PROFESSIONAL
PROGRAMME

GROUP 2
PAPER 5

STRATEGIC MANAGEMENT & CORPORATE FINANCE

PART I – STRATEGIC MANAGEMENT

PART II – CORPORATE FINANCE

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament
(Under the jurisdiction of Ministry of Corporate Affairs)

STUDY MATERIAL

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PROFESSIONAL PROGRAMME

STRATEGIC MANAGEMENT & CORPORATE FINANCE

Strategic Management is a discipline that deals with long-term development of an organisation with a clear-cut vision about organisational purpose, scope of activities and objectives. It provides overall direction to the organisation in many ways and includes specifying the organization's objectives, developing policies and plans designed to accomplish these objectives, allocating resources to for the implementation of such plans.

Finance is crucial for corporates, not only to invest and to expand, but also to operate their daily business. Some corporate rely more intensively on internal funds, while others rely more intensively on external funding. The never- ending requirement for funds germinates from the continuous business expansion undertaken by corporate.

In today era, the market offers numerous ways to obtain finance. With each passing day, a different product is getting evolved to meet the requirements of the growing industries. There are a number of ways to finance a business and a range of lenders and investors to choose from when the treasury function is making financing decisions.

The paper Strategic Management & Corporate Finance has been introduced to provide the blended knowledge of implementation of various strategies in the competitive environment and various source of finances available to raise funds in the Indian as well international market along with the legislative framework for raising such funds.

This paper is divided into two parts: Part I deals with Strategic Management and Part II deals with Corporate Finance.

Part I elaborates the concept of strategic management, analyzing the external and internal environment, formulation of business strategies, strategic analysis and planning, competitive positioning, analyzing strategic edge etc.

Part II elaborates on the conceptual and legal framework of corporate finance like Equity, Debt, Public Funding, Private funding, Fund based, Non-fund based funding, Securitization, Project Finance etc. Listing and issuance of Securities in IFSC, foreign funding- instruments, laws and procedure, role of intermediaries in fund raising project evaluation etc. are also covered in this part.

The Company Secretary being a compliance officer of the company and Senior Management Personnel, plays a pivotal role in formulating the strategies and advising the Board in raising finance for a company. Further, the corporates in India look upon especially company secretaries to provide the impetus, guidance and direction for raising funds from different source and to advise the Board on their regulatory compliances while raising funds.

The legislative changes made upto May 31, 2024 have been incorporated in the study material. In addition to Study Material students are advised to refer to the updations at the Regulator's website, supplements relevant for the subject issued by ICSI and ICSI Journal Chartered Secretary and other publications. Specifically, students are advised to read "Student Company Secretary" e-Journal which covers regulatory and other relevant developments relating to the subject, which is available on academic portal at *https://www.icsi.edu/student-n/academic-portal/*. In the event of any doubt, students may contact the Directorate of Academics at *academics@icsi.edu.*

The amendments to law made upto 31st May of the Calendar Year for December Examinations and upto 30th November of the previous Calendar Year for June Examinations shall be applicable.

Although due care has been taken in publishing this study material, the possibility of errors, missions and /or discrepancies cannot be rules out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

PROFESSIONAL PROGRAMME

Group 2

Paper 5

STRATEGIC MANAGEMENT & CORPORATE FINANCE

SYLLABUS

OBJECTIVES

- **To enable students to acquire multidimensional skills as to equip them to comprehend the process of strategy formulation.**
- **To provide the practical and procedural knowledge on various sources of finance available to corporates at their various stages of journey and the legislative framework for raising such funds.**

Level of Knowledge : Expert Knowledge

Part I: Strategic Management (40 Marks)

1. **Introduction to Strategic Management:** Basic concepts of corporate strategy and the strategic framework ● Strategic Leadership ● Functions and Importance for Professionals like Company Secretaries ● Board of Directors and Corporate Social Responsibility ● Corporate Governance code and laws
2. **Analyzing the External and Internal Environment:** Overview- Meaning & Process ● Environmental Influencers of Business ● Characteristics and Components of Business Environment ● External Environmental analysis ● Internal Corporate Analysis ● Factors of Micro & Macro Environment of Business ● Competitive Environment ● Porter's Five Force Model
3. **Business Policy and Formulation of Functional Strategy:** Introduction to Business Policy ● Strategic Decision Model ● Aligning the Vision, Mission ● Objectives and Goals ● Strategic Levels of the Organization ● Formulation of Functional Strategy-Formulation of Financial, Marketing, Production, Human Resource and Logistics strategies
4. **Strategic Analysis and Planning:** Situational Analysis ● Strategic Choices-SWOT and TOWS Analysis ● PERT (Programme Evaluation Review Technique) and CPM (Critical Path Method), Portfolio analysis-Boston Consulting Group (BCG) growth-share Matrix, Ansoff's Product Growth Matrix ● ADL Matrix and General Electric (GE) Model ● Strategic Planning ● Strategic Alternatives ● Glueck and Jauch and Michael Porter's Generic Strategies
5. **Competitive Positioning:** Business level competitive strategies ● Cost leadership strategy ● Differentiation strategy ● Issues in Strategy Implementation ● Strategic enablers ● Strategic risk and related issues ● Strategic Leadership and its forms ● Establish a strategic mind-set to diagnose problems and make recommendations ● E-Business and Strategy

6. **Managing the Multi-Business firm and Analyzing Strategic Edge:** Case Studies from the Indian context to establish a strategic mindset to diagnose problems and make recommendations

Part II: Corporate Finance (60 Marks)

7. **Sources of Corporate Funding:** Equity Shares ● Preference Shares ● Venture Capital ● Alternative Investment Funds ● Angel Funds ● Debentures ● Bonds ● Loan from financial institutions ● Foreign Funding ● Foreign Direct Investment (FDI) & Foreign Institutional Investment (FII) ● External Commercial Borrowings (ECB) ● Private Equity ● Securitization

8. **Raising of Funds from Equity and Procedural aspects:**

   (a) **Public Funding:** Initial Public Offer (IPO) ● Further Public Offer (FPO) ● Preferential Allotment ● Private Placement ● Qualified Institutional Placement ● Institutional Private Placement ● Offer for Sale ● Rights Issue ● Fast Track Issue ● Green Shoe Option

   (b) **Sources of Funds for Mega projects:** Real Estate Investment Trust (REIT) ● Infrastructure Investment Trust (InvIT)

   (c) **Private funding:** Venture Capital ● Alternative Investment Fund ● Angel Funds ● Seed Funding ● Private Equity

   (d) **Non Fund based:** Bonus Issue ● Sweat Equity ● ESOP

   (e) **An overview on Listing and Issuance of Securities in International Financial Services Centre**

9. **Raising of Funds from Debt and Procedural aspects:**

   (a) **Indian Fund Based**: Debentures ● Non-Convertible Securities ● Public Deposits ● Bonds ● Bank Finance ● Promoter Funding ● Working Capital Finance ● Overdrafts ● Cash Credits ● Bill Discounting ● Factoring ●NBFCs Funding

   (b) **Indian Non Fund Based:** Letter of Credit ● Bank Guarantee ●Stand by Letter of Credit etc.

10. **Foreign Funding-Institutions:** International Finance Corporation (IFC) ● Asian Development Bank (ADB) ● International Monetary Fund (IMF) ● World Bank

11. **Foreign Funding-Instruments, laws and Procedures:** External Commercial Borrowing (ECB) ● American Depository Receipt (ADR)/Global Depository Receipt (GDR) ● Foreign Currency Convertible Bonds (FCCB) ● Foreign Currency Exchangeable Bonds (FCEB)

12. **Role of Intermediaries in fund raising:** Investment Advisor ● Merchant Banker ● Portfolio Manager and Role of Company Secretary

13. **Project Evaluation:** Factors affecting the cost of project ● Project appraisal through feasibility and Due Diligence (Technical, Financial, and Legal) ● Project viability and research on innovation ● Regulatory Authorities/ agencies ● Risk Assessment and mitigation ● Credit Risk Management in Project Finance ● Preparation of detailed project report

ARRANGEMENT OF STUDY LESSONS
STRATEGIC MANAGEMENT & CORPORATE FINANCE
GROUP 2 • PAPER 5

PART I: STRATEGIC MANAGEMENT

PART II: CORPORATE FINANCE

LESSON WISE SUMMARY
STRATEGIC MANAGEMENT & CORPORATE FINANCE

PART I - STRATEGIC MANAGEMENT (40 MARKS)

Lesson 1 – Introduction to Strategic Management

Strategic Management is a discipline that deals with long-term development of an organisation with a clear-cut vision about organisational purpose, scope of activities and objectives. It provides overall direction to the organisation and includes specifying the organization's objectives, developing policies and plans designed to accomplish these objectives, allocating resources to for the implementation of such plans. The purpose of this lesson is to acquaint the students about the concept of strategic management and its process; functions performed by a strategic leader; Role of Company Secretary in Strategic Leadership; Role of Board of Directors in Corporate Social Responsibility; Corporate Governance Code and Laws.

Lesson 2 – Analyzing the External and Internal Environment

A business organisation does not exist in a vacuum but has to take into account external and internal environment. Business environment may offer opportunities for any firm or pose threats to the firm. A business firm is also affected by a number of internal factors, which are forces inside the business organisation. It is expected that, after going through with this lesson, students will be in position to understand the environment influencers of business; the Characteristics and Components of Business Environment; Porter's five forces model- the tool to determine the intensity of competition in an industry and its profitability level.

Lesson 3 – Business Policy and Formulation of Functional Strategy

This lesson throws a light on the core concepts of business policy. Business Policy is the study of the functions and responsibilities of senior management, the crucial problems that affect success in the total enterprise and the decisions that determine the direction of the organisation and shape its future. It describes in detail about the roles and responsibilities of top level management, significant issues affecting organizational success and the decisions affecting organization in long-run. The objective of this lesson is to enable the students to understand the concepts related to business policy.

Lesson 4 – Strategic Analysis and Planning

This lesson studies strategic analysis and planning for providing overall direction to the organisation and specifying the organization's objectives, developing policies and plans designed to achieve these objectives, and then allocating resources to implement the plans. All this requires a careful analysis of the vision, mission, objectives, goals and resources of the organisation and in-depth analysis of the external environment.

Lesson 5 – Competitive Positioning

The implementation of policies and strategies is concerned with the design and management of systems to achieve the best integration of people, structures, processes and resources in reaching organization objectives. Strategy implementation may also consist of securing resources, organizing these resources and directing the use of these resources within and outside the organization. An effective strategy implementation works for competitive positioning for an organisation. Implementation of strategy in an organization covers a number of inter-related decisions, choices, and a broad range of activities such as the commitments and cooperation of all units, sections and departments. The objective of this lesson is to assist the students to understand the various competitive strategies for competitive positioning; issues in Strategy Implementation; strategic leadership and its forms; Role of Strategy in e-business etc.

Lesson 6 – Managing the Multi-Business Firm and Analyzing Strategic Edge

In order to boost effectiveness and produce higher quality products for end customer, it is important to analyse strategic edge. This is also important for enabling new business growth and expansion and also to save cost by improving efficiency in the production process. The objective of this lesson is to assist the students to understand the tools and techniques of strategic management such as Business Process Reengineering, Benchmarking, Total Quality Management and Six Sigma etc. This lesson also covers the various case studies from Indian Context to establish a strategic mindset to diagnose the problems.

PART II – CORPORATE FINANCE (60 MARKS)

Lesson 7 – Sources of Corporate Funding

Corporate Finance deals with the sources of funding and the capital structure of corporations, the actions that managers take to increase the value of the firm to the shareholders, and the tools and analysis used to allocate financial resources. The primary goal of corporate finance is to maximize or increase shareholder value. This lesson aims to provide an overview of various sources of finance available with an organisation for raising of funds to meet its requirements. This covers Equity Shares; Preference Shares; Debentures; Bonds; Alternative Investment Funds; Venture Capital; Angel Funds; Private Equity; Depository Receipts; Convertible and Exchangeable Bonds; External Commercial Borrowing; FDI; Securitization etc.

Lesson 8 – Raising of Funds from Equity and Procedural Aspects – Public Funding

With the growth of company form of organisation in India, the demand for equity capital gained steam. With the passage of time, different variants of equity capital emerged in Indian capital market, i.e. Initial Public Offer (IPO), Further Public Offer (FPO), Private Placement, Rights issue etc. So, a need was felt, to institute a regulatory structure that governs the significant angles of issue of capital, especially, the equity shares.

In light of this, the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 were notified with the objective to bring more clarity to the provisions of the rescinded SEBI DIP Guidelines by removing the redundant provisions and amending certain provisions in order to cope up with the dynamics of capital market.

In order to align its provisions under ICDR Regulations with Companies Act, 2013 and allied regulations, SEBI had revised the regulations and came up with the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 which lay down guidelines relating to conditions for various kinds of issues including public and rights issue.

This lesson has touched upon various significant concepts pertaining to raising of funds from the public, various provisions and practical aspects relating to public issue such as conditions relating to an Initial Public Offer (IPO) and Further Public Offer (FPO), conditions relating to pricing in public offerings, conditions governing promoter's contribution, restriction on transferability of promoter's contribution, minimum offer to public, reservations, manner of disclosures in offer documents, etc. It also covers the brief introduction about the Social Stock Exchange.

Lesson 9 – Real Estate Investment Trusts

Real Estate Investment Trusts (REITs) has been one of the most important vehicles for making collective investment in commercial real estate. Emanating in the USA in 1960s as a tax transparent collective investment vehicle, REITs have subsequently been used by several other countries, and have done remarkably well.

In India, SEBI had introduced real estate mutual funds pursuant to recommendations of an AMFI Committee, and thereafter, it came with draft regulations on REITs in 2008. In 2013, a regulatory framework was once again put on public domain. After taking industry inputs, amendments to regulations were made and the draft was approved allowing setting up and listing of REIT's. Post the clarification provided in the budget, SEBI on 26th September 2014 finally notified the final regulations - SEBI (Real Estate Investment Trust) Regulations, 2014.

In view of the importance of REIT, this lesson makes an endeavour to throw light on critical aspects like SEBI (Real Estate Investment Trust) Regulations, 2014; Issue and Listing of units; Guidelines for Public Issue of Units of REITs etc.

Lesson 10 – Infrastructure Investment Trusts

Infrastructure being one of the critical sectors of Indian economy as it contributes immensely towards economic development; it creates substantial academic interest to explore a vital facet associated with it i.e Infrastructure Investment Trust.

An Infrastructure Investment Trust (InvITs) is Collective Investment Scheme similar to a mutual fund, which enables direct investment of money from individual and institutional investors in infrastructure projects to earn a small portion of the income as return. SEBI (Infrastructure Investment Trusts) Regulations, 2014 provides a regulatory framework for registration and regulation of InvITs in India. The regulations, inter alia, prescribe conditions for making a public offer and private placement, initial and continuous disclosures, investment conditions, unit-holder approval requirements, related party disclosures, etc.

This lesson makes an attempt to delve deep into various essential aspects pertaining to the SEBI (Infrastructure Investment Trust), Regulations, 2014, Key stakeholder of InvlTs; Eligibility Criteria; Guidelines for preferential issue of units by InvlTs etc.

Lesson 11 – Raising of Funds – Private Funding

Private equity and venture capital acts as a messiah in meeting out the capital requirements of entrepreneurs. The main providers of this form of capital are private equity and venture capital funds which are channelled through Alternative Investment Funds (AIFs). However, as the mentioned source of finance is not in abundance in India it calls for a congenial regulatory environment.

It is to be noted that AIFs in India are regulated by the Securities and Exchange Board of India (SEBI). Other government agencies which play an important role are the Ministry of Finance and sector regulators in the pension and insurance areas as well as the Reserve Bank of India. Previously, SEBI had framed the SEBI (Venture Capital Funds) Regulations, 1996 ("VCF Regulations") to encourage investments in to start-ups and mid-size companies. Since the arrival of the VCF Regulations, it was observed by SEBI that the venture capital route was being used by several other categories of funds such as private equity funds, real estate funds etc. Further, since registration as a venture capital fund ("VCF") was not mandatory under the VCF Regulations, not all private equity or other categories of funds were registering with the SEBI.

In light of the soaring significance of private equity and venture capital in India, this lesson aims to throw light on various critical issues pertaining to private equity and venture capital, like, SEBI (Alternative Investment Funds) Regulations, 2012; Categories of AIF; Investment in an AIF; Placement Memorandum etc.

Lesson 12 – Raising of Funds – Non Fund Based

Any company can attain astral heights if it takes care of its two key stakeholders, one shareholders and other human capital. If shareholders are paid high dividends or additional shares in the form of bonus shares are issued then they remain loyal to the company and even at times of distress they are with the management of the company. Similarly, the work force is vital component of a business organisation and those executives who possess the potential to take the organisation to newer heights needs to be remunerated suitable. Now remuneration or incentives may be financial as well as non-financial. One of the key non-financial incentives may be issues of shares to the employees in the form of ESOP (Employee Stock Option).

But it is also equally important to be conversant with the legal dimensions associated with above mentioned form of equity issues. This lesson undertakes a holistic approach by focusing on all the significant facets of equity issue, i.e. Meaning of Bonus Issue; Provisions pertaining to issue of Bonus shares; ESOP and Sweat Equity Shares covered under Companies Act, 2013; Concept of Employee Stock Option etc.

Lesson 13 – An Overview on Listing and Issuance of Securities in International Financial Services Centre

The International Financial Services Centres Authority (IFSCA) has been established on April 27, 2020 under the International Financial Services Centres Authority Act, 2019. The IFSCA is a unified authority for the development and regulation of financial products, financial services and financial institutions in the International Financial Services Centre (IFSC) in India. At present, the GIFT IFSC is the maiden international financial services centre in India. Prior to the establishment of IFSCA, the domestic financial regulators, namely, RBI, SEBI, PFRDA and IRDAI regulated the business in IFSC. The IFSCA has been established as a unified regulator with a holistic vision in order to promote ease of doing business in IFSC and provide world class regulatory environment. The main objective of the IFSCA is to develop a strong global connect and focus on the needs of the Indian economy as well as to serve as an international financial platform for the entire region and the global economy as a whole.

At the end of this lesson, the students would have an understanding about the Listing and Trading of Securities in IFSC and the Regulatory Framework; the concept of Special Purpose Acquisition Company (SPAC) and regulatory framework for listing of SPACS; Framework on listing of ESG Debt Securities; Listing Obligations and Disclosure Requirements under IFSCA Listing Regulations.

Lesson 14 – Raising of Funds from Debt and Procedural Aspects

Today majority of corporate houses are espousing the debt financing trajectory to finance their business expansion plans; mergers and acquisitions; setting up of new business etc. Currently, in India the debt market comprises mainly of two segments viz., the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures / Corporate bonds. Government securities form the major part of the market in terms of outstanding issues, market capitalization and trading value.

This lesson is divided in two sections i) Indian Fund Based ii) Indian Non-Fund Based.

Keeping in view the rising importance of debt funding in Indian capital market, the first section of the lesson aims to cover various important topics pertaining to debt funding- Debt Market in India; Forms of Debentures; Regulatory framework governing debt securities; Electronic Book Mechanism for issuance of securities on private placement basis; Online Bond Platform Providers and its significance; Role of Company Secretary in Corporate Bond Market; Public Deposits; NBFC Funding etc.

Generally, it is observed that whenever there is raising of funds it involves movement of money but there is a form of financing wherein there is no movement of funds from the banks / financial institutions. Such type of funding is called non-fund based credit facilities. In this form of financing or funding, the bank or financial institution do not disburse funds to the borrower directly but it assist its borrowers in managing the business in other ways by issuing Letter of Credit; Stand by Letter of Credit and Bank Guarantees. This form of non fund based funding occupies a significant position in Indian financial ecosystem, and so it generates substantial academic interest to explore various essential dimensions of the mentioned form of funding.

In light of the above, the second section of lesson focuses on the critical facets of Letter of Credit; Documentation under Letter of Credit; Bank Guarantee etc.

Lesson 15 – Foreign Funding-Institutions

We are living in the era of globalisation and opportunities have galore due to it especially, in the form of foreign funding. Financial assistance received from foreign countries assist organisations to foray into cross-border transactions with foreign business partners, such as customers, investors, suppliers and lenders. Various international sources from where funds may be generated include the following (i) Commercial Banks (ii) International Agencies and Development Banks iii) International Capital Markets.

Many development banks and international agencies have come forth over the years for the purpose of international financing. These bodies are set up by the Governments of developed countries of the world at national, regional and international levels for funding various projects. This lesson throws light on Role and functions of various international agencies and development banks covering International Finance Corporation (IFC), Asian Development Bank, International Monetary Fund (IMF), World Bank etc.

Lesson 16 – Foreign Funding-Instruments, Laws and Procedures

In view of the dynamic global financial ecosystem, it is imperative to explore critical facets of foreign funding. This lesson have amply covered almost all those crucial aspects that influence the foreign funding, i.e. Regulatory framework governing foreign funding in India; External Commercial Borrowings; Depository Receipts and its forms and laws governing them; Foreign Currency Exchangeable Bonds etc.

Lesson 17 – Role of Intermediaries in Fund Raising

Market intermediaries, being a vital link between the regulators, issuers and investors, constitute as one of the various components of the financial market. They play a very important role in development of the market by providing a variety of services. SEBI is responsible for the registration, supervision, compliance monitoring and inspections of all market intermediaries in respect of all segments of the markets viz. equity, equity derivatives, currency derivatives, debt and debt related derivatives and commodity derivatives.

This lesson covers the various Intermediaries associated with the Primary Market, Role and Responsibilities of Investment Advisor, Merchant Banker and Portfolio Manager and their Regulatory framework. It also covers the role of a Company Secretary.

Lesson 18 – Project Evaluation

Project evaluation is a systematic and objective assessment of an ongoing or completed project. The aim is to determine the relevance and level of achievement of project objectives, development effectiveness, efficiency, impact and sustainability. Evaluations also feed lessons learned into the decision-making process of the project stakeholders, including donors and national partners.

As a Company Secretary, it is important to understand the concept of project evaluation, appraisal process, feasibility studies, factors affecting cost of project etc. The organization raises funds for the various new and undergoing projects. Company Secretary as a Key Managerial Personnel can advise the Board on the optimum utilization of funds raised by the organization for the said purposes.

This lesson aims to provide an understanding to the students about the concept of project evaluation; Factors affecting the cost of Project; Due Diligence in Project Finance; Project Appraisal through Feasibility and Due Diligence (Technical, Financial, and Legal) and Role of Company Secretary; the concept of risk assessment and mitigation; Credit Risk Management in Project Finance and Steps involved in preparation of Detailed Project Report (DPR).

CONTENTS

PART I: STRATEGIC MANAGEMENT

LESSON 1

INTRODUCTION TO STRATEGIC MANAGEMENT

LESSON 2

ANALYZING THE EXTERNAL AND INTERNAL ENVIRONMENT

LESSON 3

BUSINESS POLICY AND FORMULATION OF FUNCTIONAL STRATEGY

LESSON 4

STRATEGIC ANALYSIS AND PLANNING

LESSON 5

COMPETITIVE POSITIONING

LESSON 6

MANAGING THE MULTI-BUSINESS FIRM AND ANALYZING STRATEGIC EDGE

PART II: CORPORATE FINANCE

LESSON 7

SOURCES OF CORPORATE FUNDING

LESSON 8

RAISING OF FUNDS FROM EQUITY AND PROCEDURAL ASPECTS – PUBLIC FUNDING

LESSON 9

REAL ESTATE INVESTMENT TRUSTS

LESSON 10

INFRASTRUCTURE INVESTMENT TRUSTS

LESSON 11

RAISING OF FUNDS – PRIVATE FUNDING

LESSON 12

RAISING OF FUNDS – NON FUND BASED

LESSON 13

AN OVERVIEW ON LISTING AND ISSUANCE OF SECURITIES IN INTERNATIONAL FINANCIAL SERVICES CENTRE

LESSON 14

RAISING OF FUNDS FROM DEBT AND PROCEDURAL ASPECTS

SECTION–I : INDIAN FUND BASED

SECTION–II : INDIAN NON FUND BASED

LESSON 15

FOREIGN FUNDING – INSTITUTIONS

LESSON 16

FOREIGN FUNDING – INSTRUMENTS, LAWS AND PROCEDURES

LESSON 17

ROLE OF INTERMEDIARIES IN FUND RAISING

LESSON 18

PROJECT EVALUATION

PART I

STRATEGIC MANAGEMENT

Introduction to Strategic Management

Lesson 1

KEY CONCEPTS

■ Strategic Management ■ Strategic Leadership ■ Captivator ■ Global Thinker ■ Change Driver ■ Enterprise Guardian ■ Strategic Planning ■ Corporate Social Responsibility ■ Corporate Governance ■ Board of Directors

Learning Objectives

To understand:

- The concept of strategic management
- The four phases involved in strategic management
- Manager's potential to articulate the strategic vision in the form of strategic leadership
- Functions performed by a strategic leader
- Functions and Importance for Professionals like Company Secretaries
- Strategic Planning
- Board of Directors and Corporate Social Responsibility (CSR)
- Factors influencing CSR
- Corporate Governance – Code and Laws in India
- International Regulatory Framework of Corporate Governance
- Corporate Governance and Role of Company Secretary

Lesson Outline

- Strategic Management: Meaning & Process
- Strategic Leadership
- Functions and Importance for Professionals like Company Secretaries
- Strategic Planning
- Board of Directors and Corporate Social Responsibility
- Definition of CSR under Companies Act, 2013
- Benefits of CSR
- Factors influencing CSR
- Role of Board of Directors in CSR related activities of a Company
- CSR & Corporate Governance
- Corporate Governance
- Corporate Governance & Role of Company Secretary
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

STRATEGIC MANAGEMENT : MEANING AND PROCESS

Meaning

Strategic Management is a discipline that deals with long-term development of an organisation with a clear-cut vision about organisational purpose, scope of activities and objectives.

Definitions of Strategic Management

"Determination of the basic long-term goals and objectives of an enterprise and adoption of course of action and allocation of resources necessary to carry out these goals."

- Chandler

"That set of decisions and actions which leads to the development of an effective strategy or strategies to help achieve corporate objectives."

- Glueck

"Strategic management involves the decision-making and the activities in an organisation which (1) have wider ramifications, (2) have a long time perspective, and (3) use critical resources towards perceived opportunities or threats in a changing environment."

- Paine and Naumes

"Strategic management is the formulation and implementation of the major goals and initiatives taken by a company's top management on behalf of owners, based on consideration of resources and an assessment of the internal and external environments in which the organization competes."

- Hambrick and Chen

It can be understood from the analysis of mentioned definitions that strategic management provides overall direction to the organisation and includes specifying the organization's objectives, developing policies and plans designed to accomplish these objectives, allocating resources for the implementation of such plans.

Michael Porter identifies three principles underlying strategy: creating a "unique and valuable market position", making trade-offs by choosing "what not to do", and creating "fit" by aligning company activities with one another to support the chosen strategy.

Strategic Management: Process

The strategic management process is defined as the process by which the managers'/decision makers' are able to make a choice of a set of strategies for the organization that will enable it to accomplish improved performance. Strategic management is not a static but continuous process as it involves continuous appraisal of the micro and macro environment surrounding the organization and choosing between alternatives that meet the objectives and thereafter re-assessment of such strategy. The strategic management consists of different phases, which are sequential in nature.

Four Phases of Strategic Management Process

There are four indispensable phases of every strategic management process. In diverse companies these phases may have altered nomenclatures and different sequences, nevertheless, the fundamental substance remains same. The four phases can be listed as below.

1. **Environmental Scanning-** The Board of Directors and the top management will have to review the current performance. To review, the organization will have to scan the internal environment for the strengths and weaknesses and the external environment for opportunities and threats. The internal and external scan helps in selecting the strategic factors. These have to be reviewed and redefined in relation to the mission and objectives. All the organizations have missions that define the significance of their existence.

   The details of Internal and External Environment are covered in Lesson 2 of this study.

2. **Strategy Formulation-** Strategy formulation is the process of deciding about the best course of action for accomplishing organizational objectives and therefore, attaining organizational purpose. After conducting environment scanning, managers formulate corporate, business and functional strategies.

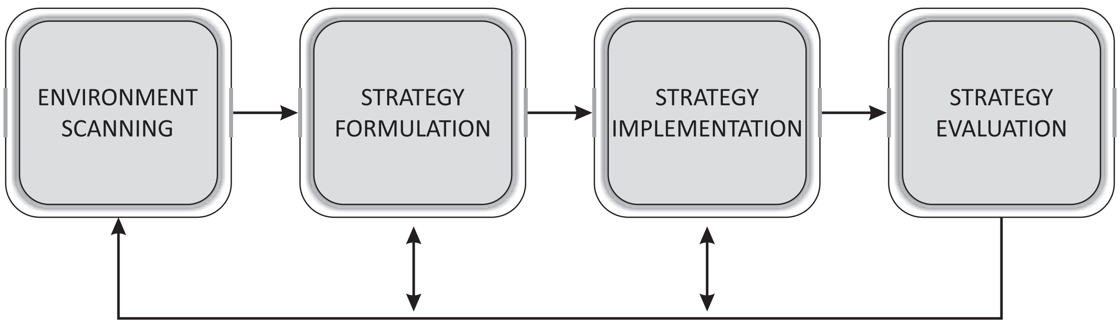
   The Formulation of Functional Strategy in detail is covered in Lesson 3 of this study.

3. **Strategy Implementation-** Strategy implementation implies putting the chosen strategy into action. Strategy implementation includes designing the organization's structure, distributing resources, developing decision making process, and managing the human resources.

   The Strategy Implementation in detail is covered in Lesson 3 of this study.

4. **Strategy Evaluation-** Strategy evaluation is the final step of strategy management process. The key strategy evaluation activities are: appraising internal and external factors that are the root of present strategies, measuring performance, and taking remedial/corrective actions. Evaluation ascertains that the organizational strategy as well as its implementation is in line with the organizational objectives.

These components are steps that are carried in sequential order, while creating a new strategic management plan. Present businesses that have already created a strategic management plan will revert to these steps as per the situation's requirement, so as to make essential changes.



Components of Strategic Management Process

STRATEGIC LEADERSHIP

> As per May, "Strategic Leadership is the ability to influence others to voluntarily make decisions that enhance the prospects for the organisation's long-term success while maintaining long-term financial stability. Different leadership approaches impact the vision and direction of growth and the potential success of an organization. To successfully deal with change, all executives need the skills and tools for both strategy formulation and implementation."

Strategic leadership refers to a manager's potential to articulate the strategic vision for the organization, and to motivate, guide and influence his subordinates to attain the objectives of that vision. Strategic leadership can also be defined as utilizing strategy in the management of employees. It is the ability to influence organizational members and to accomplish organizational change. Strategic leaders generate organizational structure, assign resources and communicate strategic vision. Strategic leaders have to work in an uncertain environment on various strategic issues.

The main purpose of strategic leadership is strategic productivity. Another aim of strategic leadership is to generate an environment in which employees match the organization's needs in context of their individual job. Strategic leaders instill confidence to the employees in an organization to follow their own ideas, yet, moving in the direction of organisation's overall goals. Strategic leaders make better use of reward and incentive system for encouraging productive and quality employees. Functional strategic leadership is about creativity, resourcefulness, and preparing to assist an individual in realizing his objectives and goals.

Functions and Importance of a Strategic Leader

Following are the nine key strategic leadership roles and brief meaning of each.

- **Navigator** – Clearly and quickly works through the complexity of key issues, problems and opportunities to affect actions (e.g., leverage opportunities and resolve issues).
- **Strategist** – Develops a long-range course of action or set of goals to align with the organization's vision.
- **Entrepreneur** – Identifies and exploits opportunities for new products, services and markets.
- **Mobilizer** – Proactively builds and aligns stakeholders, capabilities, and resources for getting things done quickly and achieving complex objectives.
- **Talent Advocate** – Attracts, develops, and retains talent to ensure that people with the right skills and motivations to meet business needs are in the right place at the right time.
- **Captivator** – Builds passion and commitment toward a common goal.
- **Global Thinker** – Integrates information from all sources to develop a well-informed, diverse perspective that can be used to optimize organizational performance.
- **Change Driver** – Creates an environment that embraces change; makes change happen – even if the change is radical – and helps others to accept new ideas.
- **Enterprise Guardian** – Ensures shareholder value creation through courageous decision-making that supports enterprise – or unit-wide interests.

These nine roles are important at senior strategic levels because they help leaders understand what to do to be strategic. They address the broader challenges leaders face as they transition from managing more narrowly focused "silos," to taking on the challenges of more enterprise-wide leadership.

