Initial Public Offering

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I. DEFINITION

Initial public offering is the process by which a private company can go public by sale of its stocks to general public. It could be a new, young company or an old company which decides to be listed on an exchange and hence goes public

II. FACTORS CONSIDERED BEFORE APPLING FOR AN IPO

- Historical record before providing IPO
- Promoters their reliability
- Products offered
- Whether it has any collaboration
- Estimating of the project
- Risk aspects

III. CRITERIA SHOULD BE FULFILLED TO LAUNCH AN IPO IN INDIA

- "Net tangible assets" of at-least □3 cr in each of the last 3 years, of which not more than 50% is held in monetary assets. The only exemption available to the 50% monetary assets is that a company must have firm commitments to utilize the excessive amount for the business in the future.
- The total paid up capital shall not be less than □10 Cr. and the market capitalization shall not be less than □25 cr
- The company must have delivered profits in at-least 3 out of the last 5 years subject to the exclusion of extraordinary items like sale of land or key parts of the business.
- It has to have a minimum net worth of at-least □1 cr in each of the last 3 years (12 preceding months)
- If the company's name has been changed in the last 1 year, at-least 50% of its revenues of the last 1 year should be earned after the name was changed

IV. TYPES OF IPO

1. Fixed pricing

Fixed price at which shares are offered to investors. The investors knows the share price before the company goes public

2. Book building

It totally depends on investor bids where the least price is known as floor price and highest price is known as cap price. It totally depends on price band

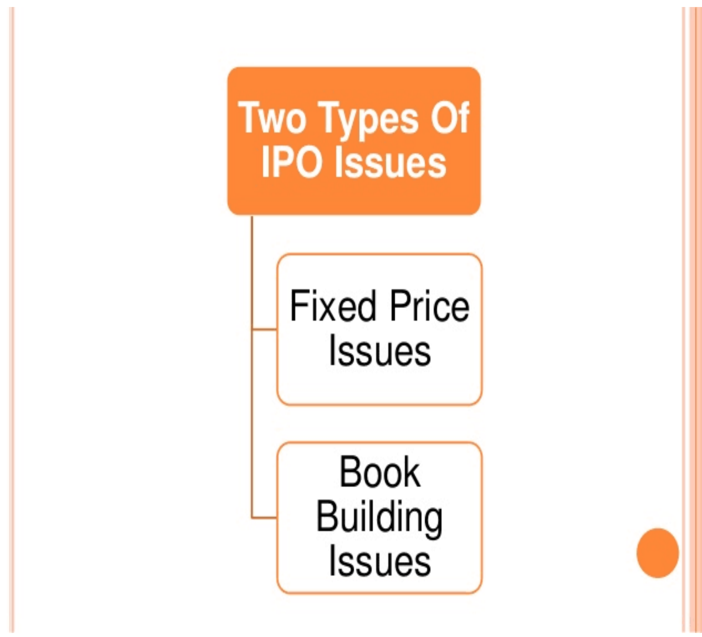


Figure 1-Types of IPO
Source: pehlatrade wordpress

V. TYPES OF APPLICANTS IN IPO

1. **Qualified institutional buyer (QIBs**)

Are those institutional investors who are generally perceived to possess expertise and the financial muscle to evaluate and invest in the capital markets.

Ex:a. foreign mutual fund banks, insurance companies, pension funds registered with (SEBI) b. Indian mutual fund banks, insurance companies or any other public financial institution recognised by (SEBI)

Anchor investor-Any company going for public issue has an option to open anchor Investor issue. Under anchor investor issue company can issue equity shares to selected QIBs up to 60% of QIBs portion one day before the public issue

2. Retail individual investor (RII)

Investors applying for IPO of an amount less than 2 lakhs

3. Non-institutional investor(NII)

- Investors other than 1&2 category
- Retail investors applying for more than 2 lakhs or private ltd company, public ltdcompany, charitable trust, partnership firm or any other organization

VI. IPO PROCESS

Step 1: Hire an investment bank

A company seeks guidance from a team of under-writers or investment banks to start the process of IPO. The team will study the company's current financial situation, work with their assets and liabilities and then they plan to cater to the financial needs. An underwriting agreement will be signed which will have all the details of the deal and the amount that will be raised, the securities that will be issued

Step 2: Register with sec

The Company and the under-writers together file the registration statement which comprises of every fiscal data and business plans of the company. It will also have to declare how the Company is going to utilize the funds it will raise from the IPO and about the securities of public investment.

