

GUIDELINES RELATING TO INITIAL PUBLIC OFFERS IN INDIA
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The principle Indian regulations pertaining to listing of securities are the SEBI (Disclosure and Investor Protection) Guidelines, 2000 (“DIP Guidelines”). These guidelines are applicable to all public issues by listed and unlisted companies, all offers for sale and rights issues by listed companies, except rights issues where the average value of the shares offered does not exceed Rs. 5,000,000 (Rupees five million). (Clause 1.4 of the DIP Guidelines)

Criteria for Initial Public Offers (“IPOs”)

In order to make an IPO, an unlisted company must satisfy the following conditions:

1. it must have a pre-issue net worth of not less than Rs. 10,000,000 (Rupees ten million) in three (3) out of the preceding five (5) years, with a minimum net worth to be met during the two (2) immediately preceding years;
2. it must have a track record of distributing dividends for at least three (3) out of the immediately preceding five (5) years; and
3. the issue size, i.e., the offer through the offer document, the firm allotment and the promoter’s contribution through the offer document, should not exceed five times the pre-issue net worth as per the last available audited account, either at the time of filing the draft offer document with the Securities and Exchange Board of India (“SEBI”) or at the time of opening of the issue. (Clause 2.2.1 of the DIP Guidelines)

If the above conditions are not satisfied, then the IPO can be made only through a book-building process, provided that sixty percent (60%) of the issue size must be allotted to Qualified Institutional Buyers (“QIBs”). (Clause 2.2.2 of the DIP Guidelines)

QIBs, inter alia, includes public financial institutions, scheduled commercial banks, mutual funds, venture capital funds registered with the SEBI (“VCFs”), foreign venture capital investors registered with the SEBI (“FVCIs”), etc.

“Net worth” means the average of the value of the paid up equity capital and free reserves (excluding reserves created out of revaluation), minus the average value of the accumulated losses and deferred expenditure not written off (including

miscellaneous expenses not written off). (Clause 1.2.1(xixa) of the DIP Guidelines)

For the purpose of calculating the track record of distributing dividends, profits emanating only from the information technology (“IT”) business or activities of the company will be considered in the following cases:

1. for companies in the IT sector or proposing to raise money for projects in the IT sector; and
2. for companies whose name suggests that they are engaged in IT activities or business, i.e., names containing the words software, hardware, info, infotech, com, informatics, technology, computer, information, etc.

IT comprises of the following activities:

1. production of computer software;
2. IT services;
3. manufacturing of IT hardware, products, and components;
4. computer education and training, maintenance, and consultancy; and
5. e-commerce or internet related activities.

Promoters’ Contribution

In an IPO, the promoters must contribute at least twenty percent (20%) of the post-issue capital.

The term promoter includes:

1. person(s) in overall control of the company;
2. person(s) who are instrumental in the formulation of a plan or program pursuant to which the securities are offered to the public; and
3. persons named in the prospectus as promoters.

Any person acting as a director or officer of the issuer company merely in a professional capacity is not included in the definition of promoter.

A promoter group includes:

1. the promoter;
2. an immediate relative of the promoter; and
3. in case the promoter is a company:
 - a) a subsidiary or holding company of that company;
 - b) any company in which the promoter holds ten percent (10%) or more of the equity capital or which holds ten percent (10%) or more of the equity capital of the promoter;
 - c) any company in which a group of individuals, companies or combinations thereof holds twenty percent (20%) or more of the equity capital and also holds twenty percent (20%) or more of the equity capital of the issuer company; and
4. in case the promoter is an individual:
 - a) any company in which the promoter, an immediate relative of the promoter or a firm in which the promoter or his immediate relative is a member, holds ten percent (10%) or more of the share capital;
 - b) any company in which a company specified in (a) above, holds ten percent (10%) or more, of the share capital; and
 - c) any firm in which the aggregate share of the promoter and his immediate relatives is equal to or more than ten percent (10%) of the total; and
5. all persons whose shareholding is aggregated for the purpose of disclosing in the prospectus as the shareholding of the promoter group.

Financial institutions, scheduled banks, foreign institutional investors and mutual funds are not deemed to be a promoter or a promoter group merely because they hold ten percent (10%) or more of the equity of the issuer company. However, such entities will be treated as promoters or a promoter group with respect to the subsidiaries or companies promoted by them or for the mutual funds sponsored by them.

The following will not be eligible to be considered for computation of the promoters' contribution:

1. equity acquired by promoters of a company during the three (3) years preceding the filing of the offer document with the SEBI, if it:
 - a) is acquired for consideration other than cash and revaluation of assets or capitalization of intangible assets is involved in such transactions; or
 - b) results from a bonus issue, out of revaluation of reserves, or reserves without accrual of cash resources (Clause 4.6.1 of the DIP Guidelines);
2. securities that have been issued to the promoters, during the preceding year, at a lower price than at which they are being offered to the public, except if the promoters bring in the difference between the offer price and the issue price for the shares and all the requirements under the Companies Act, 1956 are fulfilled, i.e., passing of revised resolutions by shareholders or Board filing of the revised return of allotment with the ROC, etc. (Clause 4.6.2 of the DIP Guidelines); and
3. securities for which a specific written consent has not been obtained from the shareholders for inclusion of their shares in the minimum promoters' contribution subject to lock-in. (Clause 4.6.7 of the DIP Guidelines)

The ineligible shares mentioned in 1 and 2 above, acquired pursuant to a scheme of merger or amalgamation approved by a High Court, will be eligible to compute the promoters' contribution. (Clause 4.6.4 of the DIP Guidelines)

A minimum contribution of Rs. 25,000 (Rupees twenty-five thousand) per application from each individual and Rs. 100,000 (Rupees hundred thousand) from firms and companies will be eligible for consideration to calculate the minimum promoters' contribution. (Clause 4.6.5 of the DIP Guidelines)

The promoters must bring in the full amount of contribution at least one (1) day before the issue opening date, to be kept in an escrow account with a scheduled commercial bank, which will be released to the company along with the public issue proceeds. If the promoters' contribution has been brought before the public issue and has already been deployed by the company, the company must give a cash flow statement in the offer document, disclosing how the promoters' contribution was used. If the minimum promoters' contribution exceeds Rs.