Strategic Management: Functions and Importance for Professionals like Company Secretaries

A lot has changed since the passage of Indian Companies Act, 2013. A Company Secretary has stepped into various crucial roles such as Key Managerial Personnel, Compliance officer, Internal Auditor, GST Professional, Registered Valuer, Insolvency Professional, Adviser to the Board of Directors, Corporate Planner and Strategic Manager etc., thereby playing a pivotal role in ensuring best governance practices of the corporate world. In order to ensure that every activity of the business organization is conducted in the interests of the stakeholders, i.e. shareholders, employees, suppliers, government agencies etc., it is essential that a Company Secretary work as a strategist and not as a simple knowledge worker.

Company Secretary is required to contemplate the future changes in the political, economic, social, technological and legal environment and its impact on the industry as well as the company per se. Further, the job of a company secretary is a balancing act, meaning that on the one hand he needs to take care of almost all the aspects of corporate affairs, i.e. acting as a mediator between the board and the shareholders, communicating with the outside world on various corporate issues, conducting of meetings and proper maintenance of its records etc. On the other hand, he needs to take care of a bigger but extremely important aspect, in absence of which, it may exert a debilitating impact on the business, i.e. Corporate Governance. At times, while performing his duties, he may find himself at a crossroad or a dilemma, where he needs to choose between the two, i.e. what is good for the company and what is ethically correct.

Due to higher degree of association with business matters, now a company secretary's platter is full of various tasks. For instance, they interact with the top management on a continuous basis to apprise them of the latest developments taking place in the capital markets, corporate laws, securities laws and their impact on the organization and also communicating with different external agencies and regulatory authorities, thereby enlarging their role in the organization. Further, a company secretary has to take care of the following critical facets of the business, i.e. Risk management, assessing the sustainability of an organization, contribution towards corporate vision and mission, assessment of the magnitude of business competition, guiding the company on the path of corporate social responsibility etc. have enhanced the significance of a company secretary manifold.

Thus, it is clear that the role of a Company Secretary encompasses almost all the functions which a top management official needs to perform and in view of this, strategic management is of paramount significance for a company secretary.

The ensuing paragraph makes an attempt to comprehend how a company secretary is also a part and parcel of strategic management.

A company secretary in today's era while discharging his or her professional obligations has to perform several key roles which are also integral components of strategic management. A brief discussion on some of the roles is as follows:

(1) *Advisory* : As an advisor to the Board Members, the Company Secretary must build a good relationship with them provide impartial or unbiased advice which is in the best interest of the company. He is required to offer necessary assistance to the Chairman with all development processes including board evaluation, induction and training. This involves implementation of a rigorous plan for the assessment of the performance of Directors and taking requisite measures based on the review report. Further, the company secretary should take the lead in developing tailored induction plans for new directors and devising a training plan for individual directors and the Board. Although these tasks are ultimately the responsibility of the chairman, the company secretary can add value by fulfilling, or procuring the fulfilment of, these best practice governance requirements on behalf of the chairman.

(2) *Communication with Stakeholders*: The company secretary is a distinctive interface between the Board and management and as such they act as an important link between the Board and the business. Through effective communication they can coach management to understanding the expectations of, and value brought by the Board. The company secretary also has an important role in communicating with external stakeholders, such as investors, and is often the first point of contact for queries. The company secretary should work closely with the chairman and the Board to ensure that effective shareholder relations are maintained.

(3) *Flawless Disclosure and Reporting* : In recent years there has been increased emphasis in the quality of corporate governance reporting and calls for increased transparency. The company secretary usually has responsibility for drafting the governance section of the company's annual report and ensuring that all reports are made available to shareholders according to the relevant regulatory or listing requirements.

(4) *Management of Board Meetings and Committees*: The company secretary plays a leading role in good governance by helping the Board and its committees function effectively and in accordance with their terms of reference and best practice. Providing support goes beyond scheduling meetings to proactively managing the agenda and ensuring the presentation of high quality up-to-date information in advance of meetings. This should enable directors to contribute fully in board discussions and debate and to enhance the capability of the Board for good decision making. Following meetings, the company secretary should pursue and manage follow up actions and report on matters arising.

(5) *Compliances*: In current scenario, a business has to adhere to various laws and regulations failing which may invite various legal hassles. A company secretary is required to ensure compliance with various laws and regulations and for doing so he / she should be conversant with the laws as well as the amendments that take place. For instance, in Indian context a company secretary has to ensure compliance of the following laws but not limited to- Companies Act; SEBI Act, Securities Contracts

(Regulation) Act and rules and regulations made there under; Foreign Exchange Management Act; Consumer Protection Act; Depositories Act; Environment and Pollution Control Laws; Labour and Industrial Laws etc.

(6) *Representation*: A Company Secretary has to represent before various tribunals and courts in order to present the legal issue of the company. In India, a company secretary appears before the legal bodies *inter-alia* includes National Company Law Tribunal (NCLT); National Company Law Appellate Tribunal (NCLAT); Competition Commission of India (CCI); Registrar of Companies; Tax Tribunals etc.

STRATEGIC PLANNING

As per Allison and Kaye (2005), "Strategic planning is an organization's process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy. It may also extend to control mechanisms for guiding the implementation of the strategy."

In 1960s, the concept of Strategic planning gained prominent in strategic management in corporate sector and it has maintained its importance in contemporary times too. It follows a cycle that is interpreted below:

The Strategic Planning Cycle

Although, strategic planning process may be unique as per the specific requirements of any organisation, yet the Strategic Planning process is modelled in cycle shown above contains the steps most commonly followed by most of the organisations:

- Deliberating mission of the organisation;
- Developing goals based on chosen mission;
- Examining internal environment (strengths and weaknesses);
- Examine external environment (opportunities and threats);
- Summarize findings of SWOT analysis;
- Formulate final strategy based on SWOT.

Strategic planning is an iterative process; it may begin with one mission and end with another, depending on the outcomes of the process.

Benefits of Strategic Planning

Strategic planning can help your organization in a number of critical ways:

- *Improved results and confidence*: A proper plan may positively influence organizational performance and can contribute to a greater sense of purpose, progress and accountability among its team.
- *Focus*: Good strategic planning forces future thinking and can refocus and re-energise a disorientated organization.
- *Problem solving*: Strategic planning focuses on an organization's most critical problems, choices and opportunities.
- *Teamwork*: Strategic planning provides an excellent opportunity to build a sense of teamwork, to promote learning, and to build commitment across the organization.
- *Communication*: All stakeholders have an interest in knowing the direction in which organisation is heading and also how their contribution will fit in overall plan.
- *Greater control*: Strategic planning can provide an organisation greater control the environment in which it operates.

Limitations of Strategic Planning

- *Costs can outweigh benefits*: Strategic planning can consume a lot of time and money. This can be wasteful if the strategic planning is not successful.
- *Development of Poor plans*: Faulty assumptions about the future, poor assessment of an organization's capabilities, poor group dynamics and information overload can lead to the development of poor plans.
- *Implementation*: if not implemented properly, whole planning exercise will go futile. Disillusionment,cynicism and feelings of powerlessness often result if people have contributed energy for development of a plan which is not implemented.

BOARD OF DIRECTORS AND CORPORATE SOCIAL RESPONSIBILITY

The Board of Directors plays a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself. A board's responsibilities derive from law, custom, tradition and prevailing practices.

In the present times transparency, disclosure, accountability, issues of sustainability, corporate citizenship, globalization are some of the concerns that the Boards have to deal with. In addition, the Boards have to respond to the explosive demands of the marketplace. This two dimensional role of the Board of Directors is the cornerstone in evolving a sound, efficient, vibrant and dynamic corporate sector for attaining of high standards in integrity, transparency, conduct, accountability as well as social responsibility. The professionals like company secretaries are best fit to advise the Board of Directors to play their role efficiently.

Role of Board of Directors in making Strategic Decision

The institution of board of directors was based on the premise that a group of trustworthy and respectable people should look after the interests of the large number of shareholders who are not directly involved in the management of the company. The position of the board of directors is that of trust as the board is entrusted with the responsibility to act in the best interests of the company.

The contribution of board of directors of companies is critical for ensuring appropriate directions with regard to leadership, vision, strategy, policies, monitoring, supervision, accountability to shareholders and other stakeholders, and to achieving greater levels of performance on a sustained basis as well as adherence to the best practices of corporate governance.

An effective board defines the company's purpose and then sets a strategy to deliver it, shapes its culture and the way it conducts the business. It sets the main trends and factors affecting the long-term success and future viability of the company – for example technological change or environmental impacts – and how these and the company's principal risks and uncertainties have been addressed.

The board should have sound understanding of how value is created over time, key strategies and business models towards a sustainable future. This is not limited to value that is found in the financial statements. An understanding of how value for intangible sources is developed, managed and sustained.

For example, a highly trained workforce, intellectual property or brand recognition – is increasingly relevant to an understanding of the company's performance and the impact of its activity. These are important considerations for boards when setting corporate strategy.

Boards have a responsibility for the health of the company and need to take a long-term view. This is in contrast to the priorities of some investors, not all of whom will be aligned with the pursuit of success over the long-term. An effective board will manage the conflict between short-term interests and the long-term impacts of its decisions; it will assess shareholder and stakeholder interests from the perspective of the long-term sustainable success of the company.

The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. An effective board develops and promotes its collective vision of the company's purpose, its culture, its values and the behaviour it wishes to promote in conducting its business. The role of Board in particular includes:

- Providing direction for management;
- Demonstrate ethical leadership, displyaing and promoting the behaviour through which a company wishes to conduct its business
- Consistent with the culture and values it has defined for the organisation;
- Create a performance culture that drives value creation without exposing the company to excessive risk of value destruction;
- Make well-informed and high-quality decisions based on a clear line of sight into the business;
- Create the right framework for helping directors meet their statutory duties under the Companies Act, 2013 and/or other relevant statutory and regulatory regimes;
- Being accountable, particularly to those that provide the company's capital; and
- Think carefully about its governance arrangements and embraces evaluation of their effectiveness.

Corporate Social Responsibility (CSR)

CSR is understood to be the way by which firms integrate social, environmental and economic concerns into their values, culture, decision making, strategy and operations in a transparent and accountable manner and thereby establish better practices within the firm, create wealth and improve society.

The 1950s saw the start of the modern era of CSR when it was more commonly known as Social Responsibility. In 1953, Howard Bowen published his book, "Social Responsibilities of the Businessman", and is largely credited with coining the phrase 'corporate social responsibility' and is perhaps the Father of modern CSR. Bowen asked: "what responsibilities to society can business people be reasonably expected to assume?" Bowen also provided a preliminary definition of CSR "it refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society.

> According to the World Business Council for Sustainable Development, 1999 "Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to the economic development while improving the quality of life of the workforce and their families as well as of the local community and the society at large."

CSR is a concept whereby companies not only to consider their profitability and growth, but also interests of society and the environment by taking responsibility for the impact of their activities on the society, environment and communities in which they operate.

CSR aims to fulfill expectations that society has from business and it is viewed as a comprehensive set of social policies, practices and programs that are integrated throughout the business operations. The concept of CSR has evolved over the years and it is now used as a strategy and a business opportunity to earn stakeholders' goodwill.

Essentially, Corporate Social Responsibility is an inter-disciplinary subject in nature and encompasses in its fold:

1. Social, economic, ethical and moral responsibility of companies and managers,
2. Compliance with legal and voluntary requirements for business and professional practice,
3. Challenges posed by needs of the economy and socially disadvantaged groups,
4. Management of corporate responsibility activities, and
5. Proper implementation of the projects taken up by the company so that the benefit goes to people in need.

> CSR is an important business strategy because, wherever possible, consumers want to buy products from companies they trust; suppliers want to form business partnerships with companies they can rely on; employees want to work for companies they respect; and NGOs, increasingly, want to work together with companies seeking feasible solutions and innovations in areas of common concern. CSR is a tool in the hands of corporates to enhance the market penetration of their products, enhance its relation with stakeholders. CSR activities carried out by the enterprises affects all the stakeholders, thus making good business sense, the reason being contribution to the bottom line.

Definition of CSR under Companies Act, 2013

As per rule 2(d) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, "Corporate Social Responsibility (CSR)" means the activities undertaken by a Company in pursuance of its statutory obligation laid down in section 135 of the Act in accordance with the provisions contained in these rules, but shall not include the following, namely:-

i. activities undertaken in pursuance of normal course of business of the company. However, any company engaged in research and development activity of new vaccine, drugs and medical devices in their normal course of business may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for financial years 2020-21, 2021-22, 2022-23 subject to the conditions that-

   (a) such research and development activities shall be carried out in collaboration with any of the institutes or organisations mentioned in item (ix) of Schedule VII to the Act;

   (b) details of such activity shall be disclosed separately in the Annual report on CSR included in the Board's Report.

ii. any activity undertaken by the company outside India except for training of Indian sports personnel representing any State or Union territory at national level or India at international level;

iii. contribution of any amount directly or indirectly to any political party under section 182 of the Act;

iv. activities benefitting employees of the company as defined in clause (k) of section 2 of the Code on Wages, 2019;

v. activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services;

vi. activities carried out for fulfilment of any other statutory obligations under any law in force in India.

Benefits of CSR

Business cannot exist in isolation; business cannot be oblivious to societal development. The social responsibility of business can be integrated into the business purpose so as to build a positive synergy between the two. Some of the points highlighting the benefits of CSR are depicted below:

- CSR creates a favourable public image, which attracts customers. Reputation or brand equity of the products of a company which understands and demonstrates its social responsibilities is very high. Customers trust the products of such a company and are willing to pay a premium on its products. Organizations that perform well with regard to CSR can build reputation, while those that perform poorly can damage brand and company value when exposed. Brand equity, is founded on values such as trust, credibility, reliability, quality and consistency.
- CSR builds up a positive image encouraging social involvement of employees, which in turn develops a sense of loyalty towards the organization, helping in creating a dedicated workforce proud of its company.
- The company's social involvement discourages excessive regulation or intervention from the Government or statutory bodies, and hence gives greater freedom and flexibility in decision-making.
- The internal activities of the organisation have an impact on the external environment, since the society is an inter-dependent system.
- A business organisation has a great deal of power and money, entrusted upon it by the society and should be accompanied by an equal amount of responsibility. In other words, there should be a balance between the authority and responsibility.
- The atmosphere of social responsiveness encourages co-operative attitude between groups of companies. One company can advise or solve social problems that other organizations could not solve.

- Companies can better address the grievances of its employees and create employment opportunities for the unemployed.
- Financial institutions are increasingly incorporating social and environmental criteria into their assessment of projects. When making decisions about where to place their money, investors are looking for indicators of effective CSR management.
- In a number of jurisdictions, governments have expedited approval processes for firms that have undertaken social and environmental activities beyond those required by regulation.

Factors Influencing CSR

Many factors and influences, including the following, have led to increasing attention being devoted to CSR:

- Globalization – coupled with focus on cross-border trade, multinational enterprises and global supply chains – is increasingly raising CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things.
- Governments and intergovernmental bodies, such as the United Nations, the Organisation for Economic Cooperation and Development (OECD) and the International Labour Organization (ILO) have developed compacts, declarations, guidelines, principles and other instruments that outline social norms for acceptable conduct.
- Advances in communications technology, such as the Internet, cellular phones and personal digital assistants, are making it easier to track corporate activities and disseminate information about them. Non-governmental organizations now regularly draw attention through their websites to business practices they view as problematic.
- Consumers and investors are showing increasing interest in supporting responsible business practices and environmental issues.
- Numerous serious and high-profile breaches of corporate ethics have contributed to elevated public mistrust of corporations and highlighted the need for improved corporate governance, transparency, accountability and ethical standards. However, being ethical and being socially responsible in making positive measurable contribution to society may not be same.
- Citizens in many countries are making it clear that corporations should meet standards of social and environmental care, no matter where they operate.
- There is increasing awareness of the limits of government legislative and regulatory initiatives to effectively capture all the issues that corporate social responsibility addresses.
- Businesses are recognizing that adopting an effective approach to CSR can reduce risk of business disruptions, open up new opportunities, and enhance brand and company reputation.
- Ethical persons shall be attracted to join the company.
- Effective CSR will depend on the mindset of executives of the corporate who are taking up CSR initiatives.
- CSR also depends on the implementing agencies with regard to their seriousness, integrity, honesty and attitude.

Factors Influencing CSR

CASE STUDY – CSR

RELIANCE INDUSTRIES LIMITED

Reliance Industries Limited (RIL) diverse projects and operations touch lives of people in many ways and create value by helping in overall and holistic development of communities across multiple geographies. Through its various initiatives, the group endeavors to play a relevant role by serving communities and projects that address gaps in basic societal requirements.

RIL has been involved in various Social Responsibility initiatives over the last many years. These efforts have substantially improved the quality of lives of people through health care, education, livelihoods and community development initiatives, making their living experience dramatically better. These activities are spread across India and reach well beyond our business locations impacting the lives of marginalized communities.

The key philosophy of all CSR initiatives of RIL is guided by three core commitments of SIS:

a) S – SCALE

b) I – IMPACT

c) S – SUSTAINABILITY

RIL seeks to strategically consolidate the company's CSR initiatives to focus on discrete social problems, all aimed at enabling lives, living and livelihoods. Owing to its long tradition of social responsibility, the value of sustainable social impact at scale is instilled across the conglomerate.

RIL has identified the following focus areas:

- Community Infrastructure & Environment
- Community Health care

- Education and Skills enhancement

RIL's Board of Directors have formed a CSR&G Committee. This committee, along with the CSR team, to be responsible for the decision making with respect to RIL CSR policy. CSR&G Committee recommended the policy to RIL's Board of Directors and the Board of Directors have approved this policy. The Board level Committee to meet at least twice a year to review the implementation of CSR projects/ programs and give suitable direction.

TATA STEEL

Tata Steel's Vision strikes a balance between economic value as well as ecological and societal value by aspiring to be "a Global Benchmark in Value Creation and Corporate Citizenship". In the initial years, Tata Steel's CSR interventions were more as a 'provider' to society where the community was given support for its overall needs, both for sustenance and development. Gradually, the shift in approach led to Tata Steel being an 'enabler' focusing on building community capacity through training programmes; focusing on providing technical support rather than giving aid. At present, CSR interventions of Tata Steel focus on 'sustainable development' to enhance the quality of life of people. It guides the Company in its race to excel in all areas of sustainability. J R D Tata the Chairman of the Tata Group believed that, "to create good working conditions, to pay the best wages to its employees and provide decent housing to its employees are not enough for the industry, the aim of an industry should be to discharge its overall social responsibilities to the community and the society at large, where industry is located.

Guided by this mandate, Tata Steel has for decades uses its skills and resources, to the extent it can reasonably afford, to give back to the community a fair share of the product of its efforts.

It was the first to establish labour welfare practices, even before these were made statutory laws across the world. The Company also instituted an eight-hour workday in 1912, free medical aid in 1915, a Welfare Department in 1917, leave with pay, Workers Provident Fund and Workmen's Compensation in 1920 and Maternity Benefit for ladies in 1928.

The Company supports and propagates the principles of the United Nations Global Compact as a Founder Member, is a signatory to the World steel Sustainability Charter and supports the Affirmative Action programme of the Confederation of Indian Industry.

Tata Steel's approach to business has evolved from the concept that the wealth created must be continuously returned to society. The responsibility of combining the three elements of society - social, environmental, and economic - is of utmost importance to the way of life at Tata Steel. Today, Tata Steel's CSR activities in India encompass the Company's Steel Works, Iron ore mines and collieries, reaching out to the city of Jamshedpur, its peri-urban areas and over 800 villages in the states of Jharkhand, Odisha and Chhattisgarh. Community involvement is a characteristic of all Tata Steel Group companies around the world. It can take the form of financial support, provision of materials and the involvement of time, skills and enthusiasm of employees. The Group contributes to a very wide range of social, cultural, educational, sporting, charitable and emergency assistance programmes. The Company works in partnership with the Government, national and international development organisations, local NGOs and the community to ensure sustainable development. The Corporate Services Division delivers these responsibilities through several institutionalised bodies:

- Tata Steel Corporate Social Responsibility and Accountability Policy
- Corporate Social Responsibility
- Tata Steel Rural Development Society (TSRDS)
- Tribal Cultural Society (TCS)

- Tata Steel Family Initiatives Foundation (TSFIF)
- Tata Steel Skill Development Society (TSSDS)
- Education
- Medical Services
- Urban Services
- Sports Department
- Tata Steel Adventure Foundation
- JUSCO
- Other societies like Ardeshir Dalal Memorial Hospital, Blood Banks, Hospital etc.

Tata Relief Committee To assess the effectiveness of its social initiatives Tata Steel has innovatively devised a Human Development Index (HDI). In 2012-13, HDI assessment was completed for 230 villages. The Corporate Social Responsibility Advisory Council was also created with the objective that this apex body along with the results of the measurement of HDI will enable the Group to direct its social initiatives better and allocate resources more efficiently.

Role of Board of Directors in CSR related activities of a Company

CSR is a Board-driven process. The responsibilities of the Board of a CSR-eligible company, *inter-alia*, include the following-

- approve the CSR policy;
- disclose contents of such policy in its report and also place it on the company's website, if any;

CASE LAW

Corporate Social Responsibility - Board's Compliance Responsibility of Implementing and Reporting

In re Chettinad Earth Movers (P.) Ltd. CA NO. 1096/CB/2018 NCLT Chennai

Facts of the Case

The company was in its initial stage of implementing its CSR policies. The company and its directors failed to disclose the details about the policy developed and implementation by the company on corporate social responsibility initiatives taken during the years 2014-15, in the reports of the Board of its Directors. The Directors of the applicant company were of the view that the disclosure required to be made under the law was not mandatory. The company contended that offence in question was not intentional and inadvertently missed out to give the required disclosures under the said section in the Board's Report pertaining to the financial year ended 31.03.2015. Further, it was not prejudicial to interest of shareholders or creditors. They also filed E-form GNL-1 before Deputy Registrar of Companies. Deputy Registrar forwarded report stating that it was first offence by applicants and no prosecution was pending against applicants.

Decision:

The Hon'ble court held that the Company and its Officers are in default have violated the provisions of Section 134(3)(o) read with Section 135 of the Companies Act, 2013, which is punishable under Section 134(8) of the Companies Act, 2013. The said offence is not intentional and it is not prejudicial to the interest of the shareholders or the creditors.

> The provisions of Section 134(8) of the Companies Act, 2013, provide that the Company shall be punishable with fine which shall not be less than fifty thousand rupees but which extend to twenty-five lakhs rupees, and every officer of the Company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both. ***[This provision was amended vide Notification dated 28th September, 2020 by the Companies (Amendment) Act, 2020.]***
>
> The applicant has pleaded for taking lenient view on the ground that it was the first offence, which has been confirmed by the concerned RoC. Therefore, the Application of the Company and its Officers in default is to be allowed and the offence is to be compounded in exercise of the powers conferred under section 441, by imposing a fine under section 134(8), to the tune of Rs. 1,50,000 *i.e.* Rs. 50,000 on each the Company, and its two Officers.

- ensure that the activities included in the CSR policy are undertaken by the company;
- ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years;
- satisfy itself regarding the utilisation of the disbursed CSR funds; and
- if the company fails to spend at least two per cent of the average net profits of the company, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount and transfer the unspent CSR amount as per provisions of sections 135(5) and 135(6) of the Companies Act, 2013.
- alter such annual action plan based on reasonable justification as per recommendation of CSR committee.

Apart from the above, the Board of Directors of the Company also takes decision on the following important matters related to CSR-

- Matters relating to monitoring for all projects – ongoing or otherwise
- Administrative Overheads
- Setting off excess amount
- Transfer of Capital Asset
- CSR Reporting
- Impact Assessment Report
- Disclosure on Website etc.

CSR and Corporate Governance

The conceptualization of CSR was, initially, purely in terms of philanthropy or charity. However, a fundamental shift has been seen from this philanthropy to integrated approach towards CSR which is gradually getting infused into companies' corporate governance practices.

Corporate Governance as a concept has CSR embedded in it, whereby companies not only consider their profitability and growth, but also the interests of society and the environment by taking responsibility for the impact of their activities on stake holders, environment, consumers, employees, communities, and all stake holders. Other members of the public sphere. The basic premise is that when the corporations get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them which are more non-financial/social in nature.

Companies that practice good corporate governance are also those that are socially and environmentally responsible. That is to say, that unless there is good governance it is quite unlikely that there is a conscientious approach towards their social responsibility. Both Corporate Governance and CSR focus on the ethical practices in the business and the responsiveness of an organization towards its stakeholders and the environment in which it operates.

CORPORATE GOVERNANCE

Corporate governance is the broad term used to describe the processes, customs, policies, laws and institutions that direct the organizations and corporations in the way they act or administer and control their operations. It works to achieve the goal of the organization and manages the relationship with the stakeholders including the board of directors and the shareholders.

Corporate governance means to steer an organization in the desired direction by determining ways to take effective strategic decisions. It also deals with the accountability of the individuals through a mechanism which reduces the principal-agent problem in the organization.

> "Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders."
>
> ***The Institute of Company Secretaries of India***

Good corporate governance promotes investor confidence, which is crucial to the ability of entities listed on stock exchanges to compete for capital. Good corporate governance is essential to develop additional values to the stakeholders as it ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights.

> "Corporate Governance is concerned with the way corporate entities are governed, as distinct from the way business within those companies are managed. Corporate governance addresses the issues facing Board of Directors, such as the interaction with top management and relationships with the owners and others interested in the affairs of the company"
>
> ***Robertlan (Bob) Tricker***
>
> ***(who introduced the words corporate governance for the first time in his book in 1984)***

Objectives of Corporate Governance

Corporate Governance is aimed at creating an organization which maximizes the wealth of shareholders. It envisages an organization in which emphasis is laid on fulfilling the social responsibilities towards the stakeholders in addition to the earning of profits. The objectives of Corporate Governance is to ensure the following:

- Properly constituted Board capable of taking independent and objective decisions.
- Board is independent in terms of Non-Executive and Independent Directors.
- Board adopts transparent procedures and practices.
- Board has an effective machinery to serve the concerns of the Stakeholders.
- Board to monitor the functioning of the Management Team.

- Properly constituted Board capable of taking independent and objective decisions.
- Board is independent in terms of Non-Executive and Independent Directors.
- Board adopts transparent procedures and practices.
- Board has an effective machinery to serve the concerns of the Stakeholders.
- Board to monitor the functioning of the Management Team.
- Board remains in effective control of the affairs of the Company.

***The details on the Corporate Governance Code are covered in Lesson-1 of Environmental, Social and Governance (ESG)- Principles and Practice, study of professional programme.**

CORPORATE GOVERNANCE AND ROLE OF COMPANY SECRETARY

Corporate governance offers a comprehensive, interdisciplinary approach to the management and control of companies. Corporate professionals of today and tomorrow must imbibe in themselves the evolving principles of good corporate governance across the globe on a continual basis. Therefore Corporate Governance has emerged as an important academic discipline in its own right, bringing together contributions from accounting, finance, law and management. Excellence can be bettered only through continuous study, research and academic and professional interaction of the highest quality in the theory and practice of good corporate governance.

The corporate world especially looks upon Company Secretaries to provide the impetus, guidance and direction for achieving world-class corporate governance. Company Secretaries are the primary source of advice on the conduct of business. This can take into its fold everything from legal advice on conflicts of interest, through accounting advice, to the development of strategy/corporate compliance and advice on sustainability aspects.

Company Secretary:

- acts as a vital link between the company and its Board of Directors, shareholders and other stakeholders and regulatory authorities;
- plays a key role in ensuring that the Board procedures are followed and regularly reviewed;
- provides the Board with guidance as to its duties, responsibilities and powers under various laws, rules and regulations;
- acts as a compliance officer as well as an in-house legal counsel to advise the Board and the functional departments of the company on various corporate, business, economic and tax laws;
- is an important member of the corporate management team and acts as conscience keeper of the company.

The company secretary being an important human capital of the management of the business organization should put all the efforts to ensure that through his roles the corporate governance prevails and the business is able to attain astral heights.

However, to be an effective player of strategic management, a company secretary needs to embrace the following core competencies:

i. Possessing a thorough knowledge of the company's business.

ii. Sound knowledge of laws relating to company, capital markets, industry related etc.

iii. Must have strong Communication and Professional Skills; Legal Skills; Management Skills and IT Skills.

iv. Being intuitive and sensitive to the thoughts and feelings of board directors and the CEO.

v. Staying current with changes in corporate governance and giving the board and managers a “heads up” about new developments.

vi. Being able to work and achieve a consensus within multidisciplinary settings.

vii. Being flexible, creative and detailed.

viii. Remaining calm under pressure and not losing sight of perspective.

LESSON ROUND-UP

- Strategic Management is a discipline that deals with long-term development of an organisation with a clear-cut vision about organisational purpose, scope of activities and objectives.
- The strategic management process is defined as the process by which the managers’/decision makers’ are able to make a choice of a set of strategies for the organization that will enable it to accomplish improved performance. There are four indispensable phases of every strategic management process.
- Strategic leadership refers to a manager’s potential to articulate the strategic vision for the organization, and to motivate, guide and influence his subordinates to attain the objectives of that vision.
- The role of a Company Secretary encompasses almost all the functions which a top management official needs to perform and in view of this, strategic management is of paramount significance for a company secretary.
- Strategic planning is an organization’s process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy. It may also extend to control mechanisms for guiding the implementation of the strategy.
- According to the World Business Council for Sustainable Development, 1999 “Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to the economic development while improving the quality of life of the workforce and their families as well as of the local community and the society at large.”
- Corporate governance means to steer an organization in the desired direction by determining ways to take effective strategic decisions. It also deals with the accountability of the individuals through a mechanism which reduces the principal-agent problem in the organization.
- The company secretary being an important human capital of the management of the business organization should put all the efforts to ensure that through his roles the corporate governance prevails and the business is able to attain astral heights.

GLOSSARY

Business model canvas: The Business Model Canvas is a strategic management and lean startup template for developing new or documenting existing business models. It is a visual chart with elements describing a firm’s or product’s value proposition, infrastructure, customers, and finances.

Cascading: Cascading is arranging strategic devices (objectives) to ensure collaboration and cooperation downward through all levels of the organizational system in a connected series or sequence, like a waterfall, so that the intended strategy is exhibited from leadership levels all the way to the customer-facing personnel.

Competitive positioning: Competitive positioning is about defining how you'll "differentiate" your offering and create value for your market. It's about carving out a spot in the competitive landscape, putting your stake in the ground, and winning mindshare in the marketplace – being known for a certain "something."

Cross-functional: A process or activity that includes portions of the process or activity from two or more functions within an organization.

External analyses: An examination of the dimensions of an organization's external environment, including the close scrutiny of those trends, events, that are having, or might have an impact on the performance capabilities of the management, resources, structure, processes, and operation of an organization.

Globalization: A process of interaction and integration among the people, companies, and governments of different nations, driven by international trade and investment and aided by information technology. This process also impacts the environment, culture, political systems, economic development and prosperity, and human well-being in societies around the world. It includes investing, managing, organizing, and operating on a world-wide scale, i.e., across national boundaries and in different cultures and societies.

Strategic Initiative: Strategic initiative is a collective endeavor, with a defined beginning and end, to reduce performance gaps and help accomplish strategic objectives.

Internal analyses: Critical examination of the internal dimensions and performance capabilities of the management, resources, structure, processes, and operation of an organization.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Define strategic management.
2. Discuss four phases of strategic management process.
3. What is the concept of Strategic Leadership?
4. What are functions and importance of a Strategic Leader?
5. What are the functions and importance of strategic management for professionals like Company Secretaries?
6. Explain the role of Board of Directors in decisions related to organization's Corporate Social Responsibility.
7. Briefly explain the Corporate Governance Code and Laws in India.

LIST OF FURTHER READINGS

- Vikalpa Journal of IIM Ahemadabad Decision Journal of IIM Calcutta
- IUJ Journal of Management, ICFAI University Jharkhand on Becoming a Leader by Warren G. Bennis
- Purple Cow: Transform your business by being Remarkable by Seth Godin
- Growing a Business by Paul Hawken

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- https://www.mca.gov.in/Compendium/Ebook/mobile/index.html
- https://www.researchgate.net/publication/235278936_The_state_of_strategic_management_research_ and_a_vision_of_the_future
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Analyzing the External and Internal Environment

Lesson 2

KEY CONCEPTS

■ Business Environment ■ External Environment ■ Internal Environment ■ Micro Environment ■ Macro Environment ■ Porter's Five Forces Model

Learning Objectives

To understand:

- The influences of environment on business
- The Characteristics and Components of Business Environment
- The External and Internal Environment
- Micro and Macro factors of External Environment
- Porter's five forces model- the tool to determine the intensity of competition in an industry and its profitability level

Lesson Outline

- Environmental Influences of Business
- Characteristics and Components of Business Environment
- External Environment
  - Micro Factors
  - Macro Factors
- Internal Environment
- Porter's Five Force Model
- Case Study
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

ENVIRONMENTAL INFLUENCES OF BUSINESS

The term environment in context of business refers to all external forces or factors having a direct or indirect bearing on events related to functioning of business. Business helps a country to accomplish economic growth, generates employment opportunities and makes available various types of goods and services for human consumption. A business organisation does not exist in a vacuum but has to take into account external and internal environment. Business environment may offer opportunities for any firm or pose threats to the firm. A business firm is also affected by a number of internal factors, which are forces inside the business organisation. While the policy makers and the managers on the top are concerned with the external environment, the middle level and lower level management are more concerned with the internal environment.

