A Comparative Study on the Issues in Primary and S markets with Reference to IPO & FPO

***Prof. Roshan M.Nadaf, Asst professor, Nehru Arts, Science and commerce college, Hubli**

Abstract

This paper attempts to study the terms **IPO and FPO** are often used in the stock markets, **IPO/FPO** is a **process** by which a company on the stock exchange can raise capital**.** This is extremely important to know because the Initial Public Offering (IPO) market, also called the Primary market sometimes attracts companies offering their shares to public without actually going through a healthy round of funding in the past. Few rounds of funding by credible VC, and PE firm validate the quality of the business and its promoters. Of course you need to treat this with a pinch of salt but nevertheless it acts as an indicator to identify well run companies. Why do entrepreneurs return to the security markets with one more public offering or what is known as Follow-on Public Offer ("**FPO**")? An FPO is a subsequent offering of shares to the public, after an IPO. Companies aim to raise capital to finance debt or make growth acquisitions from the FPO proceeds. Another reason that companies promote an FPO is the absence of liquidity with banks and financial institutions or a need for substantial capital.

An FPO may be promoted either by the company itself, wherein the FPO proceeds are invested in the company against the issue of new shares or by existing shareholders, who desire to offload their shareholding in the company, called Offer-for-Sale or OFS, or by a combination of both, i.e. issue of new shares and OFS. In an OFS, the FPO proceeds are not deposited with the company but delivered to the existing shareholders. In an FPO, the company issues new shares, thereby diluting the shareholding of the existing shareholders; whereas in an OFS, the shareholding of the existing promoters remain intact, other than those who partake in the OFS. The question of whether to opt for an FPO or private placement depends on the fund requirement of the company and the willingness of the promoters to dilute their shareholding and cede some control to the private equity investor. While private equity may be ideal, since a company must deal with one or two investors, the handicap is that all decisions must be approved by the investor. In an FPO, the promoters have the flexibility to operate the company as per past practices, albeit with the approval of the shareholders to material decisions. With liquidity drying up with banks and financial institutions and private equity investors becoming cautious, entrepreneurs may prefer to use the FPO route to raise funds and realise their dreams to expand and grow their business. It will be a good opportunity for investors who have been tracking the company and wish to own a part of the company.

Key words: IPO, FPO, high net worth individuals, India, Non-Banking Financial Organisations, Demat

Introduction

An initial public offering (IPO) or stock market launch is a public offering in which shares of a company are sold to institutional investors and usually also retail (individual) investors.An IPO is typically underwritten by one or more investment banks, who also arrange for the shares to be listed on one or more stock exchanges. Through this process, colloquially known as floating, or going public, a privately held company is transformed into a public company. Initial public offerings can be used to raise new equity capital for companies, to monetize the investments of private shareholders such as company founders or private equity investors, and to enable easy trading of existing holdings or future capital raising by becoming publicly traded.

After the IPO, shares are traded freely in the open market at what is known as the free float. Stock exchanges stipulate a minimum free float both in absolute terms (the total value as determined by the share price multiplied by the number of shares sold to the public) and as a proportion of the total share capital (i.e., the number of shares sold to the public divided by the total shares outstanding). Although IPO offers many benefits, there are also significant costs involved, chiefly those associated with the process such as banking and legal fees, and the ongoing requirement to disclose important and sometimes sensitive information.

Details of the proposed offering are disclosed to potential purchasers in the form of a lengthy document known as a prospectus. Most companies undertake an IPO with the assistance of an investment banking firm acting in the capacity of an underwriter. Underwriters provide several services, including help with correctly assessing the value of shares (share price) and establishing a public market for shares (initial sale). Alternative methods such as the Dutch auction have also been explored and applied for several IPOs. From a investor's perspective, they may be comfortable investing in an FPO rather than an IPO, since FPO investors know the track record and assess the performance and stability of the issuer company.

In an IPO, although the investor invests in the company, based on its past performance, the pedigree of the promoter and the potential of the products, the risk of investing in an IPO is higher than that of investing in an FPO.

Key Difference: IPO vs. FPO

- IPO is the first public issue of the shares of a private company that is going public whereas FPO is the second or subsequent public issue of the shares of an already listed public company.
- IPO is released with an intention to raise capital through public investment whereas FPO is offered with an aim to inflow subsequent public investment.

- An IPO is generally riskier than FPO as in IPO an individual investor does not know about what may happen with the company in the future. On the other hand in FPO, the investors are aware as the company is already listed on stock exchange. Therefore, the investors can study the past performance and make assumptions about the company's future growth prospects.