10,000,000 (Rupees ten million), the promoters must bring in Rs. 10,000,000 (Rupees ten million) before the opening of the issue and the remaining amount on a pro rata basis before the calls are made on the public. (Clause 4.9.1 of the DIP Guidelines)

The company's Board must pass a resolution allotting the shares or convertible instruments to the promoters against the amount received. A copy of the resolution and a certificate from a chartered accountant indicating receipt of the promoters' contribution must be filed with the SEBI. A list of the names and addresses of friends, relatives and associates who have contributed to the promoters' quota and their subscription amount must also be attached to the chartered accountant's certificate. (Clause 4.9.2 r/w Clause 4.9.3 r/w Clause 4.9.4 of the DIP Guidelines)

The promoters' contribution will not be required in case of companies where there is no identifiable promoter or promoter group.

Lock-in Requirements

The DIP Guidelines specify the minimum lock-in period and lay down the other requirements relating to the lock-in period.

The minimum promoters' contribution, i.e., twenty percent (20%) of the post-issue capital, is required to be locked-in for a period of three (3) years, starting from the date of allotment in the proposed issue and ending three (3) years from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later. (Clause 4.11.1 r/w Clause 4.11.2 of the DIP Guidelines)

Promoters' contribution in excess of the required minimum percentage must be locked in for a period of one (1) year. The securities forming part of the promoters' contribution and issued last to the promoters must be locked-in first, except in the case of financial institutions appearing as promoters. (Clause 4.12.1 r/w Clause 4.13.1 of the DIP Guidelines)

The entire pre-issue capital, other than the promoters' contribution, must be locked in for a period of one (1) year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later. This provision is not applicable to the pre-issue share capital:

1. held by VCFs and FVCIs, which must be locked-in according to the SEBI (VCF) Regulations, 1999 and the SEBI (FVCI) Regulations, 2000; and

2. held for a period of at least one (1) year at the time of filing of the draft offer document with the SEBI and being offered to the public through an offer for sale, i.e., an offer by existing shareholders of a company to the public. (Clause 4.14.1 r/w Clause 4.14.2 of the DIP Guidelines)

Locked-in securities forming part of the promoters' contribution may be pledged only with banks or financial institutions as collateral for loans, if the pledge of shares is one of the terms of the loan. (Clause 4.15.1 of the DIP Guidelines)

Further, the transfer of securities, inter se, amongst promoters is also subject to the lock-in applicable to transferees for the remaining lock-in period. (Clause 4.16.1 of the DIP Guidelines) The face of the security certificate of locked-in securities must contain the inscription "non-transferable" and specify the period for which it is not transferable. (Clause 4.17.1 of the DIP Guidelines)

Prospectus Requirements

The offer document must contain true and sufficient information to enable the investor to make an informed decision while investing in the offered securities (Clause 6.1 of the DIP Guidelines) The prospectus must, inter alia, provide information relating to risk factors, project costs, means of financing, appraisal, issue schedule, details of the managerial personnel, capital structure of the company, terms of the issue, financial information of company and group companies, basis for issue price and details of the products, machinery and technology.

The SEBI the power to pass directions as mentioned below, for any violation of the DIP Guidelines, including misstatement in the prospectus. In addition, under the Companies Act, 1956, every person who authorizes the issue of a prospectus that contains any untrue statement is liable to be punished with imprisonment of up to two years or with a fine of up to Rs. 50,000 (US \$ 1040). (Section 62 of the Companies Act, 1956)

Powers of the SEBI

In the event of any violation of the DIP Guidelines, the SEBI can take measures to protect the interest of investors and the securities market and pass the following orders:

1. direct the persons concerned to refund the money collected under the issue to the investors with or without interest;

2. prohibit the persons concerned from accessing the capital market for a particular period;
3. direct the stock exchange not to list or permit trading in the securities;
4. direct the stock exchange to forfeit the security deposit of the issuing company; and
5. any other direction that the SEBI deems fit. (Clause 17.1 of the DIP Guidelines)

Before issuing any of the above directions, the SEBI may give the person concerned a reasonable opportunity to show cause against the direction. The Board may also initiate action against intermediaries who fail to exercise due diligence or to comply with any obligation under the DIP Guidelines. (Clause 17.2 of the DIP Guidelines)

Conclusion

The DIP Guidelines provide detailed regulations that must be complied with in all public issues by listed and unlisted companies. These guidelines set out the criteria for IPOs, including, the minimum percentage of promoters' contributions, the lock in periods and the prospectus requirements. The SEBI has the discretion to pass directions and take other actions against persons who did not comply with the DIP Guidelines. The DIP Guidelines, therefore, help in achieving greater transparency in the capital market and in protecting the interest of the investors.