Step 3: Draft the Red Herring document

An initial prospectus which contains the probable price estimate per share and other details regarding the IPO is shared with the people who are involved with the IPO. It is called a red herring document

Step 4: Go on road show

Before the IPO goes public, this phase happens over an action-packed two week. The executives of the Company travel around the country marketing the upcoming IPO to the potential investors, mostly QIBs

Step 5: IPO is priced

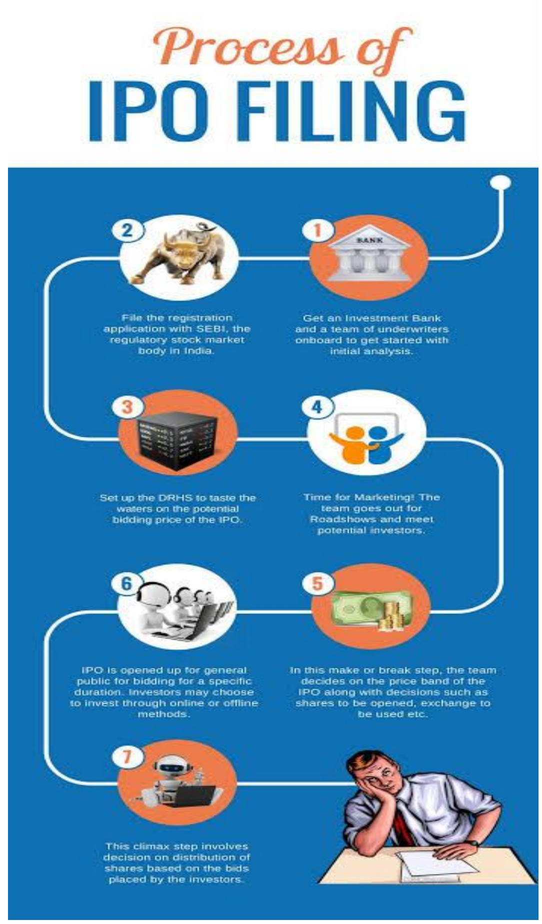
Based on whether company wants to float a fixed price IPO or Book Building Issue, the price or price band is fixed. A fixed price IPO will have a fixed price in the order document, and the book building issue will have a price band within which an investor can bid.

Step 6: Available to public

the prospectus and application forms are made available to public online and offline.

Step 7: Going through with the IPO

After the IPO price is finalized, the stakeholders and under-writers work together to decide how many shares will every investor receive. Investors will usually get full securities unless it is oversubscribed.



Allocation of shares

- Prorate basis- means every applicant will get some share propionate
- Lottery system basis- by taking random application for allocating the shares

Advantages of IPO –

- Stronger capital base
- Better for acquisition
- Increase company personal prestige
- Owner diversification

Disadvantages of IPO-

- Short term growth expansion
- Ongoing cost
- Restriction on management
- Trading restrictions

VII. CONCLUSION

An IPO being the first offer of stock by a company to the general public not only provides them largest source of funds with long or indefinite maturity but also gives an opportunity to investors for buying the shares directly from the company at the price of their choice (in book build IPO's). There are several reasons for a firm to go public and the motives are often specific to the given firm. The growing entrepreneurs approach the new issue market to finance their business expansion activities and also acquire a global exposure and recognition by listing at the stock exchange