Definition

According to Keith Davis, "Business environment is aggregate of all conditions, events and influences that surround and affect the business".

Bayord O. Wheeler defines business environment as "the total of all the things, external to a business firm, which affect the organisation and its operations".

As per Arthur M. Weimer, "Business environment encompasses the climate or set of conditions- economic, social, political, or institutional- in which business is conducted".

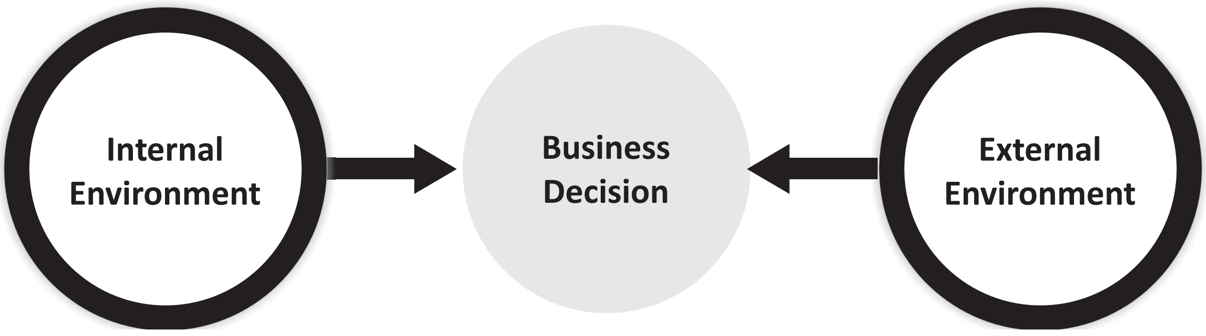
Therefore, business environment may be defined as:

"The sum total of all individuals, institutions and other forces that are outside the control of a business enterprise but the business still depends upon them as they affect the overall performance and sustainability of the business."

The forces which compose the business environment are its suppliers, competitors, consumers, government, bankers, customers, economic conditions, market conditions, investors, technologies, political parties, international institutions and multiple other institutions working externally of a business constitute its business environment. These forces influence the business even though they are outside the business boundaries.

For example, changes in income tax rate by the government while announcing the budget may make the customers reduce their consumption expenditure and reduce quantity of products purchased earlier from the company. Due to this macro level change, the business will need to re-work with its pricing policy to adapt to the tax rate change. Here, even though the business had no participation in initiating the tax rate change, still had to adapt to this change by re-working its pricing policy to maintain its previous profits.

In short, business decisions are influenced by, broadly, two sets of factors, viz., firm related factors (internal environment) and external influence (external environment).



Factors Influencing Business Decision

Importance of Environmental Study

The benefits of studying business environment are as follows:

- Development of strategies, long-term policies and objectives of the firm.
- Development of action plans to deal with changes in environment.
- To forecast the consequences of socio-economic changes at the national and global levels on the company's stability.
- Analysis of competitor's strategies and formulation of effectual counter measures.
- To keep the business dynamic and up-to-date.

CHARACTERISTICS AND COMPONENTS OF BUSINESS ENVIRONMENT

Characteristics of Business Environment

1. **Environment is dynamic in nature**: The environment keeps on changing as the changes occur. Frequently the environment changes, more frequently it will impact the business.
2. **It has direct and indirect impact**: Environment gives direct and sometimes indirect effect on the working of the business.
3. **Two types of factors**: Environment mainly consists of two type of factors namely internal and external environmental factors.
4. **Environment is integral part of business:** Without the support of either internal or external forces, the business can't run or operate.
5. **Impact on business decisions**: Due to environment, business can take proactive or reactive decisions in its operation to make operation more beneficial.
6. **Multi-dimensional**: This it always considers both aspects of a force i.e., its positive as well as negative impacts.

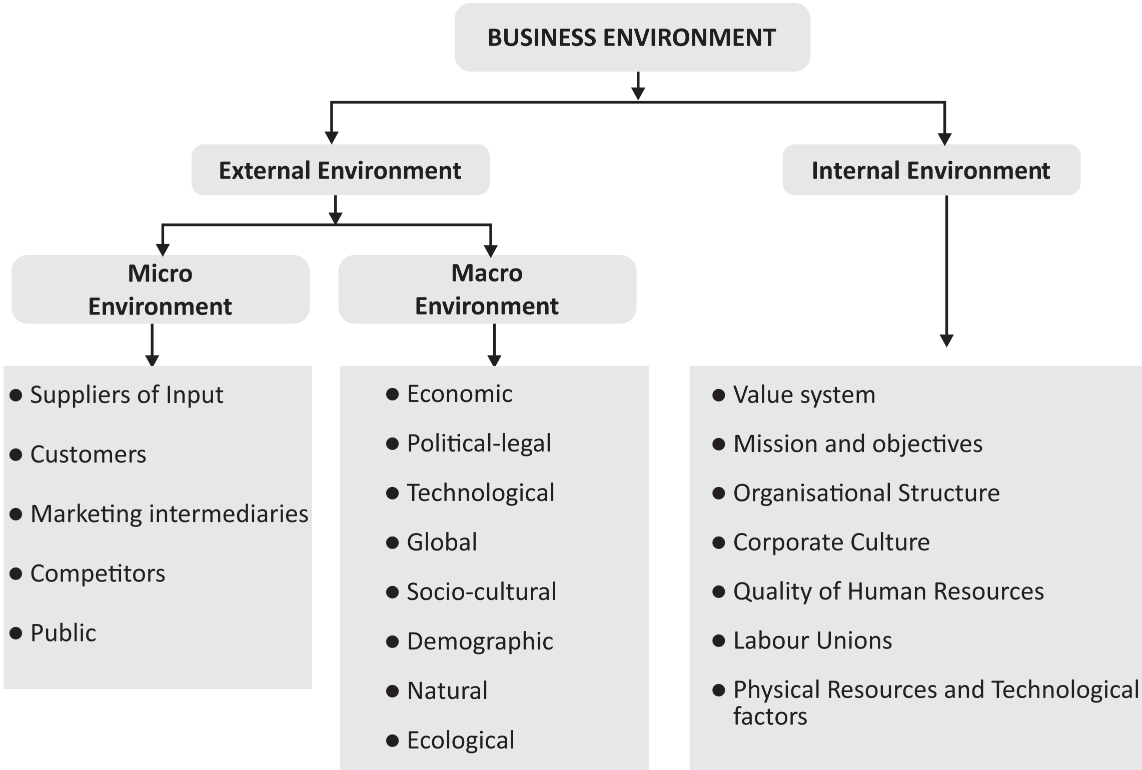
The various components of business environment are–

(i) External Environment

(ii) Internal Environment.

(i) External Environment

External environment consists of all those factors that affect a business enterprise from outside its boundaries. It consists of shareholders, legal, competitors, customers, society, government rules and regulations, policies and technology etc. These are uncontrollable factors and firms have to adapt to the components of this environment.



External environment can be sub-divided into micro environment and macro environment. Different players in the micro environment normally do not affect all firms of a particular industry equally. However, sometimes micro environment of the various businesses may remain more or less same.

A. External Micro Environment

The micro environment consists of factors in the company's immediate environment. Micro environment includes those players whose decisions and actions have a direct bearing on the company. Production and sale of goods are the two important aspects of modern business. The various constituents of micro environment are as under:

(a) **Suppliers:** These supply of resources (finances, raw materials, fuel, power and other factors of production) and pave the way for smooth conduct of the business. Firms should keep themselves updated about the policies of suppliers as rise in the cost of inputs will influence their sales volume and profitability. The scarcity of inputs also has a bearing on the production schedules. For smooth production and sales, the business should have more than one supplier in their list to have an unhampered production schedules.

(b) **Customers:** The people who buy and use products and services of business and are an important part of external micro environment. A business may have diverse customers such as households, producers, retailers, Government and foreign buyers on its portfolio. Since sales of a product or service is critical for a firm's survival and growth, it is necessary to keep the customers satisfied.

(c) **Marketing intermediaries:** In the firm's external micro environment, marketing intermediaries play an essential role of selling and distributing its products to the final customers. They are the physical distribution firms (transport firm), service agencies (media firms), financial intermediaries (banks, insurance companies) etc. that assist in production, marketing and insurance of the goods against loss of theft, fire etc. Business has to maintain healthy relations with them to carry their activities smoothly.

All these factors are largely controllable by the firms but they operate in the larger macro environment beyond their control.

(d) Competitors: Different firms in an industry compete with each other for sale of their products. This competition may be on the basis of pricing of their products and also non- price competition through competitive advertising such as sponsoring some events to promote the sale of different varieties and models of their products. They constantly watch competitors' policies and adjust their policies to gain customer confidence.

(e) Public: Finally, public is an important force in external micro environment. Public, according to Philip Kotler, "is any group that has an actual or potential interest in or impact on the company's ability to achieve its objective." A public is any group that has an actual or potential interest in or impact on an organisation's ability to achieve its interest. Environmentalists, media groups, women's associations, consumer protection groups, local groups, citizens association are some important examples of publics which have an important bearing on the business decisions of the firm. Companies observe the behaviour of these groups to make functional policies.

B. External Macro Environment

Apart from micro environment, business firms also come across some other external environmental forces which are beyond their control and operate at macro level. Because of the uncontrollable nature of such macro forces, a firm has to adjust or adapt itself to harness the opportunities thrown by such forces and mitigate the threats. These factors are:

(a) Economic Environment: Economic environment includes all those forces which have an economic impact on business. Accordingly, total economic environment consists of agriculture, industrial production, infrastructure, and planning, basic economic philosophy, stages of economic development, trade cycles, national income, per capita income, savings, money supply, price level, fiscal and monetary policies and population.

The economic environment has definitely an impact on the activities of business enterprises. In the capitalist economies, the economic decisions concerning investment, production and sale are driven by profit motives. While in socialist economies, such decisions are taken by the public sector and driven by social welfare motive rather than profit maximisation. In a mixed economy, public and private sectors have a co-existence and they may individually or jointly own the factors of production.

Choice of alternatives regarding allocation of resources such as what to produce, how to produce and for whom to produce; nature of technology and the techniques of production, timing of production etc. will be different in capitalist, social and mixed economies, therefore, the business firm has to keep in mind the economic environment in which it operates.

Economic Factors

- Government Fiscal and tax policies
- General Economic Conditions
- Economic Systems
- Economic Policies
- Economic Growth
- Unemployment Rate
- Interest rates
- Currency exchange rates
- Taxes

(b) Political-legal Environment: The political- legal environment includes the activities of three political institutions, namely, legislature, executive and judiciary which usually play a useful role in shaping, directing, developing and controlling business activities. In order to attain a meaningful business growth, a stable and dynamic political-legal environment is very important. Legal environment is also significant for functioning of the business as various laws are in force to regulate the operations of the business enterprises. They relate to standard of products, packaging, protection of environment and ecological balance, ban on advertisement of (alcohol and medicines), advertisement of certain products with statutory warning (cigarette) etc. Laws also exist to prevent restrictive trade practices (RTP) and monopoly.

Political Factors	Legal Factors
• Political climate - amount of government activity	• Minimum wage laws
• Political stability and risk	• Environmental protection laws
• Government debt	• Worker safety laws
• Budget deficit or surplus	• Labour laws
• Corporate and personal tax rates	• Copyright and patent laws
• Payroll taxes	• Anti-monopoly laws
• Import tariffs and quotas	• Municipal licences
• Export restrictions	• Laws that favour business investment.
• Restrictions on international financial flows.	

(c) Technological Environment: Technology implies systematic application of scientific or other organised knowledge to practical tasks or activities. It includes innovations too. As technology is changing fast, businessmen should keep a close look on those technological changes for its adaptation in their business activities. Not adopting technological changes and imitating innovation is not possible as technical threats from external environment have to be converted into opportunities and gainfully employed in business operations.

Technology influences the way we live, we cook (electric cooker), we drink water (filtered and mineral water), communicate (telephone, fax, e-mail, videoconferencing, e-mail chatting, etc.), prepare for a class or a case, design or read a newspaper through the Internet, get marriage alliances (through the Internet), (computer aided), produce, sells (e-commerce), satellite networks electronic fund transfers, lasers, fibre optics, unmanned factories, miracle drugs, new diagnostic methods, new studies in technology like eye scanning for the password and using the remote for car has changed our lives.

Technological Environment Factors

- Efficiency of infrastructure, including: roads, ports, airports, rolling stock, hospitals, education, healthcare, communication, etc.
- Industrial productivity
- New manufacturing processes
- New products and services of competitors
- New products and services of supply chain partners
- Any new technology that could impact the company
- Cost and accessibility of electrical power.

(d) Global or International Environment: The Global environment or 'border less world' plays an important role in shaping business activity. With the liberalisation and globalisation of the Indian economy in 1991, there have been significant economic and political changes and increasing role for the private sector to play since then. The global business environment is radically affected by the principles and agreements of World Trade Organisation (WTO) as it keeps a watch and regulates the business transacted in the international environment.

(e) Socio-cultural Environment: The social environment consists of the social values; concern for social problems like protection of environment against pollution, providing employment opportunities, health care for the aged and old etc.; consumerism (indulging in fair trade practices) to satisfy human wants.

The cultural environment represents values and beliefs, norms and ethics of the society. The buying habits, buying capacities, tastes, preferences and many other factors are dependent on the cultural environment.

(f) Demographic environment: The demographic environment includes the gender ratio, size and growth of population, life expectancy of the people, rural-urban distribution of population, the technological skills and educational levels, language skills of labour force. All these demographic features have an important bearing on the functioning of business firms. For example, huge populated countries such as Indian and China can adopt labour-intensive technologies than capital intensive ones to give employment to its labour force. Similarly, the population of kids will decide product range and space for such products to be offered in a mall while planning logistics.

Social Cultural and Demographic Factors

- Birth and death rates
- Life expectancy rates
- Attitude towards work and organization
- Attitude towards government
- Attitude towards authority
- Ethical norms
- Value system
- Composition of work force
- Attitude towards income, savings and capital formation
- Social ethos towards work and organization.

(g) Natural Environment: The natural environment is the ultimate source of many inputs such as raw materials and energy, which firms use in their productive activity. The natural environment which includes geographical and ecological factors such as minerals and oil reserves, water and forest resources, weather and climatic conditions and port facilities are all highly significant for various business activities. For example, steel producing industries are set up near the coal mines to save cost of transportion to distant locations. The natural environment also affects the demand for goods. For example, places with hot temperatures will have high demand for air conditioners. Areas which are highly polluted will have more scope of selling air-purifiers. Similarly, weather and climatic conditions influence the demand pattern for clothing, building materials for housing etc. Natural calamities like floods, droughts, earthquake etc. are devastating for business activities.

(h) **Ecological environment:** Though natural resources such as air, water and solar energy can be replenished, yet, business organisations are polluting these resources by dumping chemical industrial wastes in water and affecting the ozone layer. The environment damage to water, earth and air caused by industrial activity of mankind is harmful for future generations. Business enterprises should understand their social responsibility and use these resources meticulously. Legislative measures are also brought in by the Government (Pollution Control Board) to protect the natural environment. Even, as a part of self- accountability, the renewable resources should be used wisely so that rate of consumption does not exceed the rate of replenishment.

(ii) Internal Environment

Survival and growth of a business depends upon its strengths and adaptability to the external environment. The internal strengths represent its internal environment. These consist of financial, physical, human and technological resources. The factors in internal environment of business are to a certain extent controllable because the firm can change or modify these factors to improve its efficiency. However, the firm may not be able to transform all the factors. The various internal factors are:

(a) **Value system :** The value system of an organisation means the ethical beliefs that guide the organisation in achieving its mission and objectives. The value system of a business organisation also determines its behaviour towards its employees, customers and society at large. The value system of a business organisation makes an important contribution to its success and its prestige in the world of business. For instance, the value system of J.R.D. Tata, the founder of Tata group of industries, was its self-imposed moral obligation to adopt morally just and fair business policies and practices which promote the interests of consumers, employees, shareholders and society at large. This value system of J.R.D. Tata was voluntarily incorporated in the articles of association of TISCO, a premier Tata company.

Infosys Technologies which won the first national corporate governance award in 1999 attributes its success to its high value system which guides its corporate culture. To quote one of its reports, “our corporate culture is to achieve our objectives in environment of fairness, honesty, transparency and courtesy towards our customers, employees, vendors and society at large” Thus value system of a business firm has an important bearing on its corporate culture and determines its behaviour towards its employees, shareholders and society as a whole.

(b) **Mission and objectives:** The business domain of the company, direction of development, business philosophy, business policy etc. are guided by the mission and objectives of the company. The objective of all firms is assumed to be maximisation of profit. Mission is defined as the overall purpose or reason for its existence which guides and influences its business decision and economic activities. The Mission, vision and values of Reliance are as under:

Mission

- To provide the best and most value-adding advice within our advisory expertise areas.
- To be an independent sparring-partner and to provide excellent advice for our clients in connection within our advisory expertise areas.

Reliance's activities shall be of benefit for both our clients – first and foremost – and for our collaboration partners and employees.

Vision

- To be our clients' 'first call' and preferred collaboration partner within our business areas.
- To consistently exceed our clients' expectations for professional and value-adding advice.

Our objective is long- standing and trustful client relationships created via excellent advice and service.

Values

Reliance is governed by the following fundamental values:

- Quality: We do not compromise – we have a passion for the best quality
- Innovation: We are innovative and wish to enthuse our clients

(c) **Organisation structure:** The organisational structure, the composition of the board of directors, the professionalism of management etc. are important factors influencing business decisions. An efficient working of a business organisation requires that the organisation structure should be conducive for quick decision- making. The board of directors is the highest decision-making body in a business organisation.

For efficient and transparent working of the board of directors in India it has been suggested that the number of independent directors be increased.

(d) **Corporate culture:** Corporate culture and style of functioning of top managers is important factor for determining the internal environment of a company. Corporate culture is an important factor for determining the internal environment of any company. In a closed and threatening type of corporate culture the business decisions are taken by top level managers while the middle level and lower-level managers have no say in business decision making. This leads to lack of trust and confidence among subordinate officials of the company. In an open and participating culture, business decisions are taken by the lower- level managers and top management has a high degree of confidence in the subordinates. Free communication between the top- level management and lower-level managers is the rule in this open and participatory type of corporate culture.

(e) **Quality of human resources:** Quality of employees that is of human resources of a firm is an important factor of internal environment of a firm. The characteristics of the human resources like skill, quality, capabilities, attitude and commitment of its employees etc. could contribute to the strength and weaknesses of an organisation. It is difficult for the top management to deal directly with all the employees of the business firm. Therefore, for efficient management of human resources, employees are divided into different groups. The manager may pay little attention to the technical details of the job done by a group and encourage group cooperation in the interests of a company.

(f) **Labour unions:** Labour unions collectively bargains with the managers for better wages and better working conditions of the different categories of workers etc. For the smooth working of a business firm good relations between management and labour unions is required.

(g) **Physical resources and technological capabilities:** Physical resources such as plant and equipment and technological capabilities of a firm determine its competitive strength which is an important factor for determining its efficiency and unit cost of production. Research and development capabilities of a company determine its ability to introduce innovations which enhances productivity of workers.

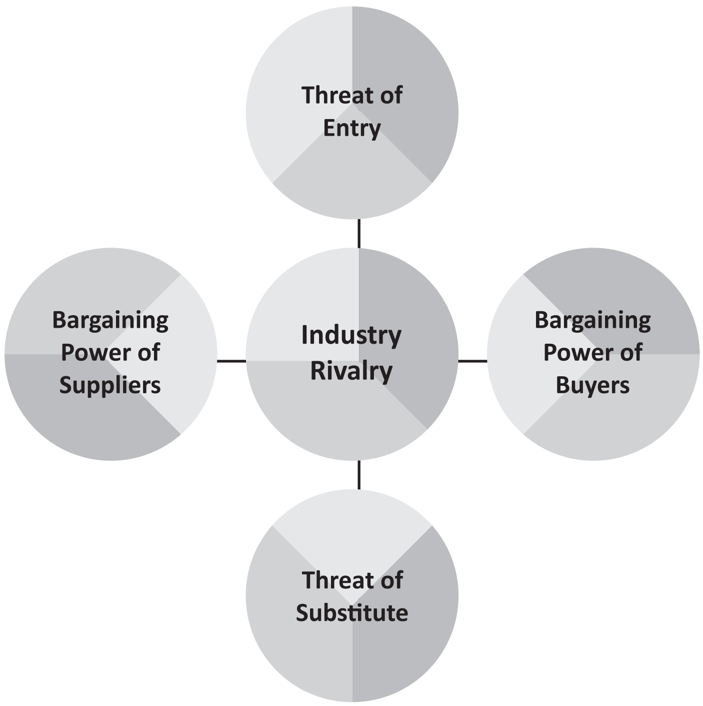
PORTER'S FIVE FORCES MODEL

Definition

The tool was created by Harvard Business School professor Michael Porter. Porter's five forces model is an analysis tool that uses five industry forces to determine the intensity of competition in an industry and its profitability level. Since its publication in 1979, it has turned into one of the most popular and highly regarded business strategy tools.

Porter was of the firm viewpoint that the organizations should keep a close watch on their rivals, but he also encouraged them to go beyond the boundaries of their competitors and make an assessment of other factors impacting the business environment. In this process, he identified five forces that build competitive environment, and have a take away its profitability.

The five forces identified are:



These five forces establish an industry structure and the level of competition in that industry. The stronger the competitive forces are in the industry, the less profitable it becomes ultimately. An industry with low barriers to enter, having not many buyers and suppliers but many substitute products and competitors will be viewed as highly competitive and thus, lesser attractive due to its low profitability.

ATTRACTIVE INDUSTRY - HIGH PROFITS

- High Barriers to enter
- Weak suppliers bargaining power
- Weak buyers bargaining power
- Few substitute products or services
- Low competition

UNATTRACTIVE INDUSTRY - LOW PROFITS

- Low Barriers to enter
- Strong suppliers bargaining power
- Strong buyers bargaining power
- Many substitute products or services
- Intense competition

It is every strategic leader's job to make an assessment of company's competitive position in the industry and to identify its strengths or weaknesses to make stronger that position. The model is very valuable in formulating firm's strategy as it reveals the strength of each of these five key forces.

- **Threat of new entrants:** This force determines the ease of new entrants to enter a particular industry. If an industry is profitable and there are hardly any barriers to enter, competition intensifies rapidly. Therefore, with the entry of more rivals, firms begin to compete for the fixed market share, profits start to decline. Hence, it is critical for existing organizations in the industry to build high barriers to enter to discourage new entrants. Threat of new entrants is high when:
  - Smaller capital is required to make an entry;
  - Existing companies are not influential/dominant to prevent new entrants;
  - Existing firms do not have patents, trademarks or do not strong brand value;
  - There is no/little government regulation;
  - Customer switching costs are low;
  - There is low customer loyalty;
  - Products are not being able to be differentiated; and
  - Economies of scale can be effortlessly acquired.
- **Bargaining power of suppliers:** This is determined by the power of the suppliers to raise their prices. It is also determined by the volume of potential suppliers in case existing supplier increase the price. Bargaining power will also be lower in case suppliers are not supplying identical product/service but a unique one. And the cost of switching from one supplier to another. Suppliers have dominant bargaining power when:
  - There are a small number of suppliers but plenty of buyers;
  - Suppliers are large in number and pose a threat to forward integrate;
  - There are not many substitutes of raw materials;
  - Suppliers hold scarce/unique resources;
  - Cost of switching supplier is relatively high.
- **Bargaining power of buyers:** Bargaining power of the buyers would depend on the number of the buyers and the volume of their order. It would also be a product of the cost of switching from company's products and services to products/services of the competitors. Buyers exert strong bargaining power when:
  - They buy in high volumes or control many access points to the final customer;
  - There are only few buyers in the market;
  - Switching costs to competitors are low;
  - They threaten to backward integrate;
  - There are many close substitutes;
  - Buyers are price sensitive.
- **Threat of substitutes:** This force is especially threatening when buyers can easily find substitute products with attractive prices or better quality and when buyers can switch from one product or service to another with little cost. For example, if a company supplies a unique software product that automates data related to human resource records , the buyer/client may substitute the software either by making the process manual or outsourcing it.

- **Rivalry among existing competitors:** It refers to the number and strength of competitors in the industry. How does the quality of their products and services compare with the company? Where rivalry is intense, companies can attract customers with aggressive price cuts and high-impact marketing campaigns. On the other hand, where competitive rivalry is minimal, and the product is differentiated, there will be high monopoly and steady profits for the company. This force is the major determinant on how competitive and profitable an industry is. In competitive industry, firms have to compete aggressively for a market share, which results in low profits. Rivalry among competitors is intense when:
  - There are several competitors;
  - Exit barriers are high;
  - Industry of growth is slow or negative;
  - Products are not differentiated
  - Products can be easily substituted;
  - Low customer loyalty.

Although, Porter originally introduced five forces affecting an industry, scholars have suggested including the sixth force: complements. Complements increase the demand of the primary product with which they are used, thus, increasing firm's and industry's profit potential. For example, Amazon Prime complements Amazon and Jio TV complements Jio telecom business. As a result, the sale of both products shot up as compared to competitors.

Implementing the model

The following steps are to be followed to implement the Porter's Model:

- Step 1. Gather the information on each of the five forces.
- Step 2. Analyze the results and display them on a diagram.
- Step 3. Formulate strategies based on the conclusions.

Step 1. Gather the information on each of the five forces. What managers should do during this step is to gather information about their industry and to check it against each of the factors (such as "number of competitors in the industry") influencing the force. We have already identified the most important factors in the table below.

Porter's Five Forces Factors

Buyer power	Supplier power
• Number of buyers • Size of buyers • Size of each order • Buyers' cost of switching suppliers • There are many substitutes • Price sensitivity • Threat of integrating backward	• Number of suppliers • Suppliers' size • Ability to find substitute materials • Materials scarcity • Cost of switching to alternative materials • Threat of integrating forward

Threat of new entry	Rivalry among existing competitors
• Amount of capital required • Retaliation by existing companies • Legal barriers (patents, copyrights, etc.) • Brand reputation • Product differentiation • Access to suppliers and distributors • Economies of scale • Sunk costs • Government regulation	• Number of competitors • Cost of leaving an industry • Industry growth rate and size • Product differentiation • Competitors' size • Customer loyalty • Threat of horizontal integration • Level of advertising expense

Threat of substitutes
• Number of substitutes • Performance of substitutes • Cost of changing

Step 2. Analyze the results and display them on a diagram. After gathering all the information, you should analyze it and determine how each force is affecting an industry. For example, if there are many companies of equal size operating in the slow growth industry, it means that rivalry between existing companies is strong. Remember that five forces affect different industries differently so do not use the same results of analysis for even similar industries.

Step 3. Formulate strategies based on the conclusions. At this stage, managers should formulate firm's strategies using the results of the analysis For example, if it is hard to achieve economies of scale in the market, the company should pursue cost leadership strategy. Product development strategy should be used if the current market growth is slow and the market is saturated.

Although, Porter's five forces is a valuable tool to analyze industry's structure and to formulate firm's strategy, it has its limitations and requires supplementary analysis to be done, such as SWOT, PEST or Value Chain analysis.

CASE STUDY – PIZZA HUT

Porter's Five Forces Model – Pizza Hut Case Study

Pizza Hut is world famous multinational fast food chain. It is a subsidiary of Yum! Brands (a Fortune 300 company), the world's largest restaurant company. It is an American restaurant chain with more than 6,000 Pizza Hut restaurants in the United States, and more than 5,600 store locations in 94 other countries and territories around the world. It offers a range of different styles of pizza along with other dishes such as salads, pastas, buffalo wings/potato rings, breadsticks, and garlic breads. It entered India in 1996, with its first branch in Bangalore and expanding all over thereafter, creating a large customer base for itself. The five forces model for Pizza Hut may be drawn as under:

Competitive Rivalry (Very High)

- Pizza Hut competes with some other large global pizza chains, Domino's Pizza, and Papa John. They all are similar in many respects such as deal in many countries across Globe, fast food offerings, dine- in and delivery service, creating intense competition.

- Ferocious price discounting and coupons by these all rivals which creates intense competition.
- Except for those pizza companies, Pizza Inn competes with some small local pizza restaurants as well. They offer low price products and faster service, taking the competitive advantages of Pizza Inn.
- The pizza segment is made more challenging for traditional restaurants by other close substitutions, including supermarkets, which not only sell frozen pizzas, but ready to bake pizza, and warehouse clubs sell large size pizzas.

Threat of New Entrants (Low)

- Pizza chains are juggling with the side-effects of a deep recession, because of higher ingredient prices, the thin margins and elevated competition from non-traditional channels.
- Existing competitors keep lowering prices and discounting discounts, and expanding distribution channels creating barriers to new entrants.
- Existing competitors have first-mover advantages such as mature technology in specialty production, and a healthy relationship with distribution channels, therefore, second mover can hardly survive without innovation in the industry.

Threat of Substitutes (High)

- Pizza is a fast food product having plenty of substitutes.
- Competition from other fast food chains such as sandwich chains, chicken fast food chains, family owned local restaurants etc.
- Traditional food chains Bikano, Haldiram etc. offer customers' fast, convenient and cheap products and services that cater to Indian taste as well.
- Substitutes make price elasticity high since customers have more alternatives.

Power of Customers (Medium/Low)

- Being a large population fan of fast food, this makes bargaining power of customers.
- Every single customer is unlikely to purchase a large quantity of product, and it's not likely that each of them contributes a large proportion of sales.
- Fast food chains are in high demand in shopping centers, malls, residential areas, college campuses and offices. In addition, customers are fragmented, with no particular effect on product or price.
- Therefore, they will not be hurt by losing a petite number of customers.
- In the industry, customers are less sensitive to price fluctuations, which is relatively inelastic, so that providers have large price controlling power.

Power of Suppliers (Low)

- The major suppliers of the fast food industry are raw material suppliers. As raw material is common and available in plenty such as flour, cheese, vegetables, therefore, bargaining power of suppliers is low.
- Raw material is perishable and can't be stored for long.
- The industry is labor intensive. Labor is in abundant in India.
- Suppliers tend to keep a long term relationship with the concentrated purchasers.

- Many big fast food chain companies are vertically integrated with the suppliers in order to maintain low costs and high quality products.

Apple in the Marketplace from a five forces perspective

Through its Macintosh computers and operating system, the iPad, iPhone, and other products, Apple, Inc. (NASDAQ: AAPL) has achieved massive success as a company despite going through a number of up and down cycles since its founding in 1976. In 2018, Apple achieved the notable distinction of being the first U.S. company to ever attain a market capitalization greater than $1 trillion.

Apple's success is attributed largely to its ability to innovate and bring unique products to market that have engendered substantial brand loyalty. Its product development and marketing strategies reveal an awareness of the need to deal with the major marketplace forces that can impact Apple's market share and profitability.

A Five Forces analysis of Apple's position in the technology sector shows industry competition and the bargaining power of buyers as the two strongest marketplace forces that can impact Apple's profitability. The bargaining power of suppliers, the threat of buyers opting for substitute products, and the threat of new entrants to the marketplace are all weaker elements among the key industry forces.

Industry Competition

The level of competition among the major companies that compete directly with Apple in the technology sector is high. Apple is in direct competition with companies such as Google, Inc., the Hewlett-Packard Company, Samsung Electronics Co., Ltd., and Amazon, Inc. All of these companies expend significant capital on research and development (R&D) and marketing, just like Apple. Thus, the competitive force within the industry is strong.

One thing that makes the industry so highly competitive is the relatively low switching cost. It does not require a substantial investment for a consumer to ditch Apple's iPad for an Amazon Kindle or other tablet computers. The threat of marketplace competition is a key consideration for Apple, which it has dealt with primarily through continually developing new and unique products to increase and strengthen its market share position.

Bargaining Power of Buyers

The element of low switching cost referred to above strengthens the bargaining power of buyers as a key force for Apple to consider. There are essentially two points of further analysis within this force: the individual bargaining power of buyers and their collective bargaining power. For Apple, individual bargaining power is a weak force, since the loss of any one customer represents a negligible amount of revenue for Apple.

However, the collective marketplace bargaining power of customers, the possibility of mass customer defections to a competitor is a strong force.

Apple counters this strong force by continuing to make substantial capital expenditures in R&D, enabling it to keep developing new and unique products such as the Airpods and the Apple Watch, and by building significant brand loyalty. Apple has been very successful in this area of competition, establishing a large customer base that, basically, would not consider abandoning its iPhones in favor of another smartphone competitor.