Difference between FPO and IPO: Comparison chart

BASIS FOR COMPARISON	IPO	FPO
Meaning	IPO refers to an offer of securities made to the public for subscription by the company for the first time	FPO refers to an offer of securities for subscription to the public by a publicly-traded enterprise
Issuer	Unlisted company	Listed company
Raising Capital	Through the first time from public	Through a subsequent public contribution
Risk	High	Comparatively low
Objective	The main objective is raising capital through public investment	The main objective is subsequent public investment
Predictability	Less predictable	More predictable
Profit	Higher than FPO	Lower than IPO
Types	Equity shares and Preferred shares	Dilutive offering and Non-Dilutive offering

Objective:

This paper intends to explore and analyze **the process of Initial Public Offering (IPO)/ Follow-on Public Offer (FPO)** transforms a privately-held company into a public company. This process also creates an opportunity for investors to fetch return on their investments.

Why do companies go public?

We closed the previous chapter with few very critical questions. One of which – Why did the company decide to file for an IPO, and in general why do companies go public?

When a company decides to file for an IPO, invariably the main reason is to raise funds to fuel their capex requirement. The promoter has 3 advantages by taking his company public..

1. He is raising funds to meet capex requirement
2. He is avoiding the need to raise debt which means he does not have to pay finance charges which translates to better profitability
3. Whenever you buy a share of a company, you are in essence taking the same amount of risk as the promoter is taking. Needless to say, the proportion of the risk and its impact will depend on the quantity of shares you hold. Nonetheless, whether you like it or not, when you buy shares you also buy risk. So when the company goes public, the promoter is actually spreading his risk amongst a large group of people.

There are other advantages as well in going for an IPO…

1. **Provide an exit for early investors** – Once the company goes public, the shares of the company start trading publicly. Any existing shareholder of the company – could be promoters, angel investors, venture capitalist, PE funds; can use this opportunity to sell their shares in the open market. By selling their shares, they get an exit on their initial investment in the company. They can also choose to sell their shares in smaller chunks if they wish.
2. **Reward employees** –Employees working for the company would have shares allotted to them as an incentive. This sort of arrangement between the employee and the company is called the "Employee Stock Option". The shares are allotted at a discount to the employees. Once the company goes public, the employees stand a chance to see capital appreciation in the shares. Few examples where the employee benefited from ESOP would be Google, Infosys, Twitter, Facebook etc
3. **Improve visibility** – Going public definitely increases visibility as the company has a status of being publicly held and traded. There is a greater chance of people's interest in the company, consequently creating a positive impact on its growth.

So let's just build on our fictional business story from the previous chapter a little further and figure out the IPO details of this company.

If you recollect, the company requires 200 Crs to fund their capex and the management had decided to fund this partly by internal accrual and partly by filing for an IPO.

Do recollect that company still has 16% of authorized capital translating to 800,000 shares which are not allotted. The last valuation of these shares when the PE firm invested in Series B was 64Crs. The company has progressed really well ever since the PE firm has invested and naturally the valuation of these shares would have gone up.

For the sake of simplicity, let us assume the company is now valuing the 16% shares anywhere between 125 Crs to 150 Crs. This translates to a per share value, anywhere between Rs.1562 to Rs.1875/-…(125Crs/8lakh).

So if the company puts 16% on the block to the public, they are likely to raise anywhere between 125 to 150 Crs. The remainder has to come from internal accruals. So naturally, the more money they raise, better it is for the company.

Merchant Bankers

Having decided to go public, the company must now do a series of things to ensure a successful initial public offering. The first and foremost step would be to appoint a **merchant banker.** Merchant bankers are also called **Book Running Lead Managers (BRLM)/Lead Manager (LM).** The job of a merchant banker is to assist the company with various aspects of the IPO process including…

- Conduct a due diligence on the company filing for an IPO, ensure their legal compliance and also issue a due diligence certificate
- Should work closely with the company and prepare their listing documents including **Draft Red Herring Prospectus (DRHP).** We will discuss this in a bit more detail at a later stage
- **Underwrite shares** – By underwriting shares, merchant bankers essentially agree to buy all or part of the IPO shares and resell the same to public
- Help company arrive at the price band for the IPO. A **price band** is the lower and upper limit of the share price within which the company will go public. In case of our example, the price band will be Rs.1562/- and Rs.1875/-
- Help the company with the road shows – This is like a promotional/marketing activity for the company's IPO
- Appointment of other intermediaries namely, registrars, bankers, advertising agencies etc. The Lead manager also makes various marketing strategies for the issue

Once the company partners with the merchant banker, they will work towards taking the company public.

