially among readers of this column. India's stock exchanges – Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) boast of state of the art technology and are among the fastest in the world in terms of transaction time. India ranks among the top two globally in terms of volume of trades in its capital markets.[1]

Moving on, we directly delve into the various ways the companies raise resources from the capital market in India. When most people think about a company raising capital, they think about a private company going public - selling an initial public offering (IPO) of stock. An IPO can indeed be an effective means of raising capital for corporate ventures, and it has many upsides. A few of them are as follows:

- ***Money to grow the business***: With an infusion of cash derived from the sale of stock, the company may grow its business without having to borrow from traditional sources and it will thus avoid paying the interest required to service debt. This new capital raised from the sale of stock, may be spent on marketing and advertising, hiring more experienced personnel who require lucrative compensation packages, research and development of new products and/or services, renovation of physical plants, new construction and dozens of other programs to expand the business and improve profitability, etc.

- ***Money for shareholders and others*:** With more cash in the company coffers, additional compensation may be offered to investors, stakeholders, founders and owners, partners, senior management and employees enrolled in stock ownership

[1] https://www.bloombergquint.com/opinion/2017/04/28/sensex-at-30000-are-indias-capital-markets-a-boon-or-bane-for-the-economy

plans. In recruiting talented senior management personnel, stock and options are an attractive inducement. For employees, a performance-based program of stock and/or option bonuses is an effective means of increasing productivity and managerial successes.

- ***Other benefits of going public*:** Once the company has gone public, additional equities may be easily sold to raise capital. A publicly-traded company with stock that has performed successfully will usually find it easier to borrow money, and at a more favourable rate, when additional capital is needed. Customers usually have a better perception of companies with a presence on a major stock exchange, another advantage over privately-held companies. This favourable opinion is largely due to the audit and financial statement scrutiny that public companies have to undergo on a regular basis.

But before undertaking the complex, expensive and time-consuming preparations and incurring the risks involved, the upside and downside of this critical move must be fully assessed. Although there are numerous benefits to being a public company, this prestige comes with an increased amount of restrictions and compliance requirements.

Raising Resources via the Issue of Shares and Statutory Provisions

Section 23 of the Companies Act, 2013 discusses the option to issue shares. In order to issue shares a company needs to be a registered company. There are four ways in which shares can be issued:

1. Public issue (includes Initial Public Offering and Further Public Offering)
2. Rights issue
3. Bonus issue
4. Private Placement

Where a Public company can issue shares through Public Issue, Private Placement, Rights issue or Bonus issue, a Private Company may issue shares by way of Rights issue or Bonus issue and Private Placement.

The following are the different methods through which a public company can raise funds from the primary market:

(a) Public issue: When an issue/offer of securities is made to new investors for becoming part of shareholders' family of the issuer it is called a public issue. Public issue can be further classified into Initial public offer (IPO) and Further public offer (FPO). The significant features of each type of public issue are illustrated below:

1. **Initial public offer (IPO):** When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO. This paves way for listing and trading of the issuer's securities in the Stock Exchanges.

2. **Further public offer (FPO)**: When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a FPO.

(b) Right issue (RI): When an issue of securities is made by an issuer to its shareholders existing as on a particular date fixed by the issuer (i.e. record date), it is called a Rights Issue. The rights are offered in a particular ratio to the number of securities held as on the record date.

(c) Bonus issue: When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account in a particular ratio to the number of securities held on a record date.

(d) Private placement: When an issuer makes an issue of securities to a select group of persons not exceeding 49, and which is neither a rights issue nor a public issue, it is called a private placement. Private placement of shares or convertible securities by listed issuer can be of two types:

1. **Preferential allotment:** When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter VII of SEBI (ICDR) Regulations, it is called a preferential allotment. The issuer is required to comply with various provisions which inter alia include pricing, disclosures in the notice, lock in etc., in addition to the requirements specified in the Companies Act.