The Threat of New Entrants to the Marketplace

The threat of a new entrant to the marketplace that could seriously threaten Apple's market share is relatively low. This is primarily due to two factors: the extremely high cost of establishing a company within the industry and the additional high cost of establishing brand name recognition.

Any new entrant to the marketplace of personal computing or smartphones needs to have a massive amount of capital just to spend on R&D and manufacturing to develop and produce its own product portfolio prior to ever bringing its products to market and beginning to generate revenue. Such an entrant faces the already identified strong competition within the industry that exists between Apple and its major competitors, all of which are large, well-established firms.

The secondary challenge is establishing brand name recognition within an industry that already has several companies, such as Apple, Google, and Amazon, with very strong brand recognition.

Although it is possible some new company (perhaps a Chinese firm with financial backing from the government), might eventually challenge Apple's position within the industry, for the immediate future, the likelihood of such a challenger arising is remote.

Nonetheless, it is important for Apple to continue strengthening its competitive position through new product development and building brand loyalty to place any potential new entrants to the industry at a larger competitive disadvantage.

Bargaining Power of Suppliers

The bargaining power of suppliers is a relatively weak force in the marketplace for Apple's products. The bargaining position of suppliers is weakened by the high number of potential suppliers for Apple and the ample amount of supply. Apple is free to choose from among a large number of potential suppliers for component parts for its products. The industries of its parts suppliers, such as the manufacturers of computer processors, are themselves highly competitive.

The switching cost for Apple to exchange one supplier for another is relatively low and not a significant obstacle. Plus, Apple is a major customer for most of its parts suppliers, and, therefore, its suppliers are very reluctant to risk losing the company's business. This strengthens Apple's position in negotiating with suppliers, while conversely weakening their positions. The bargaining power of component parts suppliers is not a major consideration for either Apple or its major competitors.

The Threat of Buyers Opting for Substitute Products

Substitute products, within the framework of Porter's Five Forces Model, are not products that directly compete with a company's products but possible substitutes for them. In the case of Apple, an example of a substitute product is a landline telephone that might be a substitute for owning an iPhone.

This market force is relatively low for Apple due to the fact that most potential substitute products have limited capabilities compared to Apple's products, as in the example of a landline telephone compared to an iPhone that has the capability to do much more than just make telephone calls.

The Case Study on McDonald Corporation to understand the competitive forces in prevailing Burger Market is given in Lesson 6 of this Study.

LESSON ROUND-UP

- Strategic Management is a discipline that deals with long-term development of an organization with a clear-cut vision about organizational purpose, scope of activities and objectives.
- The strategic management process is defined as the process by which the managers'/decision makers' are able to make a choice of a set of strategies for the organization that will enable it to accomplish improved performance. There are four indispensable phases of every strategic management process.

- Strategic leadership refers to a manager's potential to articulate the strategic vision for the organization, and to motivate, guide and influence his subordinates to attain the objectives of that vision.
- The internal strengths represent its internal environment. These consist of financial, physical, human and technological resources.
- Porter's five forces model is an analysis tool that uses five industry forces to determine the intensity of competition in an industry and its profitability level.

GLOSSARY

Cross-functional: A process or activity that includes portions of the process or activity from two or more functions within an organization.

External analyses: An examination of the dimensions of an organization's external environment, including the close scrutiny of those trends, events, that are having, or might have an impact on the performance capabilities of the management, resources, structure, processes, and operation of an organization.

Globalization: A process of interaction and integration among the people, companies, and governments of different nations, driven by international trade and investment and aided by information technology. This process also impacts the environment, culture, political systems, economic development and prosperity, and human well-being in societies around the world. It includes investing, managing, organizing, and operating on a world-wide scale, i.e., across national boundaries and in different cultures and societies.

Strategic Initiative: Strategic initiative is a collective endeavor, with a defined beginning and end, to reduce performance gaps and help accomplish strategic objectives.

Internal analyses: Critical examination of the internal dimensions and performance capabilities of the management, resources, structure, processes, and operation of an organization.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Define strategic management.
2. Discuss four phases of strategic management process.
3. What is the concept of Strategic Leadership?
4. What are functions and importance of a Strategic Leader?
5. What are the functions and importance of strategic management for professionals like Company Secretaries?
6. What are environmental influences of business?
7. What are components of Business Environment?
8. What is Porter's Five Forces Model?

LIST OF FURTHER READINGS

- Vikalpa Journal of IIM Ahmedabad Decision Journal of IIM Calcutta
- IUJ Journal of Management, ICFAI University Jharkhand On Becoming a Leader by Warren G. Bennis
- Purple Cow: Transform your business by being Remarkable by Seth Godin
- Business Policy and Strategic Management by Francis Cherunilam

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Business Policy and Formulation of Functional Strategy

Lesson 3

KEY CONCEPTS

■ Vision ■ Mission ■ Corporate Level Strategy ■ Business-Level Strategy ■ Finance Strategy ■ Marketing Strategy ■ Strategic Gap

Learning Objectives

To understand:

- The Concept and Features of Business Policy
- Evolution of Business Policy
- Evolution of Business Policy in India
- Role played by Business Policy
- Development and understanding of framework of Strategic Management
- Practical understanding on concept of Vision and Mission with examples from corporate world
- Strategic levels in the Organization
  - Corporate
  - Business
  - Functional
- Formulation of Financial; Marketing; Production; Human Resource and Logistics Strategies

Lesson Outline

- Introduction to Business Policy
- Framework of Strategic Management
- Vision
- Mission
- Objectives and Goals
- Strategic Levels of the Organization
- Formulation of Functional Strategy
- Strategic Marketing Planning – An Overview
- Formulation of Human Resource Strategies
- Formulation of Production Strategy
- Formulation of Logistics Strategy
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

BUSINESS POLICY – INTRODUCTION

Business policies are the guidelines developed by an organization to govern the actions of those who are a part of it. They define the potential limits within which decisions must be made. Business policy also deals with acquisition of resources with which organizational goals can be achieved. Business Policy defines the scope within which decisions may be taken by the subordinates in an organization. It permits the lower level management to deal with the routine problems and issues on their own without reverting back to top management for the purpose of decision making.

Business policy is the study of the roles and responsibilities of top level management, significant issues affecting organizational success and the decisions affecting organization in long-run. The top management consists of those managers who are primarily responsible for long-term decisions and carry designations such as Chief executive, President, General Manager, or executive Director. These are the persons who are not concerned with the day-to-day problems but are expected to devote their time and energy for thinking and deciding about the future course of action.

Features of Business Policy

Business Policy is the study of the functions and responsibilities of senior management, the crucial problems that affect success in the total enterprise and the decisions that determine the direction of the organisation and shape its future. The problems of policy in business, like those of policy in public affairs, have to do with the choice of purposes, the moldings of organizational identity and character, the continuous definition of what needs to be done, and the mobilization of resources for the attainment of goals in the face of competition or adverse circumstance. An effective business policy must have following features-

1. *Specific* – every policy must have a basic feature of being specific/definite. If it is uncertain, then its implementation will become difficult.
2. *Clear* – Policy must be unambiguous and as clear as possible in order to guide the subordinates effectively. It should avoid frequent use of jargons and connotations to create any chaos.
3. *Reliable and Uniform* – Policy must be uniform and reliable enough to be efficiently followed by the subordinates.
4. *Appropriate* – Policy should be appropriate to the represent the organizational goals.
5. *Simple* – A policy should be simple and easily understood by each and every person in the organization.
6. *Inclusive/Comprehensive* – In order to have a wide scope, a policy must be comprehensive.
7. *Flexible* – Policy should be flexible in application. It should be wide in scope so as to ensure that the line managers use them in repetitive/routine scenarios.
8. *Stable* – Policy should be stable so as to avoid the scope of any indecisiveness and uncertainty in minds of those who look into it for guidance.

Evolution of Business Policy

The origin of business policy can be traced back to the year 1911, when Harvard Business School introduced an integrative course in management aimed at the creation of general management capability. This course was based on some case studies which had been in use at the school for instructional purposes since 1908.

However, the real impetus for introducing business policy in the curriculum of business schools came with the publication of two reports in 1959, the Gordon and Howell report, sponsored by the ford foundation, recommended a capstone course of business policy "... which will give students an opportunity to pull together what they have learned in the separate business fields and utilize this knowledge in the analysis of complex business problems, the Pierson report, sponsored by the Carnegie foundation and published simultaneously, made a similar recommendation.

In 1969, the American Assembly of Collegiate Schools of Business, a regulatory body for business schools, made the course of business policy a mandatory requirement for the purpose of recognition. During the last four decades, business policy has become an integral part of management curriculum. From the US, the practice of including business policy in the management curriculum spread to other parts of the world.

Evolution based on Managerial Practices

The development in business policy as arising from the use of planning techniques by managers. Starting from day- to-day planning in earlier times, managers tried to anticipate the future through preparation of budgets and using control systems like capital budgeting and management by objectives. With the inability of these techniques to adequately emphasize the role of future, long-range planning came to be used. Soon, long-range planning was replaced by strategic planning, and later by strategic management: a term is currently used to describe the process of strategic decision – making. Strategic management is the theoretical framework for business policy courses today. Policy-making became the prime responsibility of erstwhile entrepreneurs who later assumed the role of senior management.

The Indian Scenario

Formal management education started in India in the late fifties and gained an impetus with the setting up of the Indian Institutes of Management (IIMs) and the Administrative Staff College of India in the early sixties. In the formative years of the IIMs, the curriculum and philosophy of management education "...were borrowed substantially from the American business schools". The IIM, Ahmedabad based its teaching methodology on the Harvard model of developing and using case studies as the major tool. With the setting up of three more IIMs at Bangalore, Calcutta and Lucknow and the creation of university departments, management education has experienced an unparalleled growth in the last three decades. Different nomenclature used for the course title includes, besides business policy; corporate planning, corporate strategy and planning, management policy and, lately, strategic planning or strategic management.

Importance of Business Policy

Business policy is important as a course in management curriculum and as a component of executive development programmes for middle-level managers preparing to move up to the senior management level. A study of business policy fulfils the needs of management students as well as those of middle-level managers.

To highlight the importance of business policy, we consider four areas where this course proves to be beneficial.

- **From the viewpoint of the Course itself**

  Business policy seeks to integrate knowledge and experience gained in various functional areas of management. It enables the learner to understand and make sense of the complex interaction that takes place between different functional area.

  Business policy deals with the constraints and complexities of the real-life business. In contrast, the functional area courses are based on a structured, specialized and well-developed body of knowledge resulting from the simplification of the complexity of the overall takes and responsibilities of management.

  For the development of a theoretical structure of its own, business policy cuts across the narrow functional boundaries and draws upon a variety of sources; other courses in management curriculum and from a wide variety of disciplines like economics, sociology, psychology, demography, political science, etc. In doing so, business policy offers a very broad perspective to its learners.

Business policy makes the study and practice of management more meaningful as one can view business decision-making in its proper perspective. For instance, in the context of business policy, a short-term gain for a department or a sub-unit is willingly sacrificed in the interest of the long-term benefit that may accrue to the organisation as a whole.

- **For the understanding of Business Environment**

  Regardless of the level of management where a person is, business policy creates an understanding of how policies are formulated. This helps in creating an appreciation of the complexities of the environment that the senior management faces in policy formulation.

  By gaining an understanding of the business environment, managers become more receptive to the ideas and suggestions of the senior management. Such an attitude on the part of managers makes the task of policy implementation simpler.

  By being able to relate the environmental changes to policy changes within the organisation, managers feel themselves to be a part of a greater design. This helps in reducing their feelings of isolation.

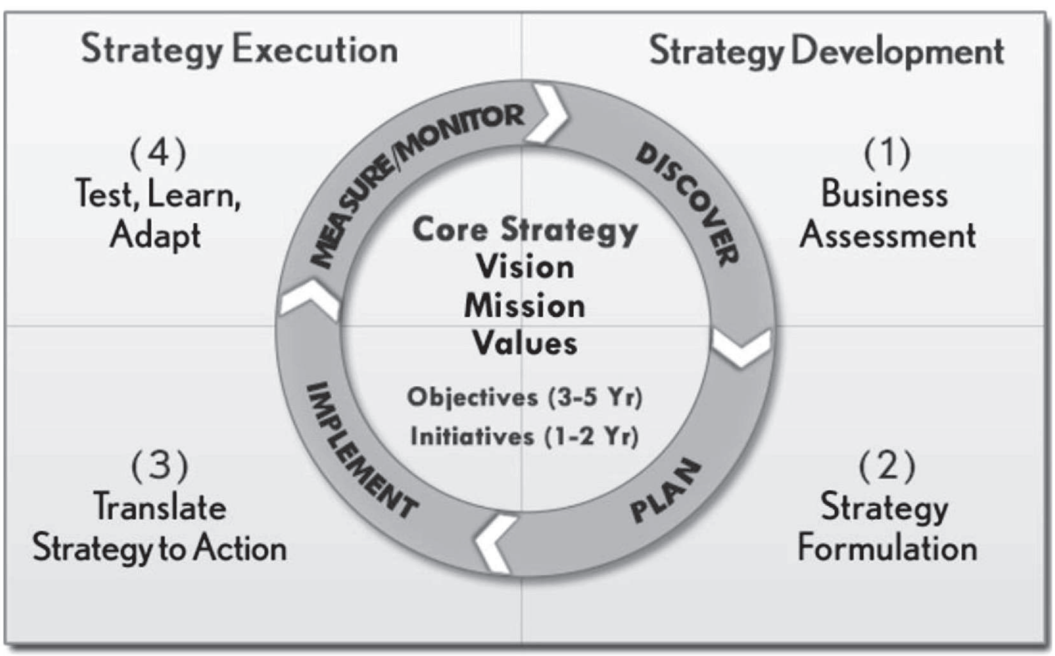
- **For understanding the Organisation**

  Business policy presents a basic framework for understanding strategic decision-making while a person is at the middle level of management. Such a framework, combined with the experience gained in working in a specialized functional area, enable a person to make preparations for handling general management responsibilities. this benefits the organisation in a variety of ways.

  Business policy, like most other areas of management, brings to the organisation and also to its managers, the benefit of years of distilled experience in strategic decision-making. Case study, which is the most common pedagogical tool in business policy, provides illustrations of real-life business strategy formulation and implementation.

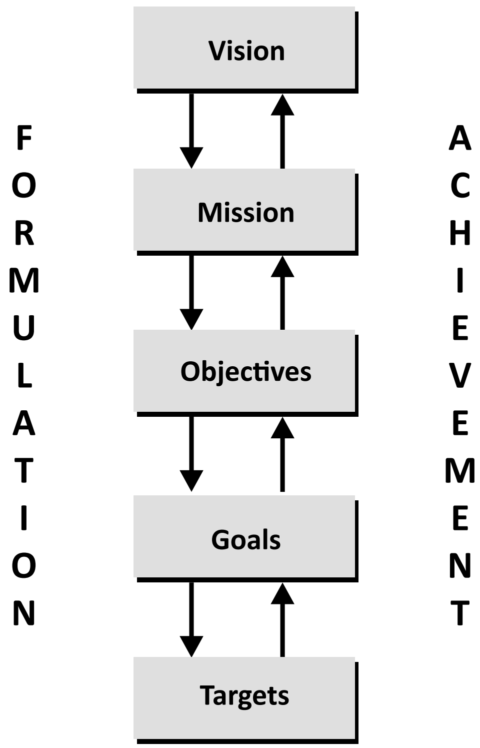
FRAMEWORK OF STRATEGIC MANAGEMENT

The Strategic Management Framework



The terms vision/mission, objectives, goals and targets are used interchangeably many a time. However, in corporate world, they are often used distinctively. However, it depends upon organization to organistaion , how they interpret. For example, while some organisations may opine that mission refers to the current situation, many others consider them in a future (often long term) perspective. Some companies state the mission after the vision statement as a logical evolution from the vision whereas for some companies there is only a mission statement that would reflect the vision. One who goes through the statements of vision, mission, purpose, motto, objectives, values etc. of different organisations would be amazed by the wide differences in the perception about the meaning of each of these terms. A review of 622 mission statements by Graham and Havlik has revealed that all mission statements varied in length as well as tone. No two mission statements had the exact same formula, or pattern.

There is a logical linkage and evolution between these different concepts such as Vision leads to mission (which fosters the vision) and mission leads to objectives (which are designed to achieve the mission), objectives lead to goals (which are designed to achieve the objectives) and goals lead to targets (which are set to achieve the goals).



VISION

Vision serves the purpose of stating what an organization wishes to achieve in the long run. It articulates the position that the organisation would like to occupy in future. The vision is about looking forward and about formalizing where you, and the business, are going. It is a future aspiration that leads to an inspiration of being the best in one's business sphere. It creates a common identity and a shared sense of purpose.

A vision statement is a company's road map, indicating both what the company wants to become and guiding transformational initiatives by setting a defined direction for the company's growth. Vision statements undergo minimal revisions during the life of a business, unlike operational goals which may be updated from year-to- year.

A consensus does not exist on the characteristics of a "good" or "bad" vision statement.

According to Oren Harari, 'Vision should describe a set of ideals and priorities, a picture of the future, a sense of what makes the company special and unique, a core set of principles that the company stands for, and a road set of compelling criteria that will help define organizational success.'

Features

- *Concise* : able to be easily remembered and repeated
- *Clear* : defines a prime goal
- *Time horizon* : defines a time horizon
- *Future-oriented* : describes where the company is going rather than the current state
- *Stable* : offers a long-term perspective and is unlikely to be impacted by market or technology changes
- *Challenging* : not something that can be easily met and discarded
- *Abstract* : general enough to encompass all of the organization's interests and strategic direction
- *Inspiring* : motivates employees and is something that employees view as desirable.

Purpose

Vision statement may fill the following functions for a company:

- Serve as foundation for a broader strategic plan.
- Motivate existing employees and attract potential employees by clearly categorizing the company's goals and attracting like-minded individuals.
- Focus company efforts and facilitate the creation of core competencies by directing the company to only focus on strategic opportunities that advance the company's vision.
- Help companies differentiate from competitors. For example, profit is a common business goal, and vision statements typically describe how a company will become profitable rather than list profit directly as the long-term vision.

MISSION

"A mission statement is an enduring statement of purpose that distinguishes one business from other similar firms. A mission statement identifies the scope of a firm's operations in product and market terms."

According to McGinnis, a mission statement:

- should define what the organisation is and what the organisation aspires to be;
- should be limited enough to exclude some ventures and broad enough to allow for creative growth;
- should distinguish a given organisation from all others;
- should serve as a framework for evaluating both current and prospective activities; and
- should be stated in terms sufficiently clear to be widely understood throughout the organisation.

A mission statement has certain desirable components. An ideal mission statement of business should define its customers, products or services, markets, technology, philosophy and self-concept. However, an examination of the mission statement of different organisations shows that the mission statements of several of them are not so comprehensive.

Elements of Mission Statement

- Clearly Articulated
- Relevant
- Written in a positive tone
- Unique
- Enduring
- Adapted to the Target Audience.

The mission statement should define its customers, products or services, markets, technology, philosophy and self-concept. The following questions to be considered while preparing for a mission statement.

1. What is the basic purpose of your organisation?
2. What is unique about your organisation?
3. What is likely to be different about your business five years down the line?
4. Who are, and who should be, your core customers?
5. What are, and what should be, your principal economic concerns?
6. What are the basic beliefs, values and philosophical priorities of your firm?

Comparison Chart

It is rightly said, "**A man without eyes is blind, but a man without a vision is dead**".

Comparison

Mission Statement versus Vision Statement		
	Mission Statement	***Vision Statement***
About	A Mission statement talks about HOW you will get to where you want to be. Defines the purpose and primary objectives related to your customer needs and team values.	A Vision statement outlines WHERE you want to be. Communicates both the purpose and values of your business.
Answer	It answers the question, "What do we do? What makes us different?"	It answers the question, "Where do we aim to be?"
Time	A mission statement talks about the present leading to its future.	A vision statement talks about your future.
Function	It lists the broad goals for which the organization is formed. Its prime function is internal; to define the key measure or measures of the organization's success and its prime audience is the leadership, team and stockholders.	It lists where you see yourself some years from now. It inspires you to give your best. It shapes your understanding of why you are working here.

Developing a statement	What do we do today? for whom do we do it? What is the benefit? In other words, Why we? do what we do? Questions on What, for Whom and Why?	Where do we want to be going forward? When do we want to reach that stage? How do we want to do it?
Features of an effective statement	Purpose and values of the organization: Who are the organization's primary "clients" (stakeholders)? What are the responsibilities of the organization towards the clients?	Clarity and lack of ambiguity: Describing a bright future (hope); Memorable and engaging expression; realistic aspirations, achievable; alignment with organizational values and culture.

Vision and Mission Statements of various Companies/Organisations

Company: State Bank of India

Vision: Be the bank of choice for a transforming India.

Mission: Committed to providing simple, responsive and innovative financial solutions.

Company: Tesla

Mission: To accelerate the world's transition to sustainable energy.

Vision: To create the most compelling car company of the 21st century by driving the world's transition to electric vehicles.

Company: Amazon

Mission: We strive to offer our customers the lowest possible prices, the best available selection, and the utmost convenience.

Company: LinkedIn

Mission: To Connect the world's professionals to make them more productive and successful.

Vision: To Create economic opportunity for every member of the global workforce.

Company: Google

Mission: To organize the world's information and make it universally accessible and useful.

Vision: To provide access to the world's information in one click.

Company: Intel

Mission: To utilize the power of Moore's Law to bring smart, connected devices to every person on earth.

Vision: If it's smart and connected, it's best with Intel.

Company: Toyota USA

Mission: To attract and attain customers with high-valued products and services and the most satisfying ownership experience in America.

Vision: To be the most successful and respected car company in America.

Company: Sony

Mission: A company that inspires and fulfills your curiosity.

Vision: Using our unlimited passion for technology, content and services to deliver groundbreaking new excitement and entertainment, as only Sony can.

OBJECTIVES AND GOALS

To accomplish the mission of the organization, a number of objectives are formulated. Achievement of the organisational objectives, in turn, requires the formulation and fulfillment of departmental and unit goals.

Used broadly, the word objectives cover "long-range company aims, more specific department goals, and even individual assignments. Thus, objectives may pertain to a wide or narrow part of an enterprise, and they may be either long or short range." Objectives should not be static, they should be dynamic. That is, changes in the environment and/or changes in the organisational strengths and weaknesses may call for modifications to objectives.

A goal is defined as "an intermediate result to be achieved by a certain time as part of the grand plan. A plan can, therefore, have many goals." Specific goals are sometimes referred to as targets.

Importance of Objectives

- Justify the organization
- Provide direction
- Basis for Management by Objectives
- Help Strategic Planning/Management
- Provide standards for assessment and control
- Help Decentralization.

***Objectives vs. Goals*:** The terms objectives and goals are differentiated by some managers based on generality and specificity of what an organisation seeks to achieve. For example, objective of an organisation is to improve its profitability whereas one of the goals of the organisation is to increase the net sales by 20% during FY 2023-24 over FY2022-2023. Thus, objectives are based on mission statement and open-ended statements whereas goals are closed ended statements.

Hierarchy of the Objectives

Process of Formulating Mission and Objectives

Environmental Analysis: A cross-functional analysis of data and information and its results provide a basis for the establishment of organisational direction in terms of mission and objectives. Environmental analysis should provide managers with adequate information and data for reflection. The data and information from all the levels of environment — general, specific, operating and internal — should be collected.

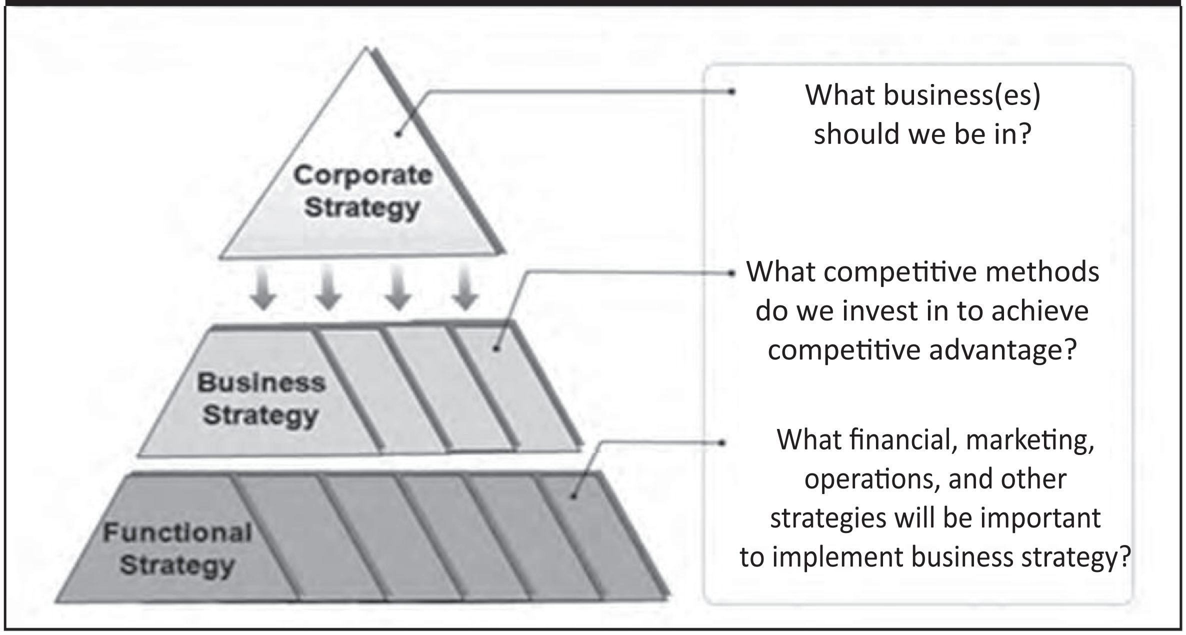
Vision and Mission: Environmental analysis serves as a foundation for the development and formulation of vision and mission. Managers should understand the information and data derived from the environment, its analysis and better equip themselves to have a visionary reflections. This reflection helps them to formulate and write the organisational vision and mission.

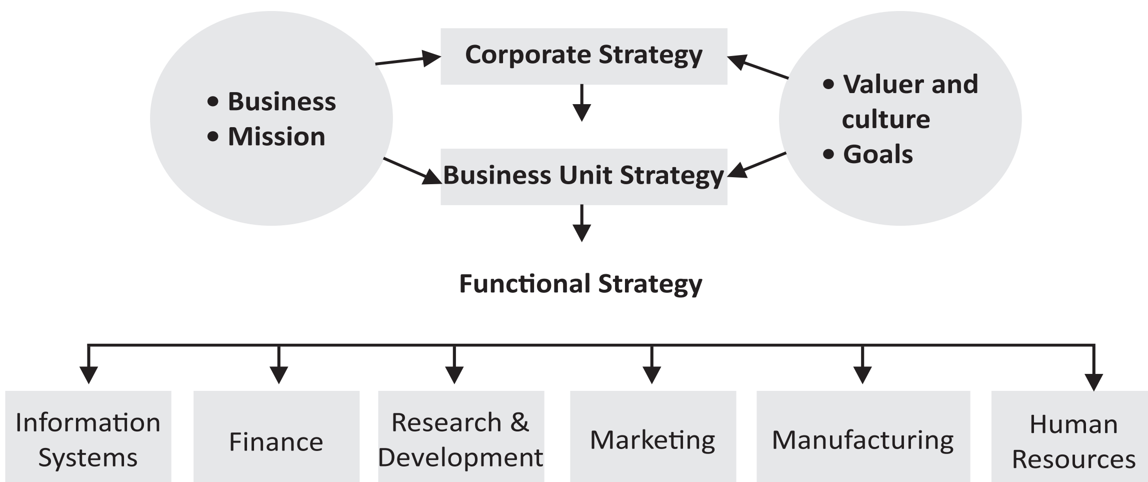
Organisational Objectives: Organisational vision and mission serve as the basis for development of appropriate organisational objectives. Managers view that objectives should be consistent with the organisational vision and mission.

Specific targets: After the objectives are formulated by the top management of the organisation, they should be translated into specific targets by the middle and lower level management. These specific targets help for the effective achievement of objectives at different levels.

STRATEGIC LEVELS OF THE ORGANIZATION

The Relationship among Corporate, Business and Functional Strategies





Corporate Level Strategy

Corporate Strategy is the essence of strategic planning process. It determines the growth objective of the company, i.e. direction, timing, extent and pace of the firm's growth. It highlights the pattern of business moves and goals concerning strategic interest, in different business units, product lines, customer groups, etc. It defines how the firm will remain sustainable in the long run.

Corporate level strategy occupies the highest level of strategic decision making and covers actions dealing with the objective of the firm, acquisition and allocation of resources and coordination of strategies of various SBUs for optimal performance.

Corporate Strategy can be explained as the management plan formulated by the highest level of organization echelon, to direct and operate the entire business organization. It alludes to the master plan that leads the firm towards the success. So, the more the aptness in the degree of the corporate level strategy, the higher will be the chances of firm's success in the market.

Definitions

According to Andrews: "the corporate strategy is the pattern of decisions in a company that determines and reveals its objectives, purposes or goals, produces the principal policies and plans for achieving those goals and defines the range of business the company pursues, the kind of economic and noneconomic contribution it intends to make for its shareholders, employees, customers and communities. " (Andrews, 1997, p.245)

Johnson et al (2009), been describing corporate strategy, highlighted the choices of markets and products as a first step, and how a company is planning to operate on those markets or with particular products. They have also discussed the corporate strategy from overall scope of an organization and how value should be added to the different parts (business units) of an organization.

Business-Level Strategy

Business level strategy is applicable in those organizations, which have different businesses-and each business is treated as Strategic Business Unit (SBU). the fundamental concept in SBU is to identify the discrete independent product / market segments served by an organization.

Since each product/market segment has a distinct environment, a SBu is created for each such segment. for example, reliance Industries Limited operates in textile fabrics, yarns, fibers, and a variety of petrochemical products. For each product group, the nature of market in terms of customers, competition, and marketing channel differs.

Therefore, it requires different strategies for its different product groups. thus, where SBu concept is applied, each SBU sets its own strategies to make the best use of its resources (its strategic advantages) given the environment it faces. At such a level, strategy is a comprehensive plan providing objectives for SBus, allocation of resources among functional areas and coordination between them for making optimal contribution to the achievement of corporate- level objectives.

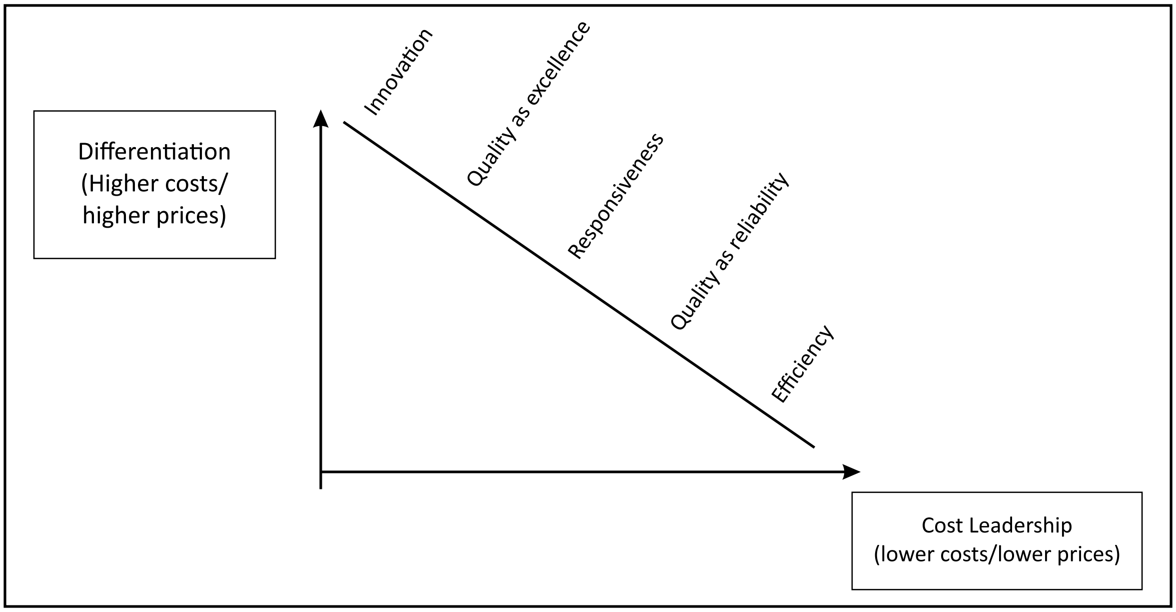
Such strategies operate within the overall strategies of the organization. The corporate strategy sets the long- term objectives of the firm and the broad constraints and policies within which a SBU operates. The corporate level will help the SBU define its scope of operations and also limit or enhance the SBUs operations by the resources the corporate level assigns to it. There is a difference between corporate-level and business-level strategies.

