Corpsec Hotline

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CHANGES TO IPO GUIDELINES IN INDIA

The Securities and Exchange Board of India ("**SEBI**") amended the Disclosure and Investor Protection Guidelines ("**DIP Guidelines**") on August 14, 2003 relating to the eligibility norms for issuer companies, the book building process and the disclosure requirements in the prospectus. The amendments have also introduced the "green shoe option" to provide stability to the price of the shares post the Initial Public Offering ("**IPO**").

The salient changes to the DIP Guidelines have been set forth below.

Eligibility norms

A company proposing an IPO must now have:

- Net tangible assets of Rs. 30 million for the preceding full three years. Earlier, the requirement was a pre-issue networth of not less than Rs. 10 million in three out of preceding five years, in order to be eligible to make an IPO. An additional qualification is that not more than 50 per cent of the net tangible assets should be held in monetary assets.
- In case the company has changed its name in the last one year, at least 50 per cent of the revenue for the preceding one year should be earned by the company from the activity suggested by the new name.

In the event that a company is not able to comply with the eligibility norms prescribed above, the IPO must be through a book-building process with at least 50 per cent of the issue size being allotted to Qualified Institutional Buyers ("**QIBs**") or through a "project appraisal method". The minimum post-issue face value capital of the company, in such a case must be Rs. 100 million or the company should have an arrangement of "market making" for at least two years from the date of the listing of the shares.

No allotment may be made pursuant to a public offering unless in addition to complying with the eligibility requirements as discussed above, the prospective allottees are more than one thousand in number.

Book Building Process

- The companies issuing shares under the book building process can now indicate a movable price band or a fixed floor price in the Red Herring prospectus, as opposed to only the indication of the floor price as was permitted earlier.
- QIBs shall not be allowed to withdraw their bids after the closure of the bidding.

Green Shoe Option

The green shoe option refers to the option of allocating shares in excess of the shares included in the public issue, with the intention of stabilizing post-listing price of the newly issued shares. A company using the book building method can now appoint a Stabilizing Agent ("**SA**") who will exercise the Green Shoe Option by borrowing shares from the promoters subject to a cap of 15 per cent of the total issue size.

In the event that the price of the shares goes below the issue price the SA will buy shares from the market so that the price rises. In the event that the price of the shares rises abnormally then the SA will supply shares to the market to lower the price.

Changes in Disclosure requirements in the offer document

The amendments to the DIP Guidelines provide for certain additional disclosures to be made in the offer document. Some of these disclosures include:

- Risk factors will need to be classified as those specific to the project and internal to the issuer company and those that are external and beyond the control of the issuer company. These factors shall be determined on the basis of their materiality.
- An undertaking by the issuer company confirming firm arrangements of finance through verifiable means towards 75% of the stated means of finance, excluding the amount to be raised through proposed Public/Rights issue.
- Information on whether the company proposes to raise funds for a purpose like fixed asset creation and/or for rotation such as working capital etc along with the requirement of funds for fixed assets.
- Details of the promoters and their backgrounds, inter alia, age, educational qualifications, work experience,

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photograph, voter identification number, driving license number to ensure that the promoters can be traced in case of fly-by-night companies.

Other amendments

In addition to the above amendments, certain additional exemptions have been provided for with regard to the lock-in period of pre-issue share capital of an unlisted company as well as some changes have been made in connection with the listing of debt instruments.

Conclusion

The eligibility and disclosure requirements have been made more stringent, making the entire process of public issue more investor friendly. The inclusion of the green shoe option has also provided the issuer company with a strong mechanism to control price fluctuations. The amendments on the whole seem to be in sync with the global best practices.

Source: SEBI/CFD/DIL/DIP/Circular No 11. dated August 14. 2003 based by Securities and Exchange Board of India

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September 22, 2024