2. **Qualified institutions placement (QIP):** When a listed issuer issues equity shares or securities convertible in to equity shares to Qualified Institutions Buyers only in terms of provisions of Chapter VIII of SEBI (ICDR) Regulations, it is called a QIP

PROCEDURE FOR ISSUE OF SHARES IN INDIA

The Companies Act, 2013 read with Companies (Prospectus and Allotment of Securities) Rules, 2014 describes the procedure of issuance and allotment of shares as follows:

Public issue of shares

Issuing the prospectus:

Section 26(1) of the Companies Act, 2013 deals with procedure of matter should be stated in the prospectus. A prospectus bears an open invitation to public to buy shares of the company. SEBI (Securities Exchange Board of India) is the regulator and thus a copy of the company's prospectus needs to be submitted before the publication date.

The prospectus gives brief information about the company, like:

Name of the directors

1. Past Performance (including Reports of the company)
2. Terms of issue
3. Type of investment (for raising capital)

Apart from these details opening and closing dates of share issue, application form, application fees, allotment and call-on dates, minimum shares for application and bank details for deposit are provided in prospectus.

The Registrar after ensuring compliance will register the prospectus.

Application of shares:

After invitation, application can be submitted through prescribed form along with application fee before closing date mentioned in prospectus. Allotment of shares is done with the selected applicants and rest of applicants receive regret letters. Share certificates are issued after the allotment is done.

Call on shares:

Call on shares is a way to collect remaining shares after application and allotment as per the provisions of the prospectus. There's first call, second call, etc. depending on the number of instalments.

Private Placement of shares

In case of Private Placement, a Private Placement Offer Letter is issued. Section 42 of Companies Act, 2013 discusses this provision and it should be read with Rules. Number of allotments of shares is limited and rules are laid down for the same. No company offering securities shall release any public advertisements or utilise any marketing agents, etc. to inform the public at large about the offer. Return of allotment has to be filed which should include a complete list of all security-holders.

ORIGINS OF STOCK MARKET

The origins of a stock market can be traced to the Dutch East India Company which issued shares to the general public in 1602 to raise capital to build the spice trade. Ever since,

- The **'primary' role** of a stock market in a nation's economy has been to **mobilise household savings** to raise capital for companies which then create jobs and boost economic growth.
- In order to be able to achieve this goal, the stock markets provide **price discovery mechanism** through **'secondary' trading** of shares.
- In order to further increase efficiency and provide capabilities to hedge losses, most stock markets also allow for **trading of derivatives** which is the **'tertiary' function**.

India's capital markets have evinced tremendous interest in the last decade. An analysis of SEBI's annual reports from 2005- 2016 shows as follows:

- The number of market participants such as brokers and sub-brokers has gone up two fold.
- There are now nearly 2000 registered foreign investors in India vis-à-vis 600 in 2005.
- The number of mutual funds has doubled from 25 to 50 in this period.
- If one agrees that the most basic function of a nation's capital markets is to route capital from households to industry, it is unclear that India's capital markets perform this basic function efficiently. As per a sobering reminder from SEBI's latest investor survey, made available recently, the phrase "stock markets" is most associated with the word "danger" by a majority of India's households. The 'Danger' is in the sense of distrust and risk. It is well known that a miniscule fraction of India's households invest in the stock markets.

In the capital markets, resources to corporates are not developing but rather are quite unstable and have remained almost flat for 10 years. However, the Sensex is at an unparalleled high and the number of foreign speculators and investors in the Indian markets are steadily rising. As such, all that cash that flowed into the securities exchanges did not really go into financing the Indian markets and industries but rather facilitated the investment and trading in derivatives. This is not the usual standard and this was quite unexpected from the capital markets across the world. It has been duly noted that:

- Chinese corporates raised nearly $250 billion from its stock exchanges in Shanghai and Shenzen in 2015.

- American corporates raised $212 billion from Nasdaq and NYSE.

- Indian corporates raised only one-tenth – $21 billion from BSE and NSE.

However, the stock exchanges in India traded double the amount in equity derivatives volumes than the United States in 2015. The markets in India India's have performed more than their tertiary function and failed to perform their primary function. Indian household units manage to spare about $400 billion a year by and large. Indian mutual funds got just $100 billion in net inflows in a whole decade. It is much needed that the policies and arrangements that include tinkering with rules and regulation do a great deal more to guarantee that the capital markets perform much better than their primary function of diverting household funds to the Indian industries and markets all the more productively.