IPO sequence of events

Needless to say each and every step involved in the IPO sequence has to happen under the SEBI guidelines. In general, the following are the sequence of steps involved.

- **Appoint a merchant banker**. In case of a large public issue, the company can appoint more than 1 merchant banker
- **Apply to SEBI with a registration statement** – The registration statement contains details on what the company does, why the company plans to go public and the financial health of the company
- **Getting a nod from SEBI** – Once SEBI receives the registration statement, SEBI takes a call on whether to issue a go ahead or a 'no go' to the IPO
- **DRHP** – If the company gets the initial SEBI nod, then the company needs to prepare the DRHP. A DRHP is a document that gets circulated to the public. Along with a lot of information, DRHP should contain the following details.
- **Market the IPO** – This would involve TV and print advertisements in order to build awareness about the company and its IPO offering. This process is also called the IPO road show
- **Fix the price band** – Decide the price band between which the company would like to go public. Of course this can't be way off the general perception. If it is, then the public will not subscribe for the IPO
- **Book Building** – Once the road show is done and price band fixed the company now has to officially open the window during which the public can subscribe for shares. For example, if the price band is between Rs.100 and Rs.120, then the public can actually choose a price they think is fair enough for the IPO issue. The process of collecting all these price points along with the respective quantities is called Book Building. Book building is perceived as an effective price discovery method
- **Closure** – After the book building window is closed (generally open for few days) then the price point at which the issue gets listed is decided. This price point is usually that price at which maximum bids have been received.
- **Listing Day** – This is the day when the company actually gets listed on the stock exchange. The listing price is the price decided based on market demand and supply on that day and the stock is listed at premium, par or discount of the cut-off price

What happens after the IPO?

During the bidding process (also called the date of issue) investors can bid for shares at a particular price within the specified price band. This whole system around the date of issue where one bids for shares is referred to as the **Primary Market**. The moment the stock gets listed and debuts on the stock exchange, the stock starts to trade publicly. This is called the **secondary markets**.

Once the stock transitions from primary markets to secondary markets, the stock gets traded daily on the stock exchange. People start buying and selling the stocks regularly.

Why do people trade? Why does the stock price fluctuate? Well, we will answer all these questions and more in the subsequent chapters.

Few key IPO jargons

Before we wrap up the chapter on IPO's let us review few important IPO jargons.

Under Subscription – Let's say the company wants to offer 100,000 shares to the public. During the book building process it is discovered that only 90,000 bids were received, then the issue is said to be under subscribed. This is not a great situation to be in as it indicates negative public sentiment

Over subscription – If there are 200,000 bids for 100,000 shares on offer then the issue is said to be oversubscribed 2 times (2x)

Green Shoe Option – Part of the underwriting agreement which allows the issuer to authorize additional shares (typically 15 percent) to be distributed in the event of over subscription. This is also called the overallotment option

Fixed Price IPO –Sometimes the companies fix the price of the IPO and do not opt for a price band. Such issues are called fixed price IPO

Price Band and Cut off price –Price band is a price range between which the stock gets listed. For example if the price band is between Rs.100 and Rs.130, then the issue can list within the range. Let's says it gets listed at 125, then 125 is called the cut off price.

Recent IPO's in India*

Here is a look at few recent IPO's in India. With all the background information you now have, reading this table should be easy.

Sl No	Name of Issue	Issue Price (INR)	BRLM	Date of Issue	Issue Size (Lakh Shares)	Price Band (INR)
01	Wonderla Holidays Limited	125	Edelweiss Financial Services and ICICI Securities Limited		14,500,000	115 to 125
02	Power Grid Coporation of India Ltd	90	SBI, Citi, ICICI, Kotak, UBS	03/12/2013 to 06/12/2013	787,053,309	85 to 90
03	Just Dial Ltd	530	Citi, Morgan Stanley	20/05/2013 to 22/05/2013	17,493,458	470 to 543
04	Repco Homes Finance Limited	172	SBI, IDFC, JM Financials	13/03/2013 to 15/03/2013	1,57,20,262	165 to 172
05	V-Mart Retail Ltd	210	Anand Rathi	01/02/2013 to 05/02/2013	4,496,000	195 to 215

**Source : NSE India, as of June 2014*

.