For example, Andrews says that in an organization of any size or diversity, corporate strategy usually applies to the whole enterprise, while business strategy, less comprehensive, defines the choice of product or service and market of individual business within the firm. In other words, business strategy relates to the 'how' and corporate strategy relates to the 'what'. Corporate strategy defines the business in which a company will compete preferably in a way that focuses resources to convert distinctive competence into competitive advantage.'

Corporate strategy is not the sum total of business strategies of the corporation but it deals with different subject matter. While the corporation is concerned with and has impact on business strategy, the former is concerned with the shape and balancing of growth and renewal rather than in market execution.

Michael Porter (1998) has identified business-level strategies which are cost leadership, differentiation, and focus to achieve a sustainable competitive advantage. The strategy of cost leadership was common in 1970s. This strategy requires construction of efficient-scale facilities, cost reductions, control over expenses, and cost minimization etc. The low-cost strategy gives several advantages before rivals. It may be explained by the possibility to be more efficient than competitors. (Porter, 1998)

Hill and Jones (2007) have developed the curve which connects together the three issues in developing a successful business model.



Competitive Positioning and the Value Creation Frontier (Hill and Jones, 2007, p.160)

Brown and Blackmon (2005) have defined business-unit strategy as a process of decision making at the strategic business unit (SBU) level. According to them, primarily it identifies how SBU supports organizational goals. furthermore, business-unit strategy refers to aggregated strategies of single firms or SBU within one diversified corporation (Brown, Blackmon, 2005). While corporate strategy deals with the question in what businesses the company should compete in, business unit level strategy decides on how to compete in these particular businesses. (Beard, Dess, 1981)

Note: More about Business Level Strategy is available in lesson 6 of this study.

Functional-Level Strategy

Functional strategy, as is suggested by the title, relates to a single functional operation and the activities involved therein. Decisions at this level within the organization are often described as tactical. Such decisions are guided and constrained by some overall strategic considerations.

Functional strategy deals with relatively restricted plan providing objectives for specific function, allocation of resources among different operations within that functional area and coordination between them for optimal contribution to the achievement of the SBU and corporate-level objectives.

Below the functional-level strategy, there may be operations level strategies as each function may be divided into several sub functions. For example, marketing strategy, a functional strategy, can be subdivided into promotion, sales, distribution, pricing strategies with each sub function strategy contributing to functional strategy.

Comparison Chart

Basis for Comparison	***Business Strategy***	***Corporate Strategy***
Meaning	Business Strategy is the strategy framed by the business managers to strengthen the overall performance of the enterprise.	Corporate Strategy is stated in the mission statement, which explains the business type and ultimate goal of the firm.

Basis for Comparison	*Business Strategy*	*Corporate Strategy*
Created by	Middle level management	Top level management
Nature	Executive and Governing	Decisive and Legislative
Relates to	Selection of plan to fulfill the objectives company of organization	Business selection in which the Company should compete
Deals with	Particular business unit or division	Entire business organization
Term	Short term strategy	Long term strategy
Focus growth	Competing successfully in the marketplace	Maximizing profitability and business growth
Approach	Introverted	Extroverted
Major strategies Differentiation.	Cost Leadership, Focus and Differentiation.	Expansion, Stability and Retrenchment.

FORMULATION OF FUNCTIONAL STRATEGY

Finance Strategy

Financial metrics have long been the standard for assessing a firm's performance. financial goals and metrics are established based on benchmarking the "best-in-industry" and include:

1. **Free Cash Flow**

   This is a measure of the firm's financial soundness and shows how efficiently its financial resources are being utilized to generate additional cash for future investments. It represents the net cash available after deducting the investments and working capital increases from the firm's operating cash flow. Companies should utilize this metric when they anticipate substantial capital expenditures in the near future or follow-through for implemented projects.

2. **Economic Value-Added**

   This is the bottom-line contribution on a risk-adjusted basis and helps management to make effective, timely decisions to expand businesses that increase the firm's economic value and to implement corrective actions in those that are destroying its value. It is determined by deducting the operating capital cost from the net income. Companies set economic value-added goals to effectively assess their businesses' value contributions and improve the resource allocation process.

3. **Asset Management**

   This calls for the efficient management of current assets (cash, receivables, inventory) and current liabilities (payables, accruals) turnovers and the enhanced management of its working capital and cash conversion cycle. Companies must utilize this practice when their operating performance falls behind industry benchmarks or benchmarked companies.

4. Financing Decisions and Capital Structure

Here, financing is limited to the optimal capital structure (debt ratio or leverage), which is the level that minimizes the firm's cost of capital. this optimal capital structure determines the firm's reserve borrowing capacity (short- and long-term) and the risk of potential financial distress. Companies establish this structure when their cost of capital rises above that of direct competitors and there is a lack of new investments.

5. Profitability Ratios

This is a measure of the operational efficiency of a firm. Profitability ratios also indicate inefficient areas that require corrective actions by management; they measure profit relationships with sales, total assets, and net worth. Companies must set profitability ratio goals when they need to operate more effectively and pursue improvements in their value-chain activities.

6. Growth Indices

Growth indices evaluate sales and market share growth and determine the acceptable trade-off of growth with respect to reductions in cash flows, profit margins, and returns on investment. Growth usually drains cash and reserve borrowing funds, and sometimes, aggressive asset management is required to ensure sufficient cash and limited borrowing. Companies must set growth index goals when growth rates have lagged behind the industry norms or when they have high operating leverage.

7. Risk Assessment and Management

A firm must address its key uncertainties by identifying, measuring, and controlling its existing risks in corporate governance and regulatory compliance, the likelihood of their occurrence, and their economic impact. then, a process must be implemented to mitigate the causes and effects of those risks. Companies must make these assessments when they anticipate greater uncertainty in their business or when there is a need to enhance their risk culture.

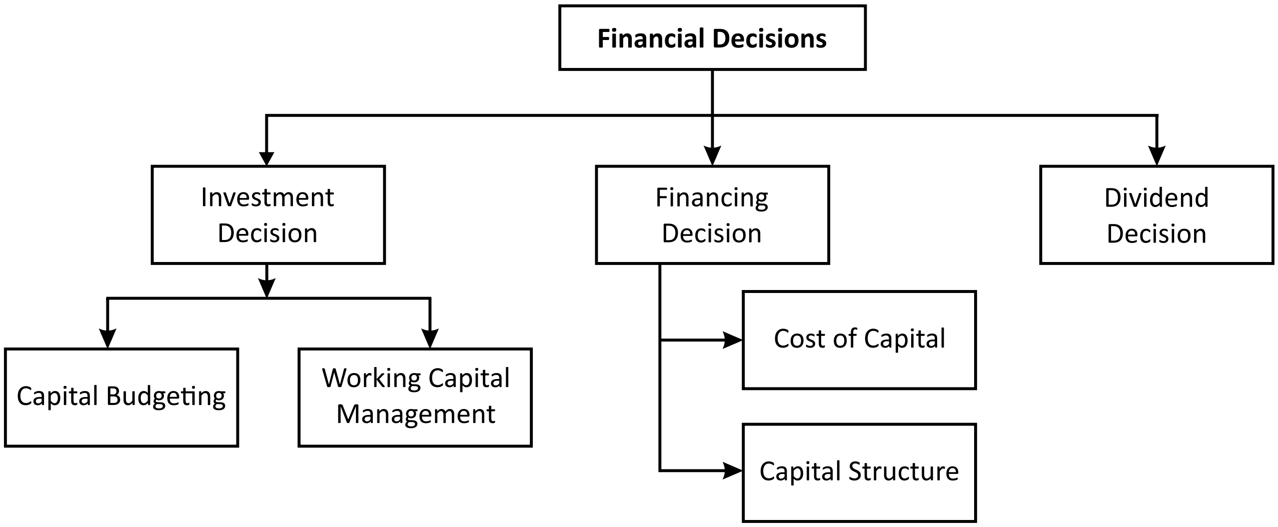
8. Tax Optimization

Many functional areas and business units need to manage the level of tax liability undertaken in conducting business and to understand that mitigating risk also reduces expected taxes. Moreover, new initiatives, acquisitions, and product development projects must be weighed against their tax implications and net after- tax contribution to the firm's value. In general, performance must, whenever possible, be measured on an after-tax basis. Global companies must adopt this measure when operating in different tax environments, where they are able to take advantage of inconsistencies in tax regulations.

The introduction of the balanced scorecard emphasized financial performance as one of the key indicators of a firm's success and helped to link strategic goals to performance and provide timely, useful information to facilitate strategic and operational control decisions. this has led to the role of finance in the strategic planning process becoming more relevant than ever.

Strategy Financial Management

Strategic Financial Management (SFM) is concerned with development of a finance strategy by identification of some key strategic alternatives which are capable of maximizing entity's Net Present Value (NPV) and by allocation of scarce capital resources among the competing opportunities. It is concerned with taking these three key financial decisions:



Investment Decision

It is the first and foremost important component of financial strategy. In the course of business, the available finance with business is usually limited but the opportunities to invest are plenty. Hence, the finance manager is required to access the profitability or return of various individual investment decisions and choose a policy which ensures high liquidity, profitably of an organization. It includes short term investment decisions known as working capital management decisions and long term investment decisions known as capital budgeting decisions.

- *Capital Budgeting*:- It is the process of making investment decisions in capital expenditure, benefits of which are expected over a long period of time exceeding one year. Investment decision should be evaluated in the terms of expected profitability, costs involved and the risks associated. This decision is important for setting up of new units, expansion of present units, reallocation of funds etc.

- *Short Term Investment Decision*:- It relates to allocation of funds among cash and equivalents, receivables and inventories. Such decision is influenced by trade-off between liquidity and profitability. Proper working capital management policy ensures higher profitability, proper liquidity and sound structural health of the organization.

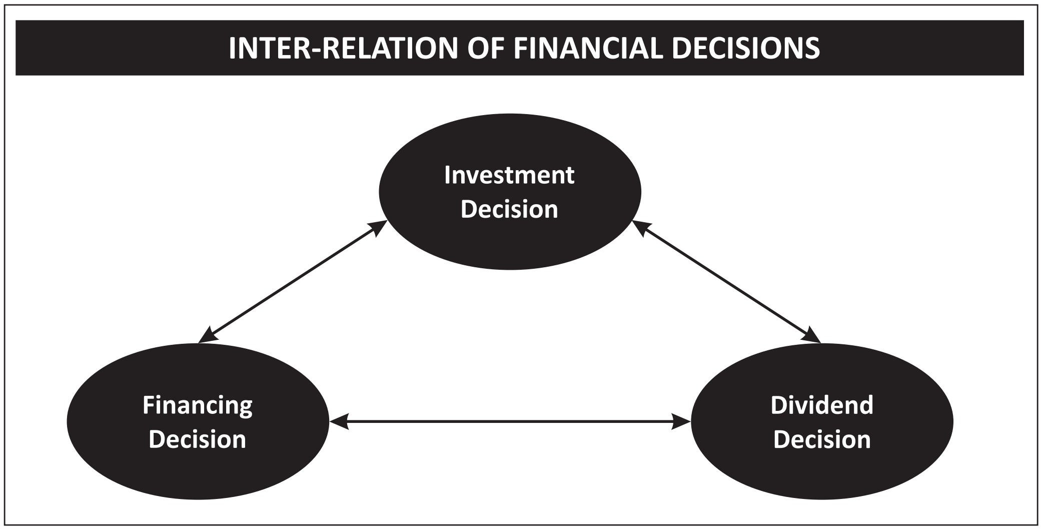
Financing Decision

Once the requirement of funds has been estimated, the next important step is to determine the sources of finance. The manager should try to maintain a balance between debt and equity so as to ensure minimized risk and maximum profitability to business.

Dividend Decision

The third and last function of finance includes dividend decisions. Dividend is that part of profit, which is distributed to shareholders as a reward to high-risk investment in business. It is basically concerned with deciding as to how much part of profit will be retained for the future investments and how much part of profit will be distributed among shareholders. High rate of dividend ensures higher wealth of shareholders and also increase market price of shares.

Influences on financial strategy: Businesses may be reluctant to obtain extra funds due to a variety of reasons such as fear of loss of control, fear of equity not getting subscribed, fear of inability to service its debts, tax shields, not having enough asset base to provide as security or to maintain good rating etc. Therefore, the manager must keep in mind such factors to make a trade-off for finance.



Although the basic decisions of finance include three types of decisions i.e. investing, finance and dividend decisions but they are interlinked with each other in a way. This is so because the main aim of all three decisions is profit maximization and wealth maximization of shareholders.

In order to make investment decisions such as investing in some major projects, the first thing is the finance available to make investment.

Finance decision is also a function of dividend decision. The more the dividend distribution, the more the dependency on external sources to raise finance and vice versa.

Marketing Strategy

Formulation of Marketing Strategy is the means by which a firm is effectively able to differentiate itself from its competitors by capitalising on its strengths (both existing as well as potential) to provide consistently better value to its customers than its competitors.

Marketing strategy is a long-term, forward-looking approach for attaining sustainable competitive advantage. It involves an analysis of the company's existing strategic situation before the formulation, evaluation and selection of market-oriented competitive position that contributes to the company's goals and marketing objectives.

Definitions of Marketing Strategy

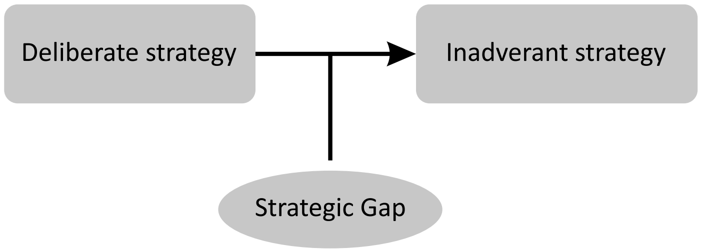
Marketing Strategy is:

- "The marketing strategy lays out target markets and the value proposition that will be offered based on an analysis of the best market opportunities." (Philip Kotler & Kevin Keller)
- "An over-riding directional concept that sets out the planned path." (Aaker and Mills)
- "Essentially a formula for how a business is going to compete, what its goals should be and what policies will be needed to carry out these goals." (Michael Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*)

In short, the Strategic Marketing answers three 'W's:

1. Which markets to compete in;
2. What is the basis of the firm's competitive; and
3. When to compete

The Strategic Gap



STRATEGIC MARKETING PLANNING: AN OVERVIEW

The Strategic Gap

Marketing strategy involves mapping out the company's direction for the future, be it three, five or ten years. It involves carrying out a 360° review of the firm and its operating environment with a view to identify new business opportunities that the firm could potentially leverage for competitive advantage. Strategic planning may also reveal market threats that the firm may need to consider for long-term sustainability.

Strategic planning is concerned with identifying the business opportunities that are likely to be successful and evaluates the firm's capacity to leverage such opportunities. It seeks to identify the *strategic gap*; that is the difference between where a firm is currently situated where it should be situated for sustainable, long-term growth.

Market Position and Strategy

In terms of market position, firms may be classified as market leaders, market challengers, market followers or market nichers.

- ***Market leader***: The market leader is the one who controls significant market share. the goal of a market leader is to reinforce their prominent position through the use of branding to develop and maintain their corporate image and to restrict the competitors brand. Market leaders may adopt unconventional or unexpected approaches to building growth and their tactical responses are likely to include: product proliferation; diversification; multi-branding; erecting barriers to entry; vertical and horizontal integration and corporate acquisitions.
- ***Market challenger***: The market challenger holds the next highest market share in the industry, following closely the most dominant player. Their market posture is generally offensive because they have less to lose and more to gain by taking risks. They will compete 'neck to neck' with the market leader in an effort to grab their market share. their overall strategy is to gain market share through product, packaging and service innovations and new market.
- ***Market follower***: Followers are generally content by taking a backseat and follow the policy of wait and watch. they rarely invest in their own funds in R&D and sit and relax to watch market leaders to bring out novel and innovative products and afterwards adopt a "me-too" approach. Their strategy is to maintain their market position by preserving existing customer base. Their strategy is to maintain steady profits by controlling costs.

- ***Market nicher***: The market nicher occupies a small niche in the market in order to avoid 'neck to neck' competition. Their objective is to build strong ties with the existing customer base and develop strong loyalty with them. Their strategy is to develop and build the smaller segment and protect it. Tactically, nichers are likely to improve the product or service offering, leverage cross-selling opportunities, offer value for money and build relationships through superior after sales service, service quality and other related value adding activities.

A key aspect of marketing strategy is to keep marketing consistent with a company's overarching mission statement. Strategies often specify how to adjust the marketing mix; firms can use tools such as Marketing Mix Modeling to help them decide how to allocate scarce resources, as well as how to allocate funds across a portfolio of brands. In addition, firms can conduct analyses of performance, customer analysis, competitor analysis, and target market analysis.

Entry strategies

Marketing strategies may differ depending on the unique situation of the individual business. According to Lieberman and Montgomery, every entrant into a market – whether it is new or existing – is classified under a Market Pioneer, Close follower or a Late follower.

- ***Pioneers***

  Market pioneers are known for innovative product development, resulting into some early entry market-share advantages than the followers as they have the first-mover advantage, pioneers must ensure that they are having at least one or more of three primary sources: technological Leadership, Pre-emption of assets or buyer switching costs.

  Technological Leadership means gaining an advantage through either Research and Development or the "learning curve" for using the research and development as a key point of selling.

  Pre-emption of Assets can help gain an advantage through acquiring scarce assets within a certain market, allowing the first-mover to be able to have control of existing assets rather than those that are created through new technology.

  By being a first entrant, it is easy to avoid higher switching costs compared to later entrants. For example, those who enter later would have to invest more expenditure in order to encourage customers away from early entrants. It has been found that while Pioneers in both consumer goods and industrial markets have gained "significant sales advantages", they are at a disadvantage in terms of cost.

- ***Close followers***

  If there is a profit potential in the innovation introduced by marker pioneer, many businesses would step in offering the same product. Such people are more commonly known as Close followers. These entrants into the market can also be seen as challengers to the Market Pioneers and the Late followers. This is because early followers are more than likely to invest a significant amount in Product Research and Development than later entrants.

  Due to the nature of early followers and the research time being later than Market Pioneers, different development strategies are used as opposed to those who entered the market in the beginning, and the same is applied to those who are Late followers in the market. By having a different strategy, it allows the followers to create their own unique selling point and perhaps target a different audience in comparison to that of the Market Pioneers.

- ***Late entrants***

  Those who follow after the close followers are known as the Late entrants. Late entrant has certain advantages such as ability to learn from their early competitors and improving the benefits or reducing the total costs. This allows them to create a strategy that could essentially mean gaining market share and most importantly, staying in the market. In addition to this, markets evolve, leading to consumers wanting improvements and advancements on products. Late followers could have a cost advantage over early entrants due to the use of product imitation. Late entry into a market does not necessarily mean there is a disadvantage when it comes to market share, it depends on how the marketing mix is adopted and the performance of the business.

The requirements of individual customer markets are unique, and their purchases sufficient to make viable the design of a new marketing mix for each customer. If a company adopts this type of market strategy, a separate marketing mix is to be designed for each customer. Specific marketing mixes can be developed to appeal to most of the segments when market segmentation reveals several potential targets.

FORMULATION OF HUMAN RESOURCE STRATEGIES

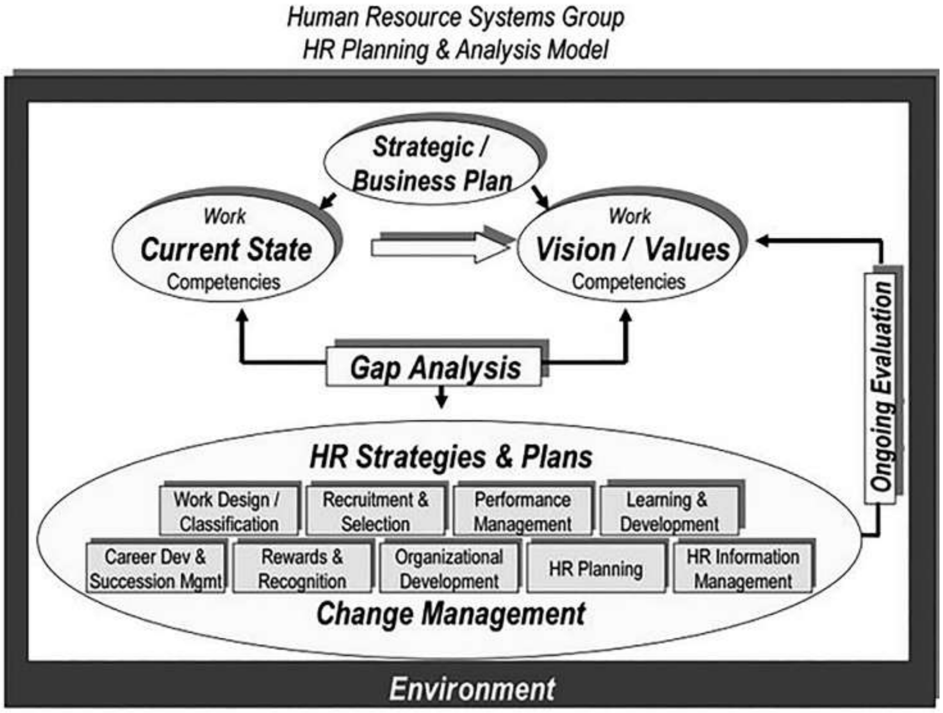
Human resource planning is a process that identifies current and future human resources needs for an organization to achieve its goals. Human resource planning should serve as a link between human resource management and the overall strategic plan of an organization. Ageing workers population in most western countries and growing demands for qualified workers in developing economies have underscored the importance of effective human resource planning.

As defined by Bulla and Scott, human resource planning is 'the process for ensuring that the human resource requirements of an organization are identified and plans are made for satisfying those requirements'.

Human resource planning includes creating an employer brand, retention strategy, absence management strategy, flexibility strategy, (talent management) strategy, (recruitment) and selection strategy.

Reilly defined (workforce planning) as: 'A process in which an organization attempts to estimate the demand for labour and evaluate the size, nature and sources of supply which will be required to meet the demand.

This Strategic HR Planning and evaluation cycle is depicted in the diagram below:



Human resource planning is the ongoing process of systematic planning to achieve the best use of an organisation's most valuable asset – its human resources. the objective of human resource (HR) planning is to ensure the best fit between employees and jobs, while avoiding workforce shortages or spares. the three key elements of the HR planning process are forecasting labour demand, analysing present labour supply, and balancing projected labour demand and supply.

Implementing HR Strategy

1. Assessing the current HR capacity

This includes taking stock of the skills of the existing human resources of the organisation to have a clear understanding of the current skill set of the company. This will help in forecasting future HR requirements.

2. Forecasting HR requirements

This step includes projecting what the HR needs for the future will be based on the strategic goals of the organization and assessment of total skill set of existing human resources. Some questions to be asked during this stage include:

- The positions to be filled in the future period.
- The number of staff will be required to meet the strategic goals of the organization.
- Effect of external environmental forces in getting new human resources.

3. Gap analysis

In this stage, one will make a comparison between existing and desired position of the organisation from strategic point of view. During this phase you should also review your current HR practices and if these require any amendments.

4. Developing HR strategies to support the strategies of the organization

The five HR strategies which may be adopted to attain the organizational goals are given hereunder:

- **Restructuring strategies**

  This includes reducing staff, regrouping tasks to create well-designed jobs, and reorganizing work groups to perform more efficiently.

- **Training and development strategies**

  This includes providing the current staff with training and development opportunities to encompass new roles in the organization.

- **Recruitment strategies**

  This includes recruiting new hires that already have the skills the organization will need in the future.

- **Outsourcing strategies**

  This includes outreaching to external individuals or organizations to complete certain tasks.

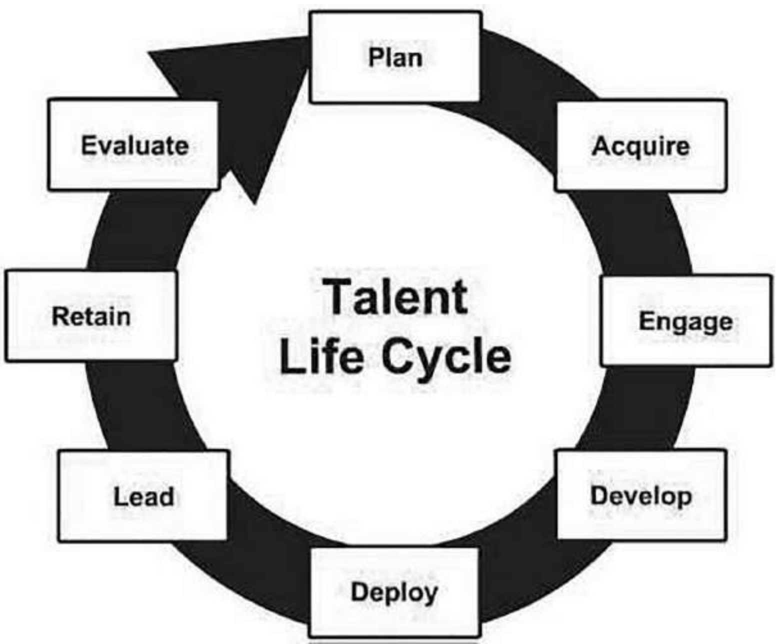
- **Collaboration strategies**

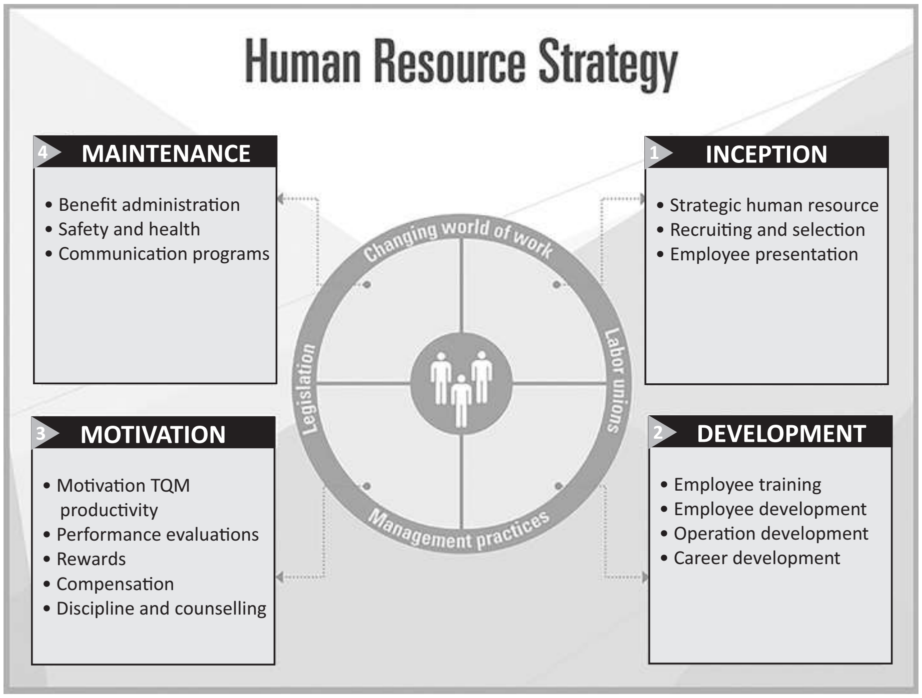
  This includes collaborating with other organizations to learn from how others do things, allow employees to gain skills and knowledge not previously available in their own organization.

- **Retention strategy**

  Every area of the employer-employee relationship in your organization deserves your attention. embrace these key strategies to improve your organization's employee retention and boost employee satisfaction.

- **Onboarding and orientation** – The job orientation is just one component of onboarding, aim to develop an onboarding process where new staff members not only learn about the job but also the company culture and how they can contribute and thrive, with ongoing discussions, goals and opportunities to address questions and issues as they arrive.
- **Mentorship programs** – Pairing a new employee with a mentor is a great for retention. new team members can learn from the experience of a senior.
- **Employee compensation** – The organisation should offer competitive compensation packages which include salaries, bonuses, paid time off, health benefits, retirement plans and all the other perks.
- **Recognition and rewards systems** – Every person wants to feel appreciated for what they do. When they go the extra mile, they should be recognized. Some companies set up rewards systems that incentivize great ideas and innovation.
- **Work-life balance –** A healthy work-life balance is essential. Companies should give a serious thought for offering telecommuting or flexible schedules to improve work-life balance for their employees.
- **Training and development –** Smart managers invest in their workers› professional development and seek opportunities for them to grow. Some companies pay for employees to attend conferences or industry events each year, or provide tuition reimbursement or continuing education training.
- **Communication and Feedback –** Lines of communication should be kept open for ensuring employee retention. their ideas, questions and concerns must be welcomed.
- **Dealing with change –** If the organization is going through a merger, layoffs or other big changes, the employees must be taken into confidence beforehand to maintain their trust.
- **Fostering teamwork –** When people work together, they can achieve more than they would have individually. foster a culture of collaboration by clarifying team objectives, business goals and roles, and encouraging everyone to contribute ideas and solutions.
- **Team celebration –** Celebrate major milestones for individuals and for the team. Whether the team just finished that huge quarterly project under budget or an employee brought home a new baby, seize the chance to celebrate together with a shared meal or group excursion.





FORMULATION OF PRODUCTION STRATEGY

The different types of production strategies are grouped, listed and explained under following three categories, viz.,

The types of production strategies under **Business Strategies** are as follows:

1. Differentiation strategy
2. Cost leadership strategy
3. Market segmentation strategy.

The production strategies under **Competitive Priorities** are as follows:

1. Price or cost strategy
2. Quality strategy
3. Delivery strategy
4. Product mix or flexibility strategy
5. Service strategy
6. Eco-friendly products.

The production strategies under **Competitive Advantages** are as follows:

1. Flexible response strategy
2. Low cost strategy.

The types of production strategies listed above are discussed as follows:

1. Differentiation strategy

Under a differentiation strategy, the company tries to make a product different and unique from that offered by its competitors in the market. Such a differentiation may be done in terms of enhanced quality, quantity, pricing, appearance, and after sales-service than its rivals. Such a uniqueness and divergence in its product quality and customer service may lead to fetching higher prices by the company in the same market.

2. Cost leadership strategy

Under a cost leadership strategy, the company tries to diminish its cost of production by reaping economies of the scale on a larger volume of production in a single batch. Higher the scale of production, lower will be the cost of production due to reduction in fixed costs per unit of production be it raw materials, labour, advertising, sales promotion, R & D etc.

3. Market segmentation strategy

In market segmentation strategy, the company divides the market according to the type of customers it has to focus and target. It sells different products and services to different types of customers. To achieve this goal, it produces and sells goods and services as per the needs of the customers. Therefore, market segmentation strategy is also called **Focus Strategy**. For example, many detergent companies offer different variants of detergents with different price brackets.

4. Price or cost strategy

Under price or cost strategy, the company sells its product at a very low price. This strategy is used when the products are homogeneous in nature and company is not able to differentiate. That is, when the customers cannot distinguish the company's product from the competitors' products. In this case, the company will fix a low price to fetch maximum market share. For example, match sticks; the customer will not care much about brand while buying this and will easily switch to other brand, if his current company tries to raise the price.

5. Quality strategy

Under quality strategy, the company produces and sells 'premium' goods and services. The prices of such goods and services are naturally very high such as luxury cars and bikes. However, this strategy attracts those customers who have huge incomes and therefore prefer top quality products as a status symbol and are ready to pay high prices intentionally. To gain success in the market, the company must smartly invest to make quality innovative products that are free from any defects.

6. Delivery strategy

Under delivery strategy, the company delivers its product and services to their customers as early as possible within a fixed time period. The company gives top priority to fast delivery of products and providing quickest accessibility of services. Speed delivery of products and fastest accessibility of services removes the problem of scarcity and unnecessary delays in the market. Delivery strategy is used as a selling tactic to fight cut-throat competition.

7. Product mix or flexibility strategy

Under this strategy, the company produces and sells a product mix. A product mix is a group of products, which are sold by the same company. For example, Hindustan Lever, P& G etc. Here, the company does not depend only on a single product for its survival and growth. It uses a product mix as it offers many advantages to the company. However, only large companies with huge production capacity can adopt this strategy.

8. Service strategy

Under this strategy, the company uses a service to attract the customers. It gives quicker and better after- sales service. It gives around the clock, i.e. 24-hour customer service. It may render this service directly via the company or through the network of call centres. Service is required for both consumer goods as well as industrial goods.

9. Eco-friendly products

Under eco-friendly strategy, the company produces and sells environment-friendly products also called as Green Products. For example, producing and selling lead-free petrol to reduce pollution, manufacturing mercury- free television panels, etc., are some good steps to preserve nature. This is a new type of production strategy. It is used to reduce pollution and protect the biosphere. Companies may also recycle certain materials like plastic, metals and papers. The properly recycled products are later used for manufacturing new products and in packaging. Companies use biodegradable packing material to reduce the problem of waste disposal. Recycling reduces continuous demand cycle of natural resources and hence somewhat minimize the exploitation of environment. The company informs the public about their environment-friendly manufacturing approach through advertisements.

