Primary Market

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Structure of Financial Market

Definition and Meaning

- The primary market is the market where the securiries are sold for the first time.
- The primary market may also be called the New Issue Market (NIM).
- In a primary issue, the company receives the money and new shares are issued directly to the investors.
- Primary issues are used by the companies for the purpose of setting up new business or for expanding or modernising the existing business.
- Securities are issued either by an Initial Public Offering (IPO) or a Follow-on Public Offering (FPO).

IPO & FPO

- An initial public offering (IPO) refers to the process of offering shares of a private corporation to the public in a new stock issuance.
- A follow-on public offer (FPO) is the issuance of shares to investors by a public company that is currently listed on a stock market exchange.
- An FPO is a stock issue of additional shares made by a company that is already publicly listed and has gone through the IPO process.
- A company selling shares is never required to repay the money to the people who buy them.

Private Placement

- Private placement refers to the sale of stocks, bonds, or securities directly to a private investor, rather than as part of a public offering.
- Investors in private placements include large financial entities including, banks, mutual funds, insurance companies and pension funds, as well venture capitalists, angel investors and other entities
- Advantages: Long term advantage – Less execution time frame – Diversification of fund raising – Lesser regulatory requirements – Choose your own investors.
- Disadvantages: Difficulty in finding a suitable investor – Higher returns requirements.

Employee Stock Ownership Plan (ESOP)

- An ESOP is a type of employee benefit plan which is intended to encourage employees to acquire stocks or ownership in the company.
- ESOPs are issued as direct stock, profit-sharing plans or bonuses, and the employer has the sole discretion in deciding who could avail of these options.
- Under ESOP, employees can acquire the company's shares at a price lower than its market value after fulfilling certain conditions and after certain period of time.

Right Shares

- Right shares are issued to the existing equity shareholders through notices to every shareholder.
- The company will offer the share holders a specific number of shares at a discounted price.
- The shareholders are required to confirm the number of shares opted within the given period.
- Companies with a poor cash flow will often use a rights issue to increase cash flow and payoff existing debts.

Bonus Shares

- Bonus shares are the additional shares given to the current share holders of a company, without any additional cost, based upon the number of shares that a share holder owns.
- These are company's accumulated earnings which are not given out in the form of dividends, but are converted into free shares.
- If an investor holds 200 shares of a company that declares 2:1 bonus, that is for every one share, he gets 2 shares for free. That is, total 400 shares for free and his total holding will increase to 600 shares.
- Bonus shares are not taxable. But the stockholder may have to pay capital gains tax, if he/she sells them.

Book Building

- Book building is a process by which an underwriter attempts to determine at what price to offer an IPO based on demand from institutional investors. It is a price discovery mechanism.
- Book building process:

  - Appointing a lead manager to the issue (book runners)
  - Syndicate members are appointed to receive orders from investors
  - Issue of Red Herring Prospectus specifying the number of securities to be issued and the price band
  - Syndicate members input the orders into the electronic book called bidding
  - The book remains open for a period of 3 – 5 days
  - On the close of the issue, the book runners evaluate the bidding price on the basis of the demand
  - Determination of the final price by the book runner and the issuer
  - Allocation of securities to the successful bidders; the rest get re-fund orders

Listing of Shares

- In corporate finance, a listing refers to the company's shares being on the list of stock that are officially traded on a stock exchange.
- The major objectives of listing are:

  - To provide ready marketability and liquidity of a company’s securities.

  - To provide free negotiability to stocks.

  - To protect shareholders and investors interests.

  - To provide a mechanism for effective control and supervision of trading.

- Stock exchanges have their own listing rules. It include providing a history of financial statements, a sufficient size of free float shares both in absolute terms and as a percentage of the total outstanding stock, an approved prospectus, reports of independent assessors, and so on.