Regulatory requirements to issue an FPO

The issue of shares by a listed company, whether it be IPO, FPO, private equity or debt instruments is regulated by the Securities and Exchange Board of India (SEBI), more specifically by the rules and regulations framed under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations).

SEBI is a statutory regulatory body entrusted with the responsibility to regulate the Indian capital markets. It monitors and regulates the securities market and protects the interests of the investors.

Some conditions a company must adhere to prior to promoting an IPO or FPO are that neither the Company nor its promoters or director or selling shareholders must be debarred from accessing the capital market nor must

they be declared as a wilful defaulter or be an economic offender. A listed company which has defaulted in interest payment or repayment of the principal amount in respect of debt instrument issued to the public is not permitted to promote an FPO of convertible debt instruments.

What are some key legal considerations while opting for an FPO?

In addition to the above, a company must also obtain an in-principle approval to list the new shares, dematerialise its securities, ensure that its issued capital is fully paid-up and it has made verifiable arrangements to finance its project for which it proposes to promote the FPO.

Listed companies that desire to promote a public offer of debt securities must obtain a credit rating for the security, appoint a debenture trustee and create debenture redemption reserve.

If the existing shareholders of a company wish to offer their shares in an OFS, they may do so, so long as they have owned and held their shares for a minimum of 1 year prior to filing the offer document. If such shares were acquired pursuant to the conversion of convertible securities or depository receipts, the holding period of such securities or receipts is considered for the calculation.

Examples of successful FPOs in the past

The last decade has seen many successful FPOs, such as Tata Steel Ltd, Engineers India Ltd, Power Grid Corporation of India, Power Finance Corporation Ltd, and NTPC Ltd. The success of any IPO or FPO, however, depends upon various factors, including market sentiments, the pedigree of the company and its promoters, the earning capacity and potential of the company.

The Government of India is a good candidate for FPOs. It has successfully used the FPO route for disinvestment of its stake in certain listed public sector undertakings. Retail participation in such disinvestments has been encouraging and some issues have even been oversubscribed, take for example the FPOs of Power Grid Corporation, Engineers India and Power Finance Corporation Ltd amongst others.

There have been several discussions around Kudremukh Iron Ore Company and IDBI Bank also considering may use the FPO route for disinvestment of their shareholding. Likewise, Yes Bank is also contemplating an FPO to satiate its capital needs.

Conclusion

All the business entities need fund flow to finance their day to day operations. Therefore, for raising funds for the business there are two ways i.e. in the form of equity or through debt which represents the borrowed capital of the company. In equity, the entity approaches various individuals to sell its shares at a fixed price and when it is done for the first time it is referred to as IPO. While on the other hand, when the shares are offered for sale for the subsequent public contribution it is referred to as FPO.

IPO is an abbreviation of Initial Public Offer. When a company is going for a process of getting listed on the stock exchange and publicly traded, IPO is the first public offering, it is the main source of the company in acquiring money from the general public to finance its projects and the company allots shares to the investors in return. FPO is an abbreviation of a Follow-On Public Offer. The process of FPO starts after an IPO. FPO is a public issue of shares to investors at large by a publicly listed company. In FPO, the company goes for a further issue of shares to the general public with a view to diversifying its equity base.

References

1. "Journal of Business & Technology Law – Academic Journals – University of Maryland Francis King Carey School of Law" (PDF). Retrieved 27 November 2016.
2. Hensel, Nayantara. (4 November 2005) Are Dutch Auctions Right for Your IPO? – HBS Working Knowledge. Hbswk.hbs.edu. Retrieved on 16 October 2012.
3. http://law.bepress.com/cgi/viewcontent.cgi?article=3706&context=expresso
4. WhiteGlove seeks to raise $32.5 million in 'Dutch auction' IPO. www.statesman.com. Retrieved on 16 October 2012.
5. Cowan, Lynn. (21 September 2011) WhiteGlove Health Shelves IPO Indefinitely – WSJ.com. Online.wsj.com. Retrieved on 16 October 2012.
6. http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-30.pdf
7. "Aramco's 'greenshoe option' pushes IPO to $29.4 billion". Arab News. 12 January 2020. Retrieved 15 January 2020.
8. "Alibaba IPO Biggest in History as Bankers Exercise 'Green Shoe' Option". The New York Times. 18 September 2013.
9. "Softbank Corp IPO Second Biggest in History". Fortune.com. 11 December 2018.
10. "Agricultural Bank of China Sets IPO Record as Size Raised to $22.1 Billion". Bloomberg. 15 August 2010.
11. "ICBC completed its record $21.9 billion IPO in October 2006". Bloomberg. 28 July 2010.
12. "AIA's IPO Boosted to $20.5 Billion With Overallotment". Bloomberg. 29 October 2010.
13. Grocer, Stephen (17 November 2010). "How GM's IPO Stacks Up Against the Biggest IPOs on Record". Wall Street Journal.