10. Flexible response strategy

Flexible response strategy is said to be used when a company makes required changes in its production plans in accordance with the emerging changes in the market. Here, focus is given to speed and reliability. That is, the company must make swift changes as per the emerging changes in the market demand. It must also give a regular supply of goods to its customers. There must not be any shortage of goods in the market. To achieve this, the company must follow a strict production schedule.

11. Low cost strategy

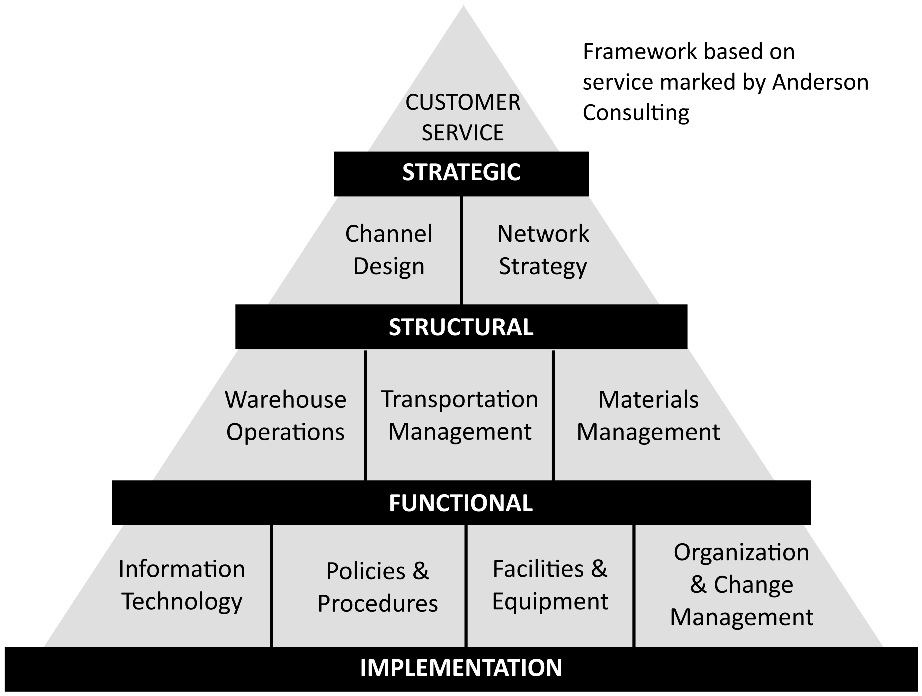
Under low cost strategy, the company fights massive market competition by selling its products at very lower prices. Simultaneously, it must also maintain the quality of its products. A company can only sell its goods at minimum prices if it maintains a low cost of production and distribution. This can be done by producing and distributing goods on a large scale. That is, company must take advantage of economies of large-scale production.

FORMULATION OF LOGISTICS STRATEGY

Logistics strategy is defined as "the set of guiding principles, driving forces and ingrained attitudes that help to coordinate goals, plans and policies between partners across a given supply chain."

Logistics is not confined to tactical decisions about transportation and warehousing. Longer-term decisions are needed to put in place the capabilities that ensure that logistics plays a full role in supporting a company's products in the market place.

When a company creates a logistics strategy, it defines the service levels at which its logistics organization will be most cost effective. Because supply chains are constantly changing and evolving, a company may develop a number of logistics strategies for specific product lines, specific countries, or specific customers.

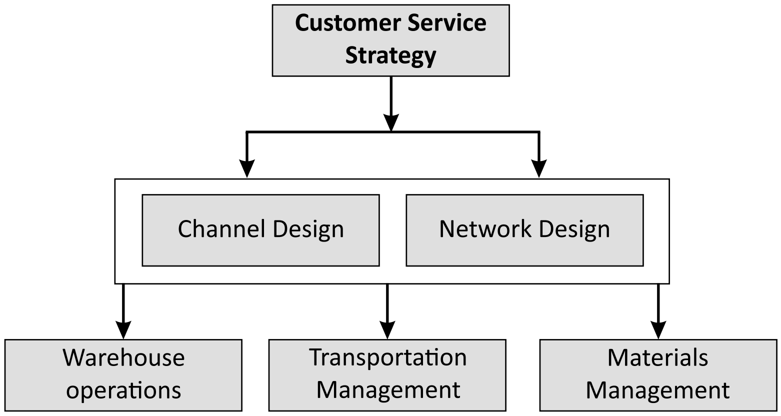


Strategic Level: By examining the company's objectives and strategic supply chain decisions, the logistics strategy should review how the logistics organization contributes to those high-level objectives. The top level is the Strategic level that defines Customer service strategy. Customer service strategy is the driving force behind the design and operations of a company's logistics supply chain. The key inputs that go into defining a customer service strategy are the company's products, its markets and its customer service goals.

Structural and Functional Levels: In any Strategic planning exercise, there is an interplay between strategy and functional operations. In our logistics strategy framework, functional layers provide important inputs to finalize the Structural layer.

Channel Design: Pertains to activities and functions that need to be carried out to achieve the customer service goal.

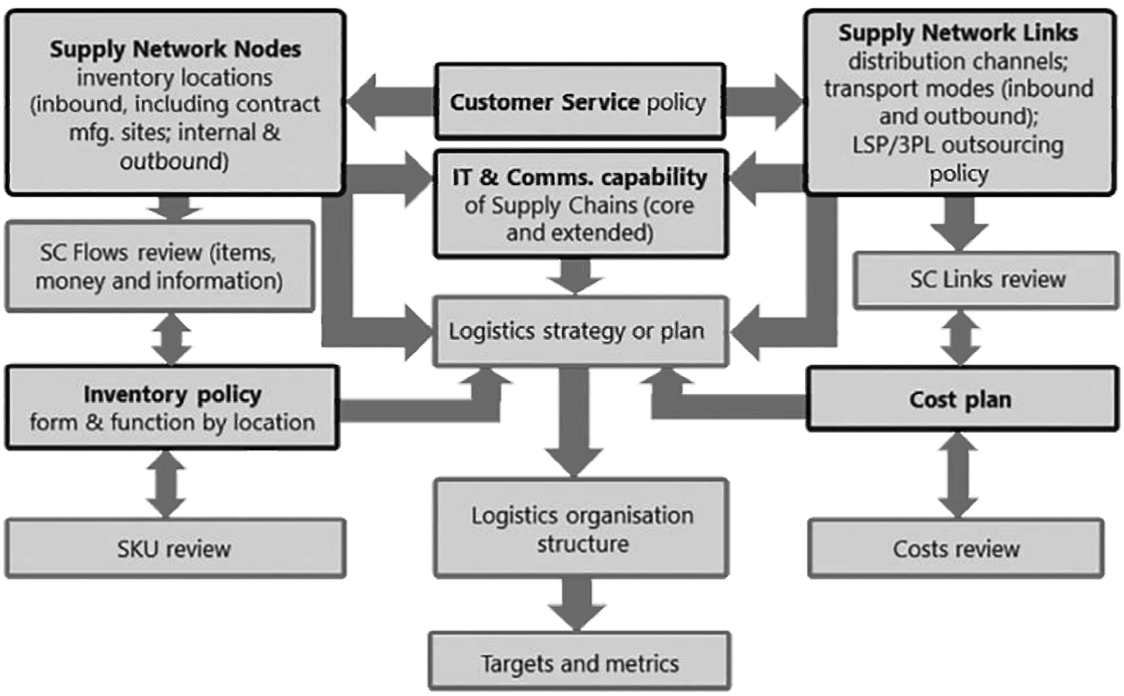
Network Strategy: Locations and missions of facilities and strategies for using these facilities to achieve the customer service strategy.



The process of designing the structural element of the strategy is integrated with the functional elements of the strategy as well. Warehouse Operations, transportation Management and Material management decisions are inputs to a detailed structural strategy.

Implementation: In this final phase, people, business processes and IT come together to support and execute the Logistics Strategy. Implementation is one of the most important and challenging aspects of your Logistics strategy.

An example of one function is the Logistics Strategy plan:



Elements of the Logistics Strategy plan

The Logistics Strategy plan is then developed within eight elements:

1. *Customer service policy* – The appropriate level of service for customers, by product group or market segment; considering: order fulfilment requirements, enquiry and investigation capability and the available information. The customer service policy informs the nodes and links of the supply network.

2. *Inventory location policy (Supply Network nodes)* – Centralised or decentralised inventory; whether to differentiate facilities by fast and slow moving stock; location of sites; use of specific technologies and layouts; company-owned or contracted facilities.
3. *Inventory policy* – Form and function of inventory by location; the appropriate amount of stock to hold for various groups of inventory; planning structure that links outbound and inbound materials.
4. *Cost plan* – Trade-off analysis between cost and service level requirements; cost of Logistics operations.
5. *Transport and distribution (Supply Network links) policy* – Affected by whether enterprise imports or exports and the size and structure of conurbations being served. This incorporates transport modes, delivery pattern and storage location considerations, based on the time taken for deliveries.
6. *IT and Communications capability:* Technologies (including software) that will be internally developed; buy planning and scheduling applications from single supplier or obtain 'best of breed' applications.
7. *Logistics organisation structure:* Function or flow based; allocation of responsibilities; managed or self-managed teams.
8. *Logistics Targets and metrics:* Measures of performance and achievement targets; operations improvements process and management.

It would be interesting to discuss some business strategy case studies, i.e., leading digital marketing strategy oriented case studies that assisted the firms in gaining success.

CASE STUDIES

1. How Mint Used Online Marketing to Successfully Launch a Digital Empire

When Mint first launched in 2006, it was nothing more than an account aggregation service. Yet Mint has now become a household name with over 20 million users. Acquired by Intuit for $170 million in 2009, Mint is a personal finance tracker that makes it easy for customers to achieve their financial goals, track their budget, and find deals on credit cards, loans, mortgages, and auto loans.

Mint faced an uphill battle, as it needed to convince users that it was safe to consolidate their banking data under a single service. When the aggregation service first came out in 2006, this was something many users were told never to do.

Despite this, through a comprehensive online marketing campaign, Mint was able to successfully start acquiring revenue through lead generation by 2008 — leveraging its referral fees.

Mint's challenges were two-fold: they needed to convince customers that this was a service they needed and that they were a reputable, safe service to use. They were able to do this through their multi-channel marketing, which built authority and brand awareness throughout their targeted millennial audience.

Key aspects of their marketing strategy included the following:

The MintLife Blog

Mint understood that their major customer demographics were likely to be millennials who wanted to get a foothold on their finances. The MintLife blog was directed at bringing in younger individuals who had questions about their finances.

What goes into a credit score? How do you get started buying a house? Is it possible to purchase a car with bad credit? Blog-based content marketing brought in an audience demographic that was likely to be interested in their services.

Social Media Interaction

Through social media, Mint became extraordinarily responsive. The team at Mint hosted promotions, gave away free items and discounts, and engaged with the audience that they expected to be most interested in its service.

By establishing relationships with known brands through social media — such as credit card companies — Mint was also able to easily build its perceived authority with its potential audience. Mint's social media was not self-promoting; instead, it focused on giving its millennial audience information about money saving tips, financial news, and more.

Explainer Videos

Finally, Mint still needed to tackle the concept of a financial tracker — showing its audience that it needed the tool that it was providing. It was able to do this through a sequence of explainer videos and articles designed to show the value of the website.

As a free website, Mint only needed to convince its users to convert to a free account — from there, the value presentation was within the tool itself. Ultimately, Mint was able to grow its business by establishing authority, creating a wide array of content marketing, and offering clear, understandable explanations about the usability of its tool.

2. Dropbox Grows from 1 Million to 500 Million Users in Just 7 Years

Ranked as one of the most valuable startups in the world, Dropbox is currently one of the most used digital utilities across the globe. Dropbox has a total of 500 million users, and its usage has been growing steadily ever since. From 2009 to 2016, Dropbox was able to achieve growth from 1 million to 500 million users. Much of this dramatic growth was fuelled by online marketing.

As an online service, Dropbox's online marketing was particularly important. Its users were already there — it just needed to find a way to tap into them. It was able to do this in a scalable, cost-effective way by essentially recruiting its own customers. Dropbox encouraged customers to invite others through a variety of social media platforms, which turned the ordinary user into a brand ambassador.

Further, Dropbox had to segregate its marketing campaigns. It wasn't just a B2C utility; its ultimate goals were to serve to businesses who would be more likely to pay for a premium model.

This meant that Dropbox had to reach a certain saturation point. The more ubiquitous its product became, the more likely it would be that commercial enterprises would invest in premium services. This underscored the importance of fast, even chaotic, growth.

Key aspects of their marketing strategy included the following:

i) A Clean, Clear Landing Page

Dropbox's landing page immediately describes its product in a single sentence and then prompts users to commit. As a free product, Dropbox yields the best results by encouraging users to test out their service. Once users test out their free service, ideally their company will be encouraged to pay for a premium version.

ii) Built-In Marketing Incentives

Dropbox encouraged users to connect with others and promote Dropbox as a service by giving them more space for their files. By sharing content on Twitter, Facebook, and other social media platforms, users could get an upgrade to the amount of space that they had. Not only did this bring users closer to the brand, but it also made for fast-paced grass roots growth.

iii) An Inspiring Market Platform

As an overall utility, Dropbox had to reach a very large audience. It geared up for this audience engagement through a unique online marketing campaign that was designed to show its values. Customers began to see the brand as standing for something, rather than being yet another software utility.

Of course, none of this marketing would have gotten as far as it did if it wasn't for the utility of the service. The advantages of a freemium model really only work when the service is clearly worth paying for. Nevertheless, the marketing strategies listed above were instrumental in securing Dropbox incredible, sustainable, and exponential growth.

3. Golden Heart Senior Care Leverages Reputation Management to Build Trust

Plumbers, restaurants, and long-term care services — they all have something in common. People seeking these services are likely to look up reviews, testimonials, and third-party ratings before making a decision. Companies that offer personal services have a long road ahead of them. Without an online reputation, few customers will be willing to give them a chance.

Golden Heart Senior Care needed to make sure that customers saw them as trustworthy and reliable. To that end, they turned to online marketing.

Through a digital marketing team, they were able to boost their online reviews as well as develop themselves as a trustworthy authority regarding long-term senior care. Active social media accounts, a polished blog, and reviews on multiple platforms were all able to bolster the care service's reputation.

Reputation management is the art of pushing positive content to the top. Not only do reputation management companies need to promote positive contact, but they also need to be able to bury content that may be incorrect or outdated. Nothing can ever be removed from the Internet; instead, through SEO and content marketing, digital marketers have to promote the best content first.

Key aspects of their marketing strategy included the following:

i) Managing Online Reviews

Through a curated online review platform, Golden Heart Senior Care was able to share positive reviews as well as curating reviews that were incorrect. Golden Heart Senior Care was offered the opportunity to address any negative reviews while also encouraging satisfied clients to post their own reviews. The more reviews posted on an online review platform, the more relevant it became to search engines — and therefore, the more it was pushed to the top of results. Presently, Golden Heart Senior Care can be seen on multiple senior care review websites, ranking at a 5 out of 5 stars.

ii) Posting Original and Curated Information

To establish themselves as an authority and reach out to their leading demographics, Golden Heart Senior Care began to produce and share valuable content about seniors and their abilities. In addition to this, Golden Heart Senior Care also shared curated information, establishing themselves as an all-around resource and giving them additional content to share beyond the custom content that they themselves had created. Together, this made for an active, versatile social media presence.

iii) Engaging with Followers Online

A long-term care service is an intensely personal relationship. Golden Heart Senior Care was able to connect with potential clients or their loved ones directly through their social media.

One-on-one interaction with potential clients improved perception of the care centre, while also addressing any questions or concerns that followers might have. Even potential clients who did not have questions could see how responsive the care centre was online, which mattered in terms of reputation.

As a relatively small company, Golden Heart Senior Care has a fairly specific demographic: seniors (and their families) within their geographic area. This type of marketing requires an extremely personal touch.

Through reputation management, Golden Heart Senior Care was able to capture an audience who already knew that they needed their services, but who also had questions and concerns about the process — and who wanted to find the most trustworthy service available.

In a rating-filled world, companies need to be especially conscientious about positive and negative reviews and how they may adversely impact them.

4. First Fruit Wellness Center Expands to Three Locations through Social Media Engagement

Converting followers to leads is one of the major challenges of any marketing campaign. Yet this wellness centre had a unique and personal take on social media marketing. By engaging with followers one-on-one, First Fruit Wellness Center developed close relationships with potential customers online. Social media campaigns don't have to feel impersonal — though they often do.

Wellness centres have a unique marketing challenge: they need to show their clientele that there is a need for them. Wellness centres need to be able to reach out to those who are interested in improving their health and show the value of their services before customers walk in the door.

Most social media campaigns are primarily based around the idea of brand awareness: making it known that your business is open and available. But First Fruit Wellness Center went a step further by actively engaging their followers — asking them questions about their health and their goals and encouraging them one-on-one to come into the centre and see what it could do for them.

For larger enterprises, this type of constant one-on-one interaction might seem taxing. But for a brick-and- mortar wellness centre, these personalised interactions ultimately led to leads.

Key aspects of their marketing strategy included the following:

i) Building Out their Content Marketing

It was through content marketing that the First Fruit Wellness Center was able to initially build an audience. Engagement campaigns cannot work without followers already available. Posting interesting content, sharing curated content, and interacting with similar brands were the first step towards building First Fruit Wellness Center's social media campaigns.

ii) Connecting Directly with Followers

When followers connected with First Fruit Wellness Center, the marketing team began to interact with them immediately — asking them questions about their interests and their goals. This type of personal interaction is extraordinarily rare on social media today and served the purpose of not only establishing relationships with customers, but also showing them that this company was different.

iii) Getting the Followers to Come In

Ultimately, to get leads the marketing team needed to get people in the door. Once relationships were sufficiently established, the marketing team of First Fruit Wellness Center encouraged potential customers to come in to find out more about the centre and what it could offer to them. By bringing in leads in this fashion, nearly all of the nurturing was done through the online platform.

Despite the time commitment, these strategies are scalable. Many large brands — most famously Wendy's — have extremely active social media accounts, through which they interact with customers and respond to customers regularly. Unique to First Fruit Wellness Center, however, is the type of ongoing interactions, relationship building, and lead generation that the marketing team engaged in. By establishing an individual rapport with each follower, the centre was able to send a message that it valued them.

First Fruit Wellness Center is interesting in another way: shortly after expanding to multiple locations, they appear to have discontinued their marketing campaigns. As a direct consequence, their account can now be seen to be mostly inactive — and all of the social media momentum they built died off. This is a sobering reminder that social media is a living entity and that it needs to be continually refuelled and revised.

5. Roofstock Uses Press Releases, News Sites, and Paid Advertising to Disrupt Real Estate Market

Not many individuals are interested in purchasing investment property sight unseen. Yet this is exactly the premise that Roofstock needed to sell. Roofstock is a disruptive real estate service, designed to make it easier for investors to purchase properties from anywhere in the world.

Once properties are purchased online, they are managed by local property management companies. Investors are able to reap the benefits of an investment property with none of the negatives — at least, that's the theory.

Of course, that's a hard sell to a lot of investors. Experienced investors already have their own networks in place, while inexperienced investors may fear such a high-risk strategy. That's where Roofstock's digital marketing came in.

Rather than just focusing on traditional content marketing and social media, Roofstock acquired coverage in magazines such as Forbes. Online press releases and news articles were used to build both credibility and awareness.

This was further augmented by paid marketing campaigns on communities such as Reddit, directed towards investors. Roofstock additionally embarked upon reputation management, and presently there are a number of solid reviews and ratings for the service — showing it as a reputable and trustworthy resource. Together, these strategies were used to establish the company in a disruptive space, providing a service that many had otherwise never heard of before.

Key aspects of their marketing strategy included the following:

i) Placement in Reputable Magazines and News Outlets

For Roofstock, traditional blog posts and content marketing wasn't enough. A company asking investors for tens (or hundreds) of thousands of dollars needed more. Positioning themselves in Forbes, Business Insider, and other high-quality online venues allowed for a better perceived reputation.

ii) Reviews and Reputation Management

Reputation was important for Roofstock as many would be looking up the company to make sure it was legitimate. Roofstock invested in reputation management enough to ensure that it had positive, reputable reviews showing up whenever potential clients searched for the company on a search engine. It wasn't enough for Roofstock itself to rank highly in terms of SEO; its reviews and testimonials needed to as well.

iii) Paid Advertising

For high-value companies such as Roofstock, the ROI of paid advertising is even more extraordinary. A company can spend a great deal on procuring leads if each lead brings in thousands of dollars. However, just general advertising often isn't enough to bring in interested leads. Roofstock was able to leverage the communities of Reddit for targeted advertising services.

Disruptive businesses often face significant challenges when advertising, as they need to show users that there is a new way to accomplish their goals. Roofstock was able to build its reputation and credibility through the use of pre-existing finance and business venues. Simultaneously they ran an education campaign that explained to prospective clients what its service did and how its service was better than its predecessors.

LESSON ROUND-UP

- Business policies are the guidelines developed by an organization to govern the actions of those who are a part of it. They define the potential limits within which decisions must be made.
- The origins of business policy can be traced back to the year 1911, when Harvard Business School introduced an integrative course in management aimed at the creation of general management capability.
- Vision serves the purpose of stating what an organization wishes to achieve in the long run.
- A mission statement defines the basic reason for the existence of that organization. Such a statement reflects the corporate philosophy, identity, character, and image of an organization.
- Corporate Strategy highlights the pattern of business moves and goals concerning strategic interest, in different business units, product lines, customer groups, etc. It defines how the firm will remain sustainable in the long run.
- Where SBU concept is applied, each SBU sets its own strategies to make the best use of its resources (its strategic advantages) given the environment it faces.
- Functional strategy, relates to a single functional operation and the activities involved therein. Decisions at this level within the organization are often described as tactical.

GLOSSARY

Competitive Positioning: Competitive positioning is about defining how you'll "differentiate" your offering and create value for your market. It's about carving out a spot in the competitive landscape, putting your stake in the ground, and winning mindshare in the marketplace – being known for a certain "something."

Strategic Business Unit: A strategic business unit, popularly known as SBU, is a fully-functional unit of a business that has its own vision and direction. Typically, a strategic business unit operates as a separate unit, but it is also an important part of the company. It reports to the headquarters about its operational status.

Differentiation Strategy: A differentiation strategy is an approach to develop businesses by providing customers with something unique, different and distinct from items their competitors may offer in the marketplace. The main objective of implementing a differentiation strategy is to increase competitive advantage.

Cost Leadership Strategy: Offering products at the lowest cost available is a strategy which the businesses often use to stimulate growth. A company is more competitive when it can offer its products at a lower price.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What is Business Policy. Give its definition and features ?
2. Discuss features of Business Policy.
3. Discuss the importance of Business Policy.
4. Elaborate framework of Strategic Management.
5. Discuss
    - Vision
    - Mission
    - Objectives
    - Goals
    - Purpose
    - Policy
    - Procedure.
6. What do you mean by Formulation of Functional Strategy?
7. Discuss tools and techniques of Strategic Analysis.
8. What are different types of production strategies?

LIST OF FURTHER READINGS

- Business Strategy: Managing Uncertainty, Opportunity, and Enterprise by J.C. Spender
- Return On Influence: The Revolutionary Power of Klout, Social Scoring, and Influence Marketing by Mark Schaefer
- Tilt: Shifting Your Strategy from Products to Customers by Niraj Dawar
- Gaining and Sustaining Competitive Advantage by Jay Barney.

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Strategic Analysis and Planning

Lesson 4

KEY CONCEPTS

■ Situation Analysis ■ SWOT / TOWS Analysis ■ PERT and CPM ■ BCG Matrix ■ ADL Matrix ■ Ansoff Growth Matrix

Learning Objectives

To understand:

- The meaning and relevance of situation analysis
- The variety of tools and methods that includes SWOT and TOWS analysis with the aid of real life case studies
- The conducting of portfolio analysis to determine Internal capabilities of a company to compete in a market and fulfil customer expectations
- The Strategic Planning Process
- The development of strategic alternatives
- The Combination Strategies

Lesson Outline

- Strategic Analysis and Planning
- Situational Analysis
- Strategic Choices-SWOT and TOWS Analysis
- Programme Evaluation Review Technique and CPM (Critical Path Method)
- Portfolio Analysis-Boston Consulting Group (BCG) Growth Share Matrix
- Ansoff Growth Matrix
- ADL Matrix
- General Electric (GE) Mckinsey Matrix
- Strategic Alternatives-Glueck and Jauch
- Michael Porter's Generic Strategies
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

STRATEGIC ANALYSIS AND PLANNING

Strategic analysis and planning involve careful formulation of the strategies and goals taken by a company's top management on behalf of the organization. It is based on deliberation of resources and an assessment of the internal and external environments in which the organization competes based on a variety of models. It aims at providing overall direction to the organisation and specifying the organization's objectives, developing policies and plans designed to achieve these objectives, and then allocating resources to implement the plans. All this requires a careful analysis of the vision, mission, objectives, goals and resources of the organisation and in- depth analysis of the external environment.

Situation Analysis

Before developing any strategy, the foremost requirement is carrying out a Situation Analysis. A Situation analysis or environmental analysis is an essential component of any strategy formulation and it has to be assured that such analysis is conducted periodically to keep the strategies up to date. A complete situation analysis focuses on four areas i.e.:

- The problem (its severity and its causes)
- The people (potential stakeholders)
- The broad context (in which the problem prevails)
- Factors (facilitating behavior change)

A situational analysis takes into account the internal and external environment of an entity or organization and clearly identifies its own capabilities, customers, potential customers, competitors and the business environment and the impact they are going to have on the entity or organization.

It can also help in identifying strengths, weakness, opportunities and threats to the organization or business which can help in forecasting the choices required to be made keeping in view the environmental developments.

Need of Situation Analysis

A Situation Analysis paves the way for strategy development by identification of priorities by bringing out a clear, detailed and realistic picture of the opportunities, resources, challenges and barriers regarding formulation of a business plan. The quality of the Situation Analysis will affect the success of the whole plan.

Suitability of Situation Analysis

A small, well knitted and focused team from different functional areas of the organisation should conduct the situation analysis. Throughout the data collection process, team members should also consider about engagement of concerned stakeholders including opinion leaders, service providers, policy makers, partners, and potential beneficiaries to reap maximum output. It may be done by conducting in-depth interviews, focus group discussions, community dialogues, small group meetings, taskforce engagements or participatory stakeholder workshops.

Conducting of Situation Analysis

A situation analysis should be conducted at the beginning of any program or project but before developing a strategy.

Elements of Situation Analysis

- **Product Situation**

  It relates with the products being offered by the business at present. It may further be sub-divided into the core product and any secondary/ancillary or supporting products/services. While doing so, the needs of the customers should be taken into. This is so because, now a days, consumer is the king, therefore, everything needs to be tailor-made to the requirements of the customers.

- **Competitive situation**

  This involves analysis of the competitive forces to identify the closest competitors. It involves finding out core competencies of the competitors as compared to our own organization and the areas in which they have strong hold and the characteristics of the customers segment that are attracted by the competitors.

- **Distribution Situation**

  Review your distribution and logistics network.

- **Environmental Factors**

  The external and internal environmental factors need to be taken into account. This includes economic or sociological factors that impact performance.

- **Opportunity and Issue Analysis**

  Carrying out a SWOT analysis (Strengths, Weaknesses, Opportunity and Threats). Current opportunities available in the market, the main threats that business is facing and may face in the future, the strengths that the business can rely on and any weaknesses that may affect the business performance.

Effectiveness of Situation Analysis

The following questions may bring out the effectiveness of situation analysis:

- Is currently adopted situational analysis simple and practical to use?
- Is it easy and clear for even an outsider to understand?
- Is it focused on key factors that are impacting my business both internally and externally?
- Does it clearly identify future goals for the business?

SWOT/TOWS ANALYSIS

Every manager is entrusted with the responsibility of setting up his/her organisation's mission and goals and creating a strategic plan that will guide the company to achieve its goals. For doing this, managers make use a variety of tools and methods to make a basis for decision making that includes SWOT and TOWS analysis, which are two closely related brainstorming exercises.

SWOT is a tool for strategic analysis of any organization, which takes into account examination of the company's internal as well as its external environment. It consists in recognition of key assets and weaknesses of the company and marching them to exploit future opportunities and combating threats. SWOT is quite helpful in formulating a company's strategy (Jezerys, 2000).

SWOT may be expanded as:

S – Strengths

W – Weaknesses

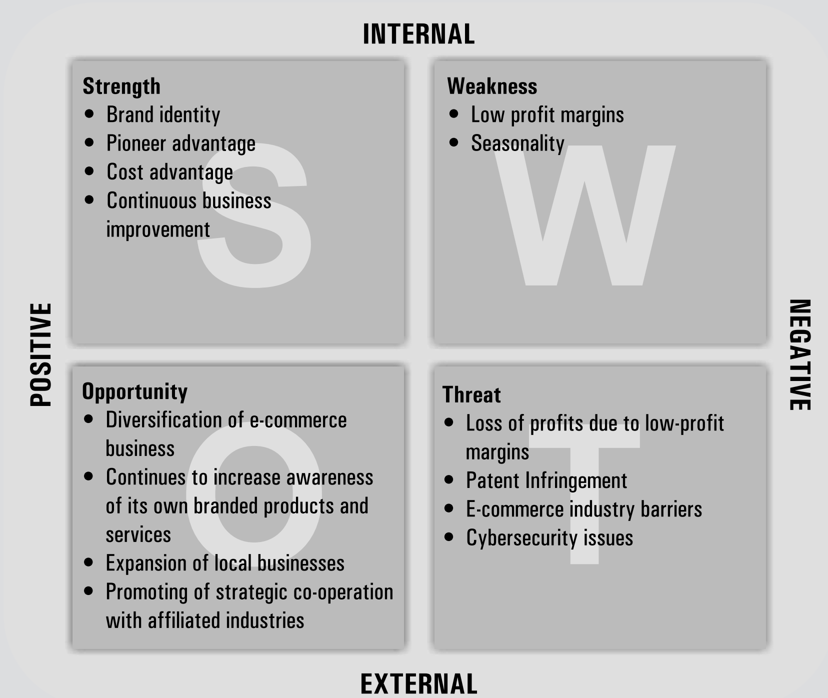
O – Opportunities

T – Threats.

The origin of the SWOT analysis is supposed to be rooted in the concept of 'Force Field Analysis' pronounced by K. Levin in 1950s. However, 'Force Field Analysis' concept was too complex to be practically applied. Yet, it became a reference for scholars to develop some simpler methods, that included the SWOT analysis as well. It is noteworthy that SWOT may be successfully applied in any kind of organization, be it business or corporate sector, political party, public institutions, sport club, schools or universities etc.

CASE STUDY – SWOT ANALYSIS

1. Amazon SWOT Analysis



Strength

- ***Brand Identity***: Amazon is synonymous with online sales services, and Amazon focuses on improving customer satisfaction during the business process.
- ***Pioneer Advantage***: Amazon is undoubtedly the leader in the online Retail Industry.
- ***Cost Structure***: Amazon effectively uses its cost advantage, operates on thin profits, and is still profitable in trading.
- ***Business Development***: Amazon continuously improves its service level and provides diversified services.

Weakness

- ***Low-Profit Margins***: Amazon has a very thin profit margin to maintain its cost-leading strategy. But low- profit margins make companies vulnerable to external shocks and crises, as well as other market changes.
- ***Seasonality***: There is a seasonal difference between Amazon's revenue and business scope, with sales and revenue peaking in the fourth quarter of each year.

Opportunity

- Today's Diversification of E-Commerce Business.
- Continues to increase awareness of Its own branded products and services.
- Amazon develops more local websites to participate in the international market. With the international expansion of Amazon, some local businesses have the opportunity to enter the international market.

- Promoting the strategic cooperation between Amazon E-Commerce and its related affiliated industries will drive positive development of the industry.