14. "GM Says Total Offering Size $23.1 Billion Including Overallotment Options", Bloomberg, 26 November 2010
15. Rusli, Evelyn M.; Eavis, Peter (17 May 2012), "Facebook Raises $16 Billion in I.P.O.", The New York Times
16. "China eclipses US as top IPO venue". 28 December 2011.
17. "Deloitte releases statistics on Hong Kong and Mainland IPOs in 2012 | Deloitte China | Press Release".
18. "Global IPO market booms 50% in 2014". 18 December 2014.
19. "Global number of IPOs highest since financial crisis". 27 December 2017.
20. "Hong Kong regains global IPO crown from New York in 2018 thanks to its listing reforms". 24 December 2018.
21. "Hong Kong exchange to remain world's largest IPO market in 2019: KPMG report". 12 December 2019.
22. "Hong Kong ranks as 2nd largest IPO market in 2020". 13 January 2021.
23. "Mainland China and Hong Kong IPO markets - KPMG 2021 Q1 review" (PDF). 26 April 2021.
24. Gregoriou, Greg (2006). Initial Public Offerings (IPOs). Butterworth-Heineman, an imprint of Elsevier. ISBN 978-0-7506-7975-6. Archived from the original on 14 March 2007. Retrieved 15 June 2006.
25. Goergen, M.; Khurshed, A.; Mudambi, R. (2007). "The Long-run Performance of UK IPOs: Can it be Predicted?". Managerial Finance. 33 (6): 401–419. doi:10.1108/03074350710748759.
26. Loughran, T.; Ritter, J. R. (2004). "Why Has IPO Underpricing Changed Over Time?" (PDF). Financial Management. 33 (3): 5–37.
27. Loughran, T.; Ritter, J. R. (2002). "Why Don't Issuers Get Upset About Leaving Money on the Table in IPOs?". Review of Financial Studies. 15 (2): 413–443. doi:10.1093/rfs/15.2.413.
28. Khurshed, A.; Mudambi, R. (2002). "The Short Run Price Performance of Investment Trust IPOs on the UK Main Market". Applied Financial Economics. 12 (10): 697–706. doi:10.1080/09603100010025706.
29. Bradley, D. J.; Jordan, B. D.; Ritter, J. R. (2003). "The Quiet Period Goes Out with a Bang". Journal of Finance. 58 (1): 1–36. CiteSeerX 10.1.1.535.3111. doi:10.1111/1540-6261.00517.
30. Goergen, M.; Khurshed, A.; Mudambi, R. (2006). "The Strategy of Going Public: How UK Firms Choose Their Listing Contracts". Journal of Business Finance and Accounting. 33 (1&2): 306–328. doi:10.1111/j.1468-5957.2006.00657.x. SSRN 886408.
31. Mudambi, R.; Treichel, M. Z. (2005). "Cash Crisis in Newly Public Internet-based Firms: An Empirical Analysis". Journal of Business Venturing. 20 (4): 543–571. doi:10.1016/j.jbusvent.2004.03.003.

32. Drucker, Steven; Puri, M. (2007). "Banks in Capital Markets". In Eckbo, B. E. (ed.). Handbook of Corporate Finance. 1. Boston: Elsevier. ISBN 978-0-444-50898-0.
33. "IPO Definitions". IPO Initial Public Offerings. Archived from the original on 21 August 2011. Retrieved 14 September 2011.
34. Mondo Visione web site: Chambers, Clem. "Who needs stock exchanges?" Exchanges Handbook. Published 2006-07-14. Accessed 21 September 2011
35. Friesen, Geoffrey C.; Swift, Christopher (2009). "Overreaction in the thrift IPO aftermarket". Journal of Banking & Finance. 33 (7): 1285–1298. doi:10.1016/j.jbankfin.2009.01.002.
36. Anderlini, Jamil (13 August 2010). "AgBank IPO officially the world's biggest". Financial Times. Retrieved 13 August 2010.
37. Hu, Bei and Vannucci, Cecile. Bloomberg.com Published 2010-10-29. Retrieved 2011-09-21