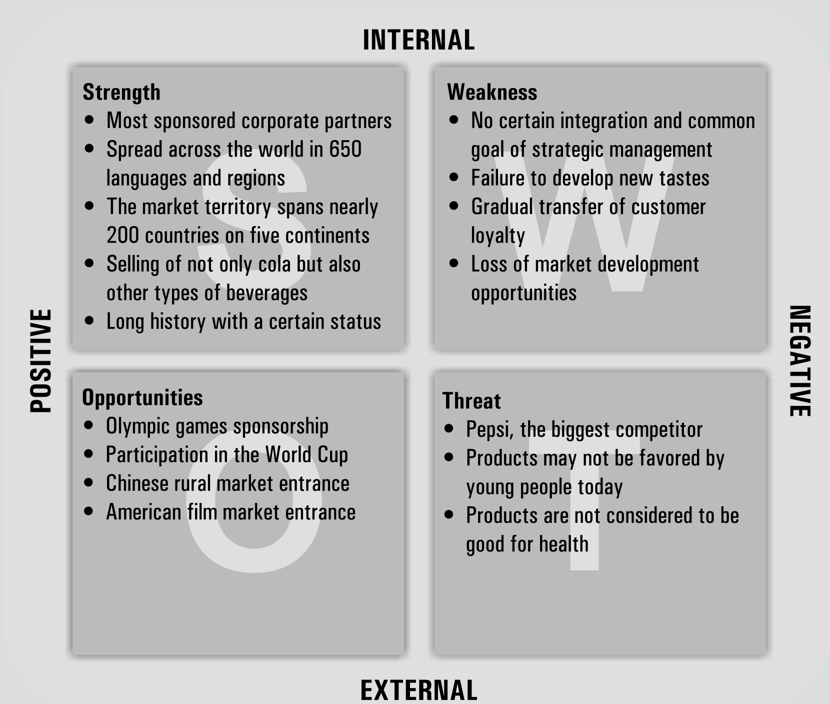
Threat

- Loss of profits due to low-profit margins.
- Patent Infringement and other aspects of Amazon's Litigation E-Commerce Industry barriers to entry barriers.
- Cybersecurity Issues.

Amazon – Recent Development

Amazon has seized the opportunity to successfully transform itself from an e-commerce company into a global leading technology company! When Amazon realized the limitations of the retail industry, it expanded its business boundaries promptly. In addition to cloud computing and smart voice, Amazon has also contacted third-party platforms such as logistics and suppliers, and even invested in the film and television industry, making its business model more diversify. In 2008, Amazon realized that content can attract and extend users' time on the platform, and began to provide original content on Prime Instant Video, Amazon's mainstream media video platform, and as part of the Prime membership service. Amazon's ecology can be described as a rotating flywheel. This flywheel is centered on Prime's membership system, and new interests have been added to it, gradually creating an all-encompassing ecology. While continuing to attract new users, it has promoted the development of Amazon's e-commerce and other new businesses, and it will continue to do so.

2. Coca-Cola SWOT Analysis



Strength

- Most sponsored corporate partners.
- Spread across the world in 650 languages and regions.

- The market territory spans nearly 200 countries on five continents.
- To develop new products, the Coca-Cola Company not only sells cola but also other types of beverages.
- Coca-Cola has a long history, so it has a certain status in the market.

Weakness

- There is no certain integration and the common goal of strategic management.
- The failure to develop new tastes.
- The gradual transfer of customer loyalty.
- Loss of market development opportunities.

Opportunity

- Sponsor the Olympic Games, use this opportunity to replace their brands, products, and make advertisements, especially The Olympic Games is a worldwide movement that allows the world's population to recognize this product, expand its market reach, and raise awareness of its products.
- Participate in the World Cup, take this world-wide activity to pave the way for your products and gain popularity.
- Enter the Chinese rural market.
- Enter the American film market.

Threat

1. Pepsi is Coca-Cola's biggest competitor.
2. The products produced by the company may not be favored by young people today.
3. Coca-Cola is not considered to be good for health by many people.

3. Skoda SWOT Analysis

Introduction

In 1895 in Czechoslovakia, two keen cyclists, Vaclav Laurin and Vaclav Klement, designed and produced their own bicycle. Their business became Skoda in 1925. Skoda went on to manufacture cycles, cars, farm ploughs and airplanes in Eastern Europe. Skoda overcame hard times over the next 65 years. These included war, economic depression and political change.

By 1990 the Czech management of Skoda was looking for a strong foreign partner. Volkswagen AG (VAG) was chosen because of its reputation for strength, quality and reliability. It is the largest car manufacturer in Europe providing an average of more than five million cars a year giving it a 12% share of the world car market.

Volkswagen AG comprises the Volkswagen, Audi, Skoda, SEAT, Volkswagen Commercial Vehicles, Lamborghini, Bentley and Bugatti brands. Each brand has its own specific character and is independent in the market. Skoda UK sells Skoda cars through its network of independent franchised dealers.

To improve its performance in the competitive car market, Skoda UK"s management needed to assess its brand positioning. Brand positioning means establishing a distinctive image for the brand compared to competing brands. Only then could it grow from being a small player. To aid its decision-making, Skoda UK obtained market research data from internal and external strategic audits. This enabled it to take advantage of new opportunities and respond to threats.

The audit provided a summary of the business's overall strategic position by using a SWOT analysis. SWOT is an acronym which stands for:

- **Strengths** - the internal elements of the business that contribute to improvement and growth.
- **Weaknesses** - the attributes that will hinder a business or make it vulnerable to failure.
- **Opportunities** - the external conditions that could enable future growth.
- **Threats** - the external factors which could negatively affect the business.

This case study focuses on how Skoda UK's management built on all the areas of the strategic audit. The outcome of the SWOT analysis was a strategy for effective competition in the car industry.

Strengths

To identify its strengths, Skoda UK carried out research. It asked customers directly for their opinions about its cars. It also used reliable independent surveys that tested customers' feelings.

For example, the annual JD Power customer satisfaction survey asks owners what they feel about cars they have owned for at least six months. JD Power surveys almost 20,000 car owners using detailed questionnaires. Skoda has been in the top five manufacturers in this survey for the past 13 years.

In Top Gear's 2007 customer satisfaction survey, 56,000 viewers gave their opinions on 152 models and voted Skoda the 'number 1 car maker'. Skoda's Octavia model has also won the 2008 *Auto Express* Driver Power 'Best Car'.

Skoda attributes these results to the business concentrating on owner experience rather than on sales. It has considered 'the human touch' from design through to sale. Skoda knows that 98% of its drivers would recommend Skoda to a friend. This is a clearly identifiable and quantifiable strength. Skoda uses this to guide its future strategic development and marketing of its brand image.

Strategic management guides a business so that it can compete and grow in its market. Skoda adopted a strategy focused on building cars that their owners would enjoy. This is different from simply maximising sales of a product. As a result, Skoda's biggest strength was the satisfaction of its customers. This means the brand is associated with a quality product and happy customers.

Weaknesses

A SWOT analysis identifies areas of weakness inside the business. Skoda UK's analysis showed that in order to grow it needed to address key questions about the brand position. Skoda has only 1.7% market share. This made it a very small player in the market for cars. The main issue it needed to address was: how did Skoda fit into this highly competitive, fragmented market?

a) *Perceptions of the brand***:** This weakness was partly due to outdated perceptions of the brand. These related to Skoda's eastern European origins. In the past the cars had an image of poor vehicle quality, design, assembly and materials. Crucially, this poor perception also affected Skoda owners. For many people, car ownership is all about image. If you are a Skoda driver, what do other people think?

   From 1999 onwards, under Volkswagen AG ownership, Skoda changed this negative image. Skoda cars were no longer seen as low-budget or low quality. However, a brand 'health check' in 2006 showed that Skoda still had a weak and neutral image in the mid-market range it occupies, compared to other players in this area, for example, Ford, Peugeot and Renault. This meant that, whilst the brand no longer had a poor image, it did not have a strong appeal either.

b) *Change of direction*: This understanding showed Skoda in which direction it needed to go. It needed to stop being defensive in promotional campaigns. The company had sought to correct old perceptions and demonstrate what Skoda cars were not. It realised it was now time to say what the brand does stand for. The marketing message for the change was simple: Skoda owners were known to be happy and contented with their cars. The car-buying public and the car industry as a whole needed convincing that Skoda cars were great to own and drive.

Opportunities

Opportunities occur in the external environment of a business. These include for example, gaps in the market for new products or services. In analysing the external market, Skoda noted that its competitors' marketing approaches focused on the product itself. Many brands place emphasis on the machine and the driving experience:

- Audi emphasises the technology through its strapline, 'Vorsprung Durch Technik' ('advantage through technology').
- BMW promotes 'the ultimate driving machine'.
- Skoda UK discovered that its customers loved their cars more than owners of competitor brands, such as Renault or Ford.

Differentiation

Information from the SWOT analysis helped Skoda to differentiate its product range. Having a complete understanding of the brand's weaknesses allowed it to develop a strategy to strengthen the brand and take advantage of the opportunities in the market.

It focused on its existing strengths and provided cars focused on the customer experience. The focus on 'happy Skoda customers' is an opportunity. It enables Skoda to differentiate the Skoda brand to make it stand out from the competition. This is Skoda's unique selling proposition (USP) in the motor industry.

Threats

Threats come from outside of a business. These involve for example, a competitor launching cheaper products. A careful analysis of the nature, source and likelihood of these threats is a key part of the SWOT process.

The UK car market includes 50 different car makers selling 200 models. Within these there are over 2,000 model derivatives. Skoda UK needed to ensure that its messages were powerful enough for customers to hear within such a crowded and competitive environment. If not, potential buyers would overlook Skoda. This posed the threat of a further loss of market share. Skoda needed a strong product range to compete in the UK and globally.

In the UK the Skoda brand is represented by seven different cars. Each one is designed to appeal to different market segments. For example:

- the Skoda Fabia is sold as a basic but quality 'city car'.
- the Skoda Superb offers a more luxurious, 'up-market' appeal.
- the Skoda Octavia Estate provides a family with a fun drive but also a great big boot.

Pricing reflects the competitive nature of Skoda's market. Each model range is priced to appeal to different groups within the mainstream car market. The combination of a clear range with competitive pricing has overcome the threat of the crowded market.

Environmental constraints

The following example illustrates how Skoda responded to another of its threats, namely, the need to respond to EU legal and environmental regulations. Skoda responded by designing products that are environmentally friendly at every stage of their life cycle. For example:-

- recycling as much as possible. Skoda parts are marked for quick and easy identification when the car is taken apart.
- using the latest, most environmentally-friendly manufacturing technologies and facilities available. For instance, painting areas to protect against corrosion use lead-free, water based colours.
- designing processes to cut fuel consumption and emissions in petrol and diesel engines. These use lighter parts making vehicles as aerodynamic as possible to use less energy.
- using technology to design cars with lower noise levels and improved sound quality.

Outcomes and benefits of SWOT analysis

Skoda UK's SWOT analysis answered some key questions. It discovered that:

- Skoda car owners were happy about owning a Skoda.
- The brand was no longer seen as a poorer version of competitors' cars. However, the following observations were found:
  - The brand was still very much within a niche market
  - A change in public perception was vital for Skoda to compete and increase its market share of the mainstream car market.
  - The challenge was how to build on this and develop the brand so that it was viewed positively. It required a whole new marketing strategy.

Unique selling proposition

Skoda UK has responded with a new marketing strategy based on the confident slogan, 'the manufacturer of happy drivers'.

The campaign's promotional activities support the new brand position. The key messages for the campaign focus on the 'happy' customer experience and appeal at an emotional rather than a practical level. The campaign includes:

- The 'Fabia Cake' TV advert. This showed that the car was 'full of lovely stuff' with the happy music ('Favourite things') in the background.
- An improved and redesigned website which is easy and fun to use. This is to appeal to a young audience. It embodies the message 'experience the happiness of Skoda online'.

Customers are able to book test drives and order brochures online. The result is that potential customers will feel a Skoda is not only a reliable and sensible car to own, it is also 'lovely' to own.

Analysing the external opportunities and threats allows Skoda UK to pinpoint precisely how it should target its marketing messages. No other market player has 'driver happiness' as its USP.

By building on the understanding derived from the SWOT, Skoda UK has given new impetus to its campaign. At the same time, the campaign has addressed the threat of external competition by setting Skoda apart from its rivals.

For more Case Studies, please refer Lesson 6 of this study.

TOWS

Weihrich developed TOWS Matrix in 1982, as the next step of SWOT Analysis in developing alternative strategies. TOWS Matrix is a conceptual framework for identifying and analyzing the threats (T) and opportunities (O) in the external environment and assessing the organization's weaknesses (W) and strengths (S). TOWS Matrix is an effective way of combining a) internal strengths with external opportunities and threats, and b) internal weaknesses with external opportunities and threats to develop a strategy.

1. The TOWS analysis starts with the external environment. Specifically, the listing of external threats (T) may be of immediate importance to the firm as some of these threats may seriously threaten the operation of the firm. These threats should be listed in quadrant T. Similarly, opportunities should be shown in quadrant O. Threats and opportunities may be found in different areas, but it is advisable to carefully look for the more common ones which may be categorized as economic, social, political and demographic factors, products and services, technology, markets and, of course, competition.
2. The firm's internal environment is assessed for its strengths (S) and weaknesses (W), and then listed in the respective quadrants. These factors may be found in management and organization, operations, finance, marketing and in other areas.

Though TOWS was created through rearrangement of the letters of SWOT analysis, yet, it may not be considered as just reversal of sequence of the SWOT analysis. This is so because, while in the SWOT analysis, one starts with evaluation of internal strengths and weaknesses and seeks the manner of their best application taking into account the external business environments, TOWS analysis scans opportunities and threats existing in external environment of any organization, and then generates, compares and selects strategies based on internal strengths and weakness to utilize such opportunities and reduce threats.

Michael Watkins of the "Harvard Business Review" says that focusing on threats and opportunities first helps lead to productive discussions about what is going on in the external environment rather than getting bogged down in abstract discussions about what a company is good at or bad at.

Therefore, it is not just reversal of letters of SWOT, but, a tool for strategy generation and selection. SWOT analysis is a tool for audit and analysis. One would use a SWOT at the beginning of the planning process, and a TOWS later as one decides upon ways forward.

- **Who can use SWOT/TOWS ?**

  The SWOT/TOWS Matrix is not just meant for the top levels of management in an organisation. Rather, these two can be very useful tool for divisions, products, functions as well as departments. These can also be used for individual employees on an operational level. (Campbell, 2017).

- **Why SWOT/TOWS ?**

  The SWOT/TOWS analysis is a very simple yet valuable technique which aids in identifying opportunities and threats from an external environment, and analyzing its own strengths and weakness. Such a review helps in establishing the relationship between threats, opportunities, weaknesses, and strengths for developing strategies and making decisions.

  Further, use of TOWS by examining threats and opportunities before analyzing strengths and weaknesses can further allow for more productive analysis and interpretation of external environment leading to more informed decisions (Watkins, 2007). The TOWS Matrix also helps in brainstorming to bring out great ideas to generating effective strategies and tactics.

Four TOWS strategies: product of Trade-off between Internal and External factors

As said earlier, whereas SWOT Analysis starts with an internal analysis, the TOWS Matrix takes the other route, with an external environment analysis; the threats and opportunities are examined first. Then, in TOWS makes a trade- off between internal and external factors. As we know, Strengths and weaknesses are internal factors and opportunities and threats are external factors. This trade-off is the point where four potential strategies derive their importance, these are Strength/Opportunity (SO), Weakness/Opportunity (WO), Strength/Threat (ST) and Weakness/Threat (WT) as shown in matrix given below:

TOWS Analysis

	Internal Factors		
External Factors		Strengths(S)	Weaknesses (W)
	Opportunities (O)	Strengths/ Opportunities (SO)	Weaknesses/ Opportunities (WO)
	Threats (T)	Strength/ Threats (ST)	Weaknesses/ Threats (WT)

Strength/Opportunity (SO): Strengths of the companies are utilized to exploit the opportunities.

Weakness/Opportunity (WO): The organisation finds options that overcome weaknesses, and then take advantage of opportunities. Therefore, it mitigates weaknesses, to exploit opportunities.

Strength/Threat (ST): Exploiting strengths to overcome any potential threats.

Weakness/Threat (WT): With Weakness/Threat (WT) strategies, one is attempting to minimise any weakness to avoid possible threat.

Strategies in TOWS

There are 4 types of strategies differentiated:

Aggressive strategy	(maxi-maxi)
Conservative strategy	(maxi-mini)
Competitive strategy	(mini-maxi)
Defensive strategy	(mini-mini)

	External Opportunities (O)	External Threats (T)
Internal Strengths (S)	SO **'Maxi-Maxi' Strategy** Strategies that use **strengths** to maximise **opportunities**.	ST **'Maxi-Mini' Strategy** Strategies that use **strengths** to minimise **threats.**
Internal Weaknesses (W)	WO **'Mini-Maxi' Strategy** Strategies that minimise **weaknesses** by taking advantage of **opportunities.**	WT **'Mini-Mini' Strategy** Strategies that minimise **weaknesses** and avoid **threats.**

Aggressive Strategy (maxi-maxi)

According to Krzysztof Obłój (2007) "the aggressive strategy (maxi-maxi) consists in maximum exploitation of the synergy effect present between the strong sides of the organization and opportunities generated by the environment. It is a strategy of strong expansion and diversified development (...)".

Therefore, maxi-maxi refers to an organization, within which the synergy effect is present and opportunities are dominating in the environment. It consists in strong expansion and development, with maximum application of strengths and available opportunities.

The aggressive strategy embraces actions such as: capturing opportunities, strengthening position on the market, taking over organizations of the same profile, concentration of resources on competitive products. It is a strategy that exploits a synergy effect of company's strong sides and opportunities that appear in the environment (Klasik, 1993).

Conservative Strategy (maxi-mini)

It is present in an organization in a situation, when with high internal potential, it undergoes unfavorable system of external conditions or threats. The threats need to overcome with use of the strengths, e.g. the competitors should be bought and its shares taken over (Gierszewska I Romanowska, 2009).

The conservative strategy embraces such actions as: selection of products, market segmentation, reduction of costs, improvement of competitive products, development of new products, searching for new markets. It is a strategy, where success of an organization is mainly sought in its strong sides and reduction of threats (Klasik 1993).

Competitive Strategy (mini-maxi)

It is present in an organization, where weaknesses dominate over the strengths still there are opportunities prevailing in the environment. The competitive strategy consists in "(...) elimination of weak sides of company's operation and construction of its competitive strength through maximal exploitation of the existing opportunities that support development" (Obłój 2007).

The competitive strategy embrace such actions as: expansion of financial resources, improvement of commercial resources, improvement of a line of products, improvement of productivity, reduction of costs, maintenance of competitive advantage. It is a strategy that embraces construction of a competitive strength of an organization (Klasik, 1993).

Defensive Strategy (mini-mini)

This strategy enables survival in a situation, when an organization works in an unfavorable environment, it is deprived of strengths. It may lead to take maximal benefits from the company before its liquidation, or to combine it with another enterprise.

The defensive strategy encompasses such actions as: gradual withdrawal, reduction of costs, reduction of productive ability, ceasing the investment process. It is a strategy that provides survival, through counteracting weak sides and threats (Klasik, 1993).

CASE STUDY - TOWS MATRIX

CASE STUDY TOWS MATRIX FOR APPLE INC.

Strengths

- Market leader in an array of products and services

- Highly strong brand image
- Financial strength
- Innovative and highly sophisticated supply chain
- High profit margins
- Large and loyal customer base.

Weaknesses

Products not priced competitively

Thin product range in comparison to the competitors Products incompatible with the other brands

Opportunities

- Rising demand for the electronic gadgets
- Product diversification

Threats

- Elevated competition
- Rise in cost of inputs

Apple TOWS MATRIX

	Strengths (S)	**Weaknesses (W)**
Opportunities (O)	SO – Using strengths to capitalize on existing opportunities. Use brand image to diversify and develop partnership with other brands by introducing compatibility feature.	WO – Overcome weaknesses to capitalize on opportunities. Attract middle class customers by reducing price. Find new customer segments and introduce new products tailored for them.
Threats (T)	ST – Use strengths to combat threats. Control cost to beat competition. Focus on cultural change.	WT- Reduce weaknesses to combat threats. Exploit existing supply chain capabilities to reduce costs. Introduce competitively priced products.

Nike TOWS Matrix

Incorporated in 1967, Nike is known as a globally renowned brand in best sports shoe and apparels in the world and its main strategic suppliers for footwear are 127 footwear factories located in 15 countries. While it makes products mainly for athletic use, its products have also been liked in casual wear segment. Apart from a strong image and a market leading position, the brand is also known for its excellent marketing capabilities. However, that does not mean it does not have changes in its way. Currently, Nike has outsourced its supply chain operations entirely. It is focused on product innovation and extending its international presence. However, US is still its largest market. More points in the brief SWOT analysis below.

Strengths	*Weaknesses*
• Brand Image • Excellent Marketing capabilities • Financial strength • International presence • Huge well managed supply chain and distribution network	• Over dependence on the US market • Increasing marketing and overhead operating expenses

Opportunities	*Threats*
• Digitization and product innovation • Acquisitions • International expansion • Backward integration	• Stronger US dollar hurting earnings • Increased competitive pressure • Growing HR and marketing expenses • Higher legal pressures

	Strengths (S)	*Weaknesses (W)*
Opportunities (O)	SO – Using strengths to capitalize on available opportunities. invest more in digitization and product innovation. Explore Asian markets. Take hold of supply chain.	WO – Overcome weaknesses to capitalize on opportunities. Expand faster in international markets by reducing dependence on US market alone. Controlling operational costs.
Threats (T)	ST – Use strengths to avoid threats. use its marketing and innovation capabilities to keep the competitive pressure under control. keep investing in marketing, R&D as well as HR management. remain focused on compliance using internal compliance teams to control legal and regulatory pressures.	WT- Reduce weaknesses to avoid threats. to invest more in marketing and grow its brand faster.

TOWS MATRIX OF PEPSI

We have discussed SWOT analysis of Pepsi-Co in our previous topic now here we are going to discuss the TOWS Matrix of Pepsi-Co, keeping in mind its SWOT analysis. Following is the detailed analysis of Pepsi-Cola TOWS matrix:

'WT' ANALYSIS

- One weakness that Pepsi possess is that it has very strong taste it really feels that something highly toxic going inside the body, where as the same product of the coke is not much strong.
- They also have a problem of imitators as receives complaints from customers that they find take product in disguised of Pepsi's product. During the last years, it was published in financial post that there have been big complaints from the customers with regard to the bad taste that they experienced.

during the span of six months. If they soon pay no attention towards that this will create a big problem for them.

- Large size may lead to conflicting interests.
- New one calorie products have no existing customer base; generic brands can make similar drinks – cheaper. It is also big threat for any company people may like or dislike new launching product.

'WO' ANALYSIS

- They have a lack of emphasis on this in their advertising such as currently when they losses the bid for official drink in the 96 cricket world cup. They started a campaign in which they highlight the factor such as "nothing official about it". If they don't focus on sudden changing's in their advertising then they can convert this weakness into opportunity.
- They lack behind in catering the rural areas and just concentrating in the urban areas. They should try to increase their distributions and also focus on capturing rural areas; this will become a big opportunity for them.
- The other big weakness on Pepsi is that they don't pay any attention towards garments. They may enter in garments business in order to promote their brand name, by making sports cloths for players which represent their name by wearing their clothes. That must increase the customer and income of the Pepsi.
- High expenses may have trouble balancing cash-flows of such a large operation. The staff may show dishonesty. They should try to pay much attention towards their cash flow, and audit their statements on regular basis.

'ST' ANALYSIS

- In many countries Pepsi had more expensive products than Coke; such a high price may limit a lower income family from buying a Pepsi product, therefore which is a big threat for Pepsi that may Pepsi have to face in the future.
- In western countries, Pepsi have many branches with different flavors as compare to Asian countries, which has only 2 or 3 Pepsi products. Non-carbonated substitutes, such as juices and tea brands are maintaining a strong foothold in the market. Pepsi has a big threat from COKE, which are its main competitor from about 100 years.
- Pepsi is a multinational company therefore they have a big threat every time on them of Political instability and civil unrest.
- The whole culture and business operating environment at Pepsi-Cola-West Asia has quick access to a centralized database and they use computers as business tools for analysis and quick decision making. Computer breakdowns, viruses and hackers can reduce efficiency, and must constantly update products or other competitors will be more advanced.

Continuous efforts to research trends an reinforce creativity, if they fail in their efforts then there is a big threat for the company. The competitors may get benefit by their plans.

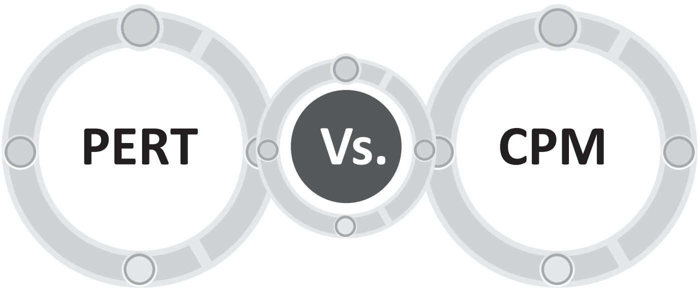
'SO' ANALYSIS

- The whole culture and business operating environment at Pepsi-Cola-West Asia has quick access to a centralized database and they use computers as business tools for analysis and quick decision making. Internet promotion such as banner ads and keywords can increase their sales, and more computerized manufacturing and ordering processes can increase their efficiency and that will become such a big opportunity for Pepsi.

- Large number of diversity businesses is also its main strength as it has diversity in many businesses such as Pepsi beverages, Pepsi foods, Pepsi Restaurants, and due to large number of diversity they can capture more customer, therefore it will become such a big opportunity for Pepsi.
- Pepsi is also a reputable organization, and is well known all over the world. Perception of producing a high quality product and strength can become a big opportunity for Pepsi if they use it in well arranged manner, such as advertising more and also by conducting concerts to attract more customers.
- They maintain a high quality as Pepsi Cola International collect sample from its different production facilities and send them for lab test in Tokyo, if they show test reports on label of their products this will also attract customers.
- They mainly use celebrities in their advertising campaigning like Imran Khan, Wasim Akram, and Waqar Younas etc. Also sponsor social activates programmed like music etc. this will become such a big opportunity to build such a large number of customers. So we can say that it is one of the big strength that may become a big opportunity for Pepsi.

Source: http://stepheny.hubpages.com/hub/pepsi-swot-analysis-with-other-soft-drinks

PERT (Programme Evaluation Review Technique) and CPM (Critical Path Method): Techniques of Project Management



One of the most challenging jobs that any manager can take on is the management of a large-scale project that requires coordinating numerous activities throughout the organization. A myriad of details must be considered in planning how to coordinate all these activities, in developing a realistic schedule, and then in monitoring the progress of the project. Therefore, the managers have to rely on Project management techniques to handle such large scale projects. Project Management is a systematic way of planning, scheduling, executing, monitoring, controlling the different aspects of the project, in order to attain the goal made at the time of project formulation.

PERT and CPM two complementary statistical techniques utilized in Project management. These two are network based scheduling methods that exhibit the flow and sequence of the activities and events. These techniques make heavy use of networks to help plan and display the coordination of all the activities.

First developed by the United States Navy in the 1950s to support the U.S. Navy's Polaris nuclear submarine project, PERT is commonly used in conjunction with the Critical Path Method (CPM). After discovery by Navy, it found applications all over industry. DuPont's Critical Path Method was invented at roughly the same time as PERT. Today, PERT and CPM have been used for a variety of projects, including the following types.

- Construction of a new plant
- Research and development of a new product
- NASA space exploration projects

- Movie productions
- Building a ship
- Government-sponsored projects for developing a new weapons system
- Relocation of a major facility
- Maintenance of a nuclear reactor
- Installation of a management information system
- Conducting an advertising campaign.

PERT/CPM identify the time required to complete the activities in a project, and the order of the steps. Each activity is assigned an earliest and latest start time and end time. Activities with no slack time are said to lie along the critical path–the path that must stay on time for the project to remain on schedule.

CPM: Key Points

The critical path method (CPM) is a project modeling technique developed in the late 1950s by Morgan R. Walker of DuPont and James E. Kelley Jr. of Remington Rand. CPM computes the longest path of planned jobs/activities to logical end points/the end of the project, and the earliest and latest time by which each activity can start and finish without making the project longer. This process determines the activities that are "critical" or on the longest path and having "total float" (i.e., can be delayed without making the project longer).

Critical Path Analysis is an effective and powerful method of assessing:

- What jobs/activities must be carried out.
- Where parallel activities can be performed.
- The shortest time to complete a project.
- Resources needed for a project.
- The sequence of activities, scheduling and timings.
- Task priorities.
- The most efficient way of shortening time on urgent projects.

An effective Critical Path Analysis can make the difference between success and failure on complex projects. It can be very useful for assessing the importance of problems faced during the implementation of the plan.

Steps in PERT and CPM

(i) Each project consists of numerous independent jobs/activities. It is vital to identify and distinguish the various activities required for the completion of the project and list them separately.

(ii) After listing, the order of precedence for these jobs needs to be determined. Certain jobs will have to be done first. Therefore, jobs have to be completed before others should be determined. Also, a number of jobs may be carried out simultaneously. All such these relationships between the different jobs need to be clearly laid down.

(iii) Then, a picture/graph portraying each of these jobs should be drawn showing the predecessor and successor relations among them. This graph shows the time required for completion of each job. This is known as the project graph or the arrow diagram.

The three steps given above can be understood with the help of an example. Suppose, a manger wishes to draw a project graph for preparing an operating budget for a manufacturing firm. To accomplish this project, the company salesmen must provide sales estimates in units for the period to the sales manager who would consolidate it and provide it to the production manager. He would also estimate market prices of the sale and give the total value of sales of the units to be produced and assign machines for their manufacture. He would also plan the requirements of labour and other inputs and give all these schedules together with the number of units to be produced to the accounts manager who would provide cost of production data to the budget officer.

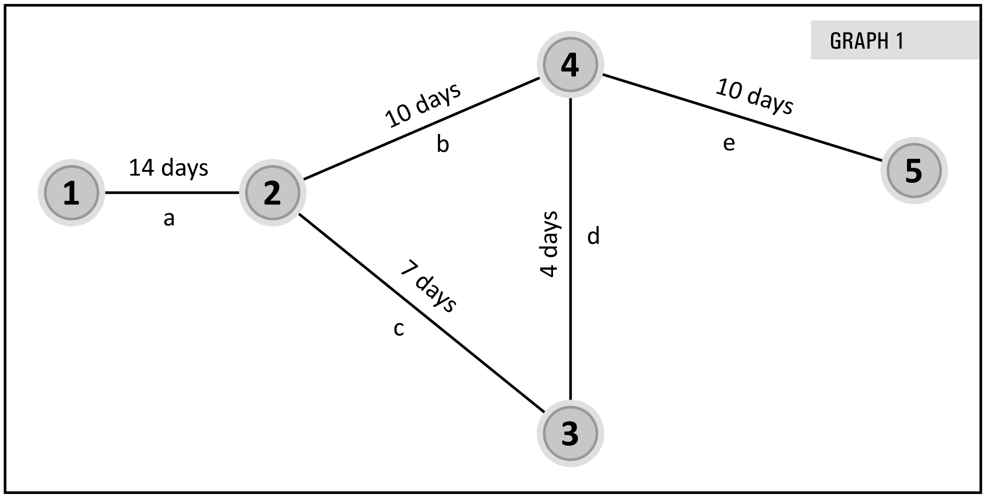
Using the information provided by the sales, production and accounting departments, and the budget officer would make the necessary arrangements for internal financing and prepare the budget. We have seen that the project of preparing the budget involves a number of activities.

These activities listed in the order of precedence are given below:

Table 1: The project of budgeting for a company

Job identification	***Alternate***	***Description***	***Deptt.***	***Time of performing the job***
a	(1.2)	Forecasting units of sale	Sales	14 Days
b	(2.4)	Pricing sales	Sales	10 Days
c	(2.3)	Preparing production schedules	Production	7 Days
d	(3.4)	Costing the production	Accounting	10 Days
e	(4.5)	Preparing the budget	Budget	10 Days
				45 days

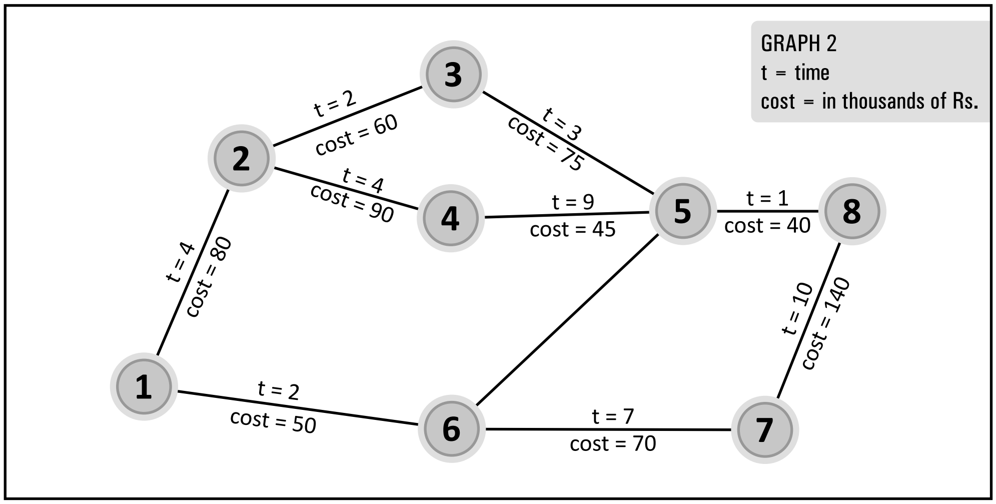
In this graph jobs are shown as arrows leading from one circle on the graph to another. Thus, the arrow connecting the two circles represents a job. Circle one and two represent job a i.e. forecasting of units sale which would take 14 days.



Path	No of Days Required					
1 - 2 - 4 - 5	14 + 10 + 10 = 34 Days					
1 - 2 - 3 - 4 - 5	14 + 7 + 4 + 10 = 35 Days	Critical duration.	Path	being	the	longest

Circles 2 and 4 represent job (b) which will take ten days and so on. It would be seen that job (c) is not dependent upon job b and therefore, the two jobs can be done simultaneously. Once we reduce the project to network of activities and events and we estimate activity durations, we are in a position to determine the minimum time required for completion of the whole project. To do so, one must find the longest path or sequence connecting the activities through the network. This is called the 'critical path' of the project. In ongoing example, there are two paths. One is connecting circle numbers 1, 2, 4 and 5. This path will take 14+10 + 10 = 34 days. The other path, is connecting circles 1,2,3,4 and 5, this path will take 14 + 7 + 4+ 10 = 35 days. Clearly, the 2nd path is the critical path. It may, however, be noticed that this time is shorter than the total time listed under Table 1 which will be 45 days. This is because jobs b and c can be done simultaneously.

This technique is very useful in case of projects which involve a large number of activities. It makes the project manager list out all the possible activities, their relationships, find out which activities can be performed first, which next and which can be performed simultaneously so as to find out the best possible manner of completing the project.



In the above diagram the project has the following paths

Path	No of Days Required	
1 - 2 - 3 - 5 - 8	4 + 2 + 3 + 1 = 10 Days	
1 - 2 - 4 - 5 - 8	4 + 4 + 9 + 1 = 18 Days	
1 - 6 - 5 - 8	2 + 5 + 1 = 8 Days	
1 - 6 - 7 - 8	2 + 7 + 10 = 19 Days	Critical Path being the longest duration

Advantages of PERT

1. Compels managers to plan their projects critically in considerable detail from beginning to the end and analyse all factors affecting the progress of the plan.
2. Provides management a tool for forecasting the impact of schedule changes. The likely trouble spots are located early enough to take preventive measures or corrective actions.
3. A considerable amount of data may be presented in a precise manner. The task relationships are presented graphically for easier evaluation.

4. The PERT time is based upon 3-way estimate and hence is the most objective time in the light of uncertainties and results in greater degree of accuracy in time forecasting.
5. Results in improved communication with all concerned parties such as designers, contractors, project managers etc. The network will highlight areas that require attention of higher priority to the key jobs without ignoring the lower priority tasks.

Limitations of PERT

1. Uncertainly about the estimate of time and resources as it is based on assumptions.
2. The costs may be higher than the conventional methods of planning and as it needs a high degree of planning skill and minute details resulting in rise in time and manpower resources.
3. Not suitable for relatively simple and repetitive processes such as assembly line work which are fixed-sequence jobs.

Comparison Chart

BASIS FOR COMPARISON	***PERT***	***CPM***
Meaning	PERT is a project management technique, used to manage uncertain activities of a project	CPM is a statistical technique of project management that manages well defined activities of a project
What is it?	A technique of planning and control of time	A method to control cost and time
Orientation	Event-oriented	Activity-oriented
Evolution	Evolved as Research & Development project	Evolved as Construction project
Model	Probabilistic Model	Deterministic Model
Main Focus	Time	Time-cost trade-off
Appropriateness	High precision time estimate	Reasonable time estimate
Activities Management	Unpredictable Activities	Predictable activities
Nature of jobs	Non-repetitive nature	Repetitive nature
Critical and Non-critical activities	No differentiation	Differentiated
Suitability	Research and Development Project	Non-research projects like civil construction, ship building etc.

PORTFOLIO ANALYSIS

Majority of business organisations have a portfolio of products on offer to their customers, rather than individual products or brands, and will in many cases have branded products which complement each other is some way. Analysis of such portfolio becomes a necessity as the strengths and weaknesses of a company in such portfolio determine its internal capabilities to compete in a market and fulfil customer expectations. The tool to identify the strengths and weaknesses of a company is a Product Portfolio Analysis. The Product Portfolio Analysis was proposed in 1973 by Peter Drucker as a way to classify current and expected profitability. Drucker classified the offerings of a particular company into seven categories i.e. Today`s Breadwinners, Tomorrow`s Breadwinners, Yesterday`s Breadwinners, Developments, Sleepers, Investments in Managerial Ego, and Failures. He classified products in the first three categories, “Today`s Breadwinners,” “Tomorrow`s Breadwinners,” and “Yesterday`s Breadwinners,” as strengths of the company while those in the last two categories, “Investments in Managerial Ego” and “Failures,” as weaknesses. Then such portfolio analysis was made by other renowned entities also. The most quoted ones are:

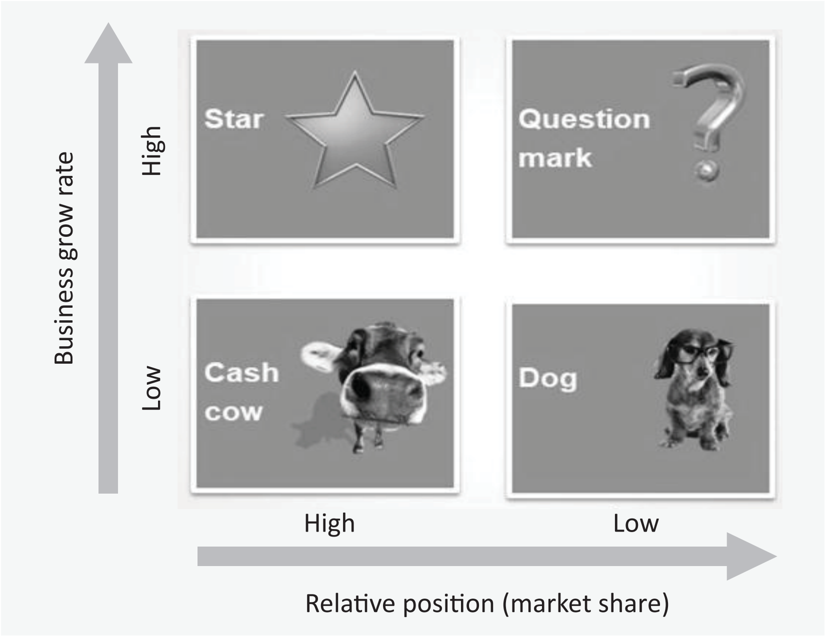
BCG MATRIX

“A company should have a portfolio of products with different growth rates and different market shares. The portfolio composition is a function of the balance between cash flows.... Margins and cash generated are a function of market share.”—Bruce Henderson, “The Product Portfolio,” 1970.

The BCG Matrix was developed by the Boston Consulting Group (BCG) and is used for the evaluation of the organization’s product portfolio in marketing and sales planning. BCG analysis is mainly used for Multi-Category/ Multi Product companies. All categories and products together are said to be the part of a Business portfolio. It aims to evaluate each product, i.e. the goods and services of the business in two dimensions:

- Market growth
- Market share

The combination of both dimensions creates a matrix into which the products from the portfolio are placed:



1) Cash Cows

Cash cows are products which have a high market share in a low growing market (see diagram above). As the business growth rate of market is low, cash cow gains the maximum advantage by generating maximum revenue due to its higher market share. Therefore, for any company, the cash cows is the category of products which require minimal investment but ensure higher returns. These higher returns raise the level of overall profitability of the firm because such excess revenue generation can be used in other businesses which carry products falling in the category of Stars, Dogs or Question marks.

Strategies for cash cow – Cash cows are the most stable product/service line for any business and hence the strategy includes retention of the market share for such category. As the market growth rate is low and acquisition is less and customer retention is higher. Thus, customer satisfaction programs, loyalty programs and other such promotional methods form the core of the marketing plan for a cash cow product.

2) Stars

The products/services falling in this category are best products/services in the product portfolio of any company. This is so because, for such category of products, both market share as well as growth rate is high. Unlike cash cows, Stars cannot be complacent when they are top on because they can immediately be overtaken by another company which capitalizes on the market growth rate. However, if the strategies are successful, a Star can become a cash cow in the long run.

Strategies for Stars – All types of marketing, sales promotion and advertising strategies are used for Stars. Similarly in Stars, because of the high competition and rising market share, the concentration and investment need to be high in marketing activities so as to increase and retain market share.

3) Question Marks

Several times, a company might come up with an innovative product which immediately gains good growth rate. However, the market share of such a product is unknown. The product might lose customer interest and might not be bought anymore in which case it will not gain market share, the growth rate will go down and it will ultimately become a Dog.

On the other hand, the product might increase customer interest and more and more people might buy the product thus making the product a high market share product. From here the product can move on to be a Cash Cow as it has lower competition and high market share. Thus, Question marks are products which may give high returns but at the same time may also flop and may have to be taken out of the market. This uncertainty gives the quadrant the name "Question Mark". The major problem associated with having Question marks is the amount of investment which it might need and whether the investment will give returns in the end or whether it will be completely wasted.

Strategies for Question marks – As they are new entry products with high growth rate, the growth rate needs to be capitalized in such a manner that question marks turn into high market share products. New Customer acquisition strategies are the best strategies for converting Question marks to Stars or Cash cows. Furthermore, time to time market research also helps in determining consumer psychology for the product as well as the possible future of the product and a hard decision might have to be taken if the product goes into negative profitability.

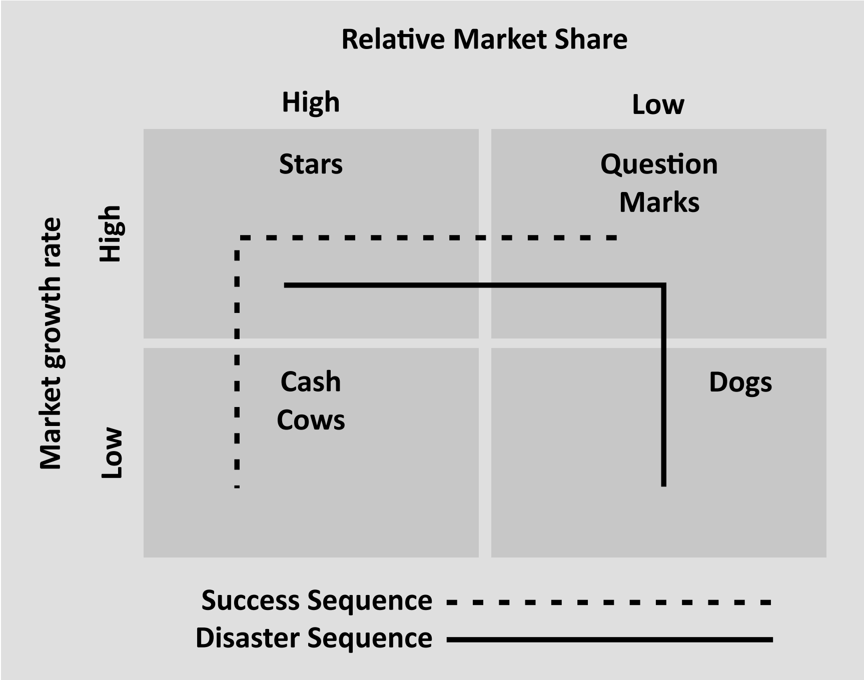
4) Dogs

$$\text{Relative Market Share} = \frac{\text{Your firm's market share (or revenues)}}{\text{Largest competitor's market share (or revenues)}}$$

Products are classified as dogs when they have low market share and low growth rate. Thus, these products neither generate high amount of cash nor require higher investments. However, they are considered as negative profitability products mainly because the money already invested in the product can be used somewhere else. Thus, over here businesses have to take a decision whether they should divest these products or they can revamp them and thereby make them saleable again which will subsequently increase the market share of the product.

Strategies for Dogs – Depending on the amount of cash which is already invested in this quadrant, the company can either divest the product altogether or it can revamp the product through rebranding / innovation / adding features etc. However, moving a dog towards a star or a cash cow is very difficult. It can be moved only to the question mark region where again the future of the product is unknown. Thus, in cases of Dog products, divestment strategy is used.

Sequences in BCG Matrix



Success Sequence in BCG Matrix – The Success sequence of BCG matrix happens when a question mark becomes a Star and finally it becomes a cash cow. This is the best sequence which really give a boost to the companies' profits and growth. The success sequence unlike the disaster sequence is entirely dependent on the *right decision making*.

Disaster sequence in BCG Matrix – Disaster sequence of BCG matrix happens when a product which is a star, due to competitive pressure might be moved to a question mark. It fails out from the competition and it is moved to a dog and finally it may have to be divested because of its low market share and low growth rate. Thus, the disaster sequence might happen because of wrong decision making. This sequence affects the company as a lot of investments are lost to the divested product. Along with this the money coming in from the cash cow which is used for other products too is lost.

Steps in BCG Matrix

BCG matrix is a framework to help understand, which brands the firm should invest in and which ones should be divested. Following are the steps involved:

- Step 1. Choose the unit
- Step 2. Define the market

- Step 3. Calculate relative market share
- Step 4. Find out market growth rate
- Step 5. Draw the circles on a matrix

Step 1. Choose the unit. BCG matrix can be used to analyze SBUs, separate brands, products or a firm as a unit itself. Which unit will be chosen will have an impact on the whole analysis. Therefore, it is essential to define the unit for which you'll do the analysis.

Step 2. Define the market. Defining the market is one of the most important things to do in this analysis. This is because incorrectly defined market may lead to poor classification. For example, if we would do the analysis for the Daimler's Mercedes-Benz car brand in the passenger vehicle market it would end up as a dog (it holds less than 20% relative market share), but it would be a cash cow in the luxury car market. It is important to clearly define the market to better understand firm's portfolio position.

Step 3. Calculate relative market share. Relative market share can be calculated in terms of revenues or market share. It is calculated by dividing your own brand's market share (revenues) by the market share (or revenues) of your largest competitor in that industry. For example, if your competitor's market share in refrigerator's industry was 25% and your firm's brand market share was 10% in the same year, your relative market share would be only 0.4. Relative market share is given on x-axis. It's top left corner is set at 1, midpoint at 0.5 and top right corner at 0 (see the example below for this).

$$\text{Relative Market Share} = \frac{\text{Your firm's market share (or revenues)}}{\text{Largest competitor's market share (or revenues)}}$$

Step 4. Find out market growth rate. The industry growth rate can be found in industry reports, which are usually available online for free. It can also be calculated by looking at average revenue growth of the leading industry firms. Market growth rate is measured in percentage terms. The midpoint of the y-axis is usually set at 10% growth rate, but this can vary. Some industries grow for years but at average rate of 1 or 2% per year. Therefore, when doing the analysis you should find out what growth rate is seen as significant (midpoint) to separate cash cows from stars and question marks from dogs.

Step 5. Draw the circles on a matrix. After calculating all the measures, you should be able to plot your brands on the matrix. You should do this by drawing a circle for each brand. The size of the circle should correspond to the proportion of business revenue generated by that brand.

Strategies based on the BCG Matrix.

There are four strategies possible for any product / SBU and these are the strategies which are used after the BCG analysis. These strategies are:

1) **Build –** By increasing investment, the product is given an impetus such that the product increases its market share. Example – Pushing a Question mark into a Star and finally a cash cow (Success sequence).

2) **Hold –** The company cannot invest or it has other investment commitments due to which it holds the product in the same quadrant. Example – Holding a star there itself as higher investment to move a star into cash cow is currently not possible.

3) **Harvest –** Best observed in the Cash cow scenario, wherein the company reduces the amount of investment and tries to take out maximum cash flow from the said product which increases the overall profitability.

4) **Divest –** Best observed in case of Dog quadrant products which are generally divested to release the amount of money already stuck in the business.

Thus, the BCG matrix is the best way for a business portfolio analysis. The strategies recommended after BCG analysis help the firm decide on the right line of action and help them implement the same.

THE ORIGINAL BCG MATRIX

At the height of its success, in the late 1970s and early 1980s, the growth share matrix (or approaches based on it) was used by about half of all Fortune 500 companies, according to estimates.

The matrix helped companies decide which markets and business units to invest in on the basis of two factors—company competitiveness and market attractiveness—with the underlying drivers for these factors being relative market share and growth rate, respectively. The logic was that market leadership, expressed through high relative share, resulted in sustainably superior returns. In the long run, the market leader obtained a self-reinforcing cost advantage through scale and experience that competitors found difficult to replicate. High growth rates signaled the markets in which leadership could be most easily built.

Putting these drivers in a matrix revealed four quadrants, each with a specific strategic imperative. Low-growth, high-share "cash cows" should be milked for cash to reinvest in high-growth, high-share "stars" with high future potential. High-growth, low-share "question marks" should be invested in or discarded, depending on their chances of becoming stars. Low-share, low-growth "pets" are essentially worthless and should be liquidated, divested, or repositioned given that their current positioning is unlikely to ever generate cash.

The utility of the matrix in practice was two fold:

- The matrix provided conglomerates and diversified industrial companies with a logic to redeploy cash from cash cows to business units with higher growth potential. This came at a time when units often kept and reinvested their own cash—which in some cases had the effect of continuously decreasing returns on investment. Conglomerates that allocated cash smartly gained an advantage.
- It also provided companies with a simple but powerful tool for maximizing the competitiveness, value, and sustainability of their business by allowing them to strike the right balance between the exploitation of mature businesses and the exploration of new businesses to secure future growth.

Criticism of the BCG Matrix

The BCG Matrix has lost some of its popularity following the development of other models, and drawn criticism for making some false suppositions such as:

- It assumes that a business unit with a higher market share will generate more cash. While it has been observed that a unit that has a high market share needs to keep investing in itself to sustain this share and, therefore, may absorb cash instead of generating it.
- Also, the matrix seems to ignore interdependencies among a corporation's business units. A dog, for example, may be helping a question mark or a star with cash.
- The matrix also seems to use broad definitions of market share and market growth overlooking niche market — a unit that makes scooter tyres, for instance, may have a big market share in this niche segment, but only a minuscule share of the overall tyre market. The corporation that owns this unit may be using it as a cash cow for the benefit of a "star" or a "question mark" in its portfolio.
- The matrix has also been criticised for suggesting that all corporations will identify units or products in the four quadrants, and that units or products will travel through all the four quadrants in their life cycles.

- The market growth rate is only one factor that makes an industry attractive. Similarly, relative market share is only one factor that gives a unit a competitive advantage. According to critics, the matrix ignores other factors that determine profitability. At least some critics suggest the use of the GE/McKinsey Matrix.
- The market share of the matrix does not guarantee profitability.
- The BCG matrix does not consider decreasing markets enough; Cash Cows could disappear without reason.
- Both axes have been assigned the same value. In practice, this value can depend on the strategy.
- The coherence as regards content between products and product groups is not incorporated.
- The BCG matrix does not show what the competition is doing.
- The BCG matrix may oversimplify the assessments of the facts.

BCG's Response to Criticism : Matrix 2.0

In a paper published in 2014, the BCG, while defending the basic principles of the matrix, acknowledges that the business world and the distribution of companies across the matrix have changed.

It recommends "strategic experimentation [with the original matrix] to allow adaptation to an increasingly unpredictable business environment."

The paper admits that in the modern business environment, the matrix needs "a new measure of competitiveness to replace its horizontal axis," as market share cannot be relied upon as a strong pointer to performance anymore.

It says companies need to look at new markets and products to renew their advantage and desist from wasting resources. They need to invest in more question marks to help the promising ones grow into stars.

Responding to the marketplace, they should also cash out stars, retire cows, and maximize the information value of pets.

The BCG gives the example of Google, with its portfolio of AdWords, AdSense, Android, and other products, and says that at that company, portfolio management is "embedded in organizational abilities that facilitate strategic experimentation."

At Google, questions marks are generated, and a few are selected and tried out before they are scaled up.

Making suggestions for using "BCG Matrix 2.0," the paper puts forward "four practical imperatives" that businesses can use in strategic experimentation.

BCG Matrix- Samsung's Product Portfolio

Samsung is a conglomerate consisting of multiple strategic business units (SBUs) with a diverse set of products. Samsung sells phones, cameras, TVs, microwaves, refrigerators, laundry machines, and even chemicals and insurances. This is a smart corporate strategy to have because it spreads risk among a large variety of business units. In case something might happen to the camera industry for instance, Samsung is still likely to have positive cash flows from other business units in other product categories.

This helps Samsung to cope with the financial setback elsewhere. However even in a well-balanced product portfolio, corporate strategists will have to make decisions on allocating money to and distributing money across all of those business units. Where to put most of the money and where should one perhaps divest? The BCG Matrix uses Relative Market Share and the Market Growth Rate to determine that.

Relative Market Share

The creator of the BCG Matrix used this variable to actually measure a company's competitiveness. The exact measure for *Relative Market Share* is the focal company's share relative to its largest competitor. So, if Samsung has a 20 percent market share in the mobile phone industry and Apple (its largest competitor) has 60 percent so to speak, the ratio would be 1:3 (0.33) implying that Samsung has a relatively weak position. If Apple only had a share of 10 percent, the ratio would be 2:1 (2.0), implying that Samsung is in a relatively strong position, which might be reflected in above average profits and cash flows.

The cut-off point here is 1.0, meaning that the focal company should at least have a similar market share as its largest competitor in order to have a high relative market share. The assumption in this framework is that an increase in relative market share will result in an increase in the generation of cash, since the focal company benefits from economies of scales and thus gains a cost advantage relative to its competitors.

Market Growth Rate

The second variable is the *Market Growth Rate*, which is used to measure the market attractiveness. Rapidly growing markets are what organizations usually strive for, since they are promising for interesting returns on investments in the long term. The drawback however is that companies in growing markets are likely to be in need for investments in order to make growth possible. The investments are for example needed to fund marketing campaigns or to increase capacity. High or low growth rates can vary from industry to industry, but the cut-off point in general is usually chosen around 10 percent per annum. This means that if Samsung would be operating in an industry where the market is growing 12 percent a year on average, the market growth rate would be considered high.

ANSOFF GROWTH MATRIX – FOUR WAYS TO GROW A BUSINESS

This matrix is also known as the **Ansoff Product-Market Growth matrix** or the four ways to grow a business model.

What is the Ansoff Growth Matrix?

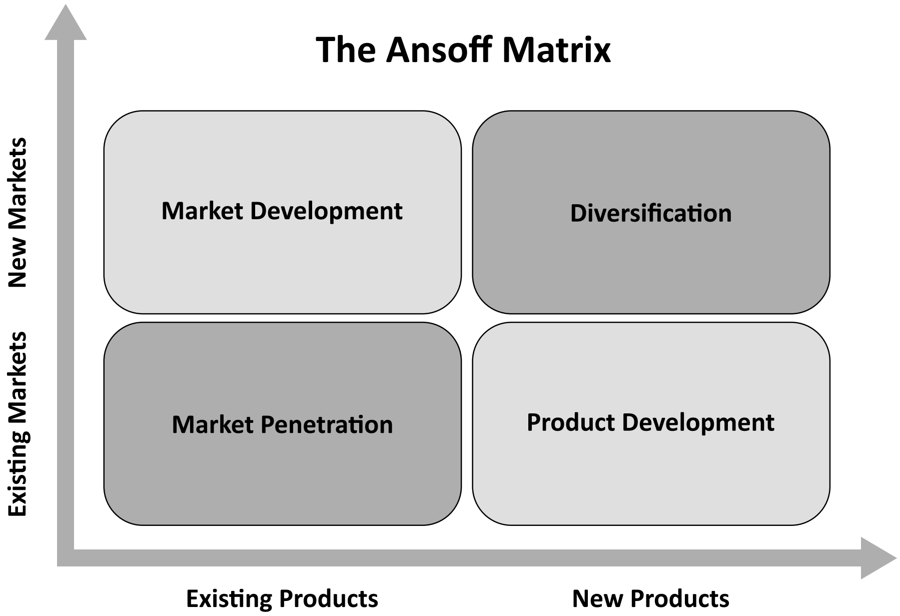
It first appeared in the Harvard Business Review in 1957 and was created by strategist Igor Ansoff to help management teams to focus on the options for business growth. In common with other popular strategy models, it is build around a two by two matrix.

- current products or new products
- current markets or new markets

The Four Growth Options of The Ansoff Growth Matrix

- Market penetration strategy – current products and current markets
- Product development strategy – new products and current markets
- Market development strategy – current products and new markets
- Diversification – new products and new markets.

These are best seen in a diagram



Option 1: Market Penetration

Market penetration strategy is the preferred route to growth for many businesses because its focus is on selling more of the existing products to:

- Current customers;
- Customers similar to current customer base but who are buying competitors products;
- Customers similar to current customer base who have need of product but aren't buying it yet.

The emphasis is on escalating market share by making some rigorous marketing promotions, or by creating more customer value.

The market penetration option within Ansoff's growth matrix uses existing resources and capabilities and can be thought of as "business as usual but on steroids".

The downsides of the market penetration strategy are:

- If a firm has already high market share, the opportunities for growth may be limited. Some markets logically limit the share of the leading player because they feature the concentration of market power.
- Aggressive market penetration strategies will add to competitive rivalries in the industry and may provoke a price war which shrinks industry profitability. To make significant increases in market share, the business must be willing to throw the competitors out of the market.
- Increasing exposure to one product-market segment can make the business more susceptible to future changes in competition by keeping "all the eggs in one basket".

Option 2: Product Development

In product development, businesses continue to focus on the needs of existing customer base and also the widen customer market they represent but they seek to understand their underlying needs so they can see opportunities for new products:

- To replace present product profile with new and better products.

- To provide products which complement the main product sold by the business.
- To provide "one stop shop" by adding new products to value chain to strengthen or leverage the relationship and to provide added convenience.

You may attract new competitors into your market as a respond to you offering the products they traditionally sell. Competition has shifted up a level from coexistence selling your specific products to active competition selling the same broader range.

Option 3: Market Development

The third option suggested by Ansoff is to take the current products and find new markets for them. There are different ways to do this:

- Opening up previously excluded market segments through pricing policies e.g. discounts for students and old age pensioners at theatres.
- New marketing and distribution channels. Making a product available on the Internet with the necessary search engine optimisation means that anyone looking can find it, rather than rely on your marketing message to reach them by convention means. The supermarkets sell financial services to people who wouldn't contact a broker or agent.
- Entering new geographic markets by moving from local to regional to national and finally international. This may require the business to acquire new capabilities including exporting, understanding different cultures and language skills.

The strength of this option from the Ansoff Growth matrix is that it puts the pressure on the marketing and sales functions of the business and leaves the operations/supply side to concentrate on what it does best.

Some product development may be inevitable as there are few global products that don't make any concessions to local market needs. Success depends on being able to identify the best markets to develop which offer a genuine opportunity and where you have an effective competitive advantage. It also requires knowing which markets to avoid either because they are too difficult, too different or risk competitive reaction.

Again, your action to expand your market may attract the attention of competitors who currently only trade in zones where you don't.

Option 4: Diversification

This option is the most controversial since diversification involves taking new products to new customers. There are three levels of diversification:

- Diversification into related markets – while the customers and products are both new, there is a logic about the move that makes sense to the outside world.
- Diversification into unrelated markets using existing resources and capabilities – while the customers and products are different, they all rely on the existing strengths of the business. Metal fabricators and plastic extrusion manufacturers are able to move across markets and produce custom designed products relatively easily because customers are buying access to the core competences.
- Diversification into unrelated markets which require new resources and capabilities.
- Diversification is the most risky growth strategy in Ansoff's growth matrix and especially if it requires the development of new resources and capabilities. It has even been referred to as the "suicide cell".

The big advantage of diversification is that while each move is risky, if it is successful, it reduces the overall risk of the business to factors outside of the control of the business like the wider economic environment, climate change etc. It may also make the business much less seasonal – think bikinis and other swimwear for the summer, umbrellas for the spring and autumn and heavy overcoats for the winter.

It may also help the business to move away from industries that are unattractive because they are super-competitive or in long term decline to fast growing, new markets.

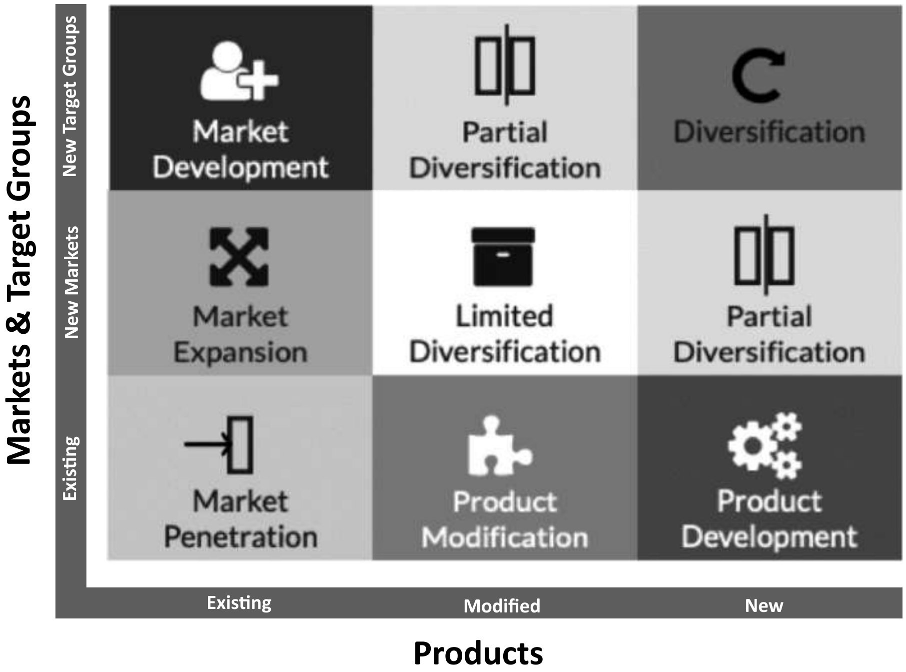
How to use Ansoff Growth Matrix

There are two ways to use the Ansoff Growth Matrix:

1. As a tool for brainstorming to help identify possible strategic options.
2. As a tool for assessing preferred strategic options to check for some kind of balance. There aren't right or wrong answers but you might be shocked to discover that all six growth strategies you intend to follow fall into the diversification box.

Developments to the Ansoff Growth Matrix

The original matrix developed by Ansoff was the simple 2 x 2 matrix presented above. Ansoff later refined the matrix into a 3 dimensional version which is placed below.



Others have turned the matrix from 2×2 into 3×3 by introducing middle categories for expanded markets and modified products to give more flexibility to the tool. This allows shading from "a little different" to "very different".

ADL MATRIX

The Arthur D. Little provides with the ADL matrix that is a portfolio management method based on thought of product life cycle. The ADL portfolio management involves the dimensions of environmental assessment and business strength assessment. The environmental assessment approaches to industry maturity whereas business strength assessment leads to competitive position. In determining both assessments, the matrix helps out the firms in analyzing their business role in the market place (Porter, 2008).

ADL Matrix (Portfolio Management)

		Industry Life Cycle Stage			
		Embryonic	Growth	Mature	Aging
Competitive Position	Dominant	All out push for share. Hold Position.	Hold Position. Hold Share.	Hold Position. Grow with Industry.	Hold Position.
	Strong	Attempt to improve position. All out push for share.	Attempt to improve position. Push for share.	Hold Position. Grow with Industry.	Hold position or Harvest
	Favorable	Selective or all out push for share. Selectively attempty to improve position.	Attempt to improve position. Push for share.	Custodial or maintenance. Find niche and attempt to protect it.	Harvest, or phase out withdrawal.
	Tenable	Selectively push for position.	Find niche and protect it.	Find niche and hang on, or phased out withdrawal.	Phased out withdrawal, or abandon.
	Weak	Up or out	Turnaround or abandon.	Turnaround, orphaned out withdrawal.	Abandon

Industry Maturity or Life Cycle stage

In ADL portfolio management, industry maturity is very close to the product life cycle or it could be renamed as industry life cycle, though with the industry segments are also considered. Industry maturity is classified in four following divisions:

- **Embryonic:** It involves the introduction stage by following rapid market growth, no or little competition, high prices and investments and new technology.
- **Growth:** In this stage, market is strengthening as the sales increases, few competitors make an appearance and company achieves excellence in bringing up a new product.
- **Mature:** At maturity stage the market is completely stable with well established base of customers and market shares are also stable. Customers are making repeated orders, but, with a lot of competitors, the company has to make efforts in differentiating their product from competitors.
- **Aging:** The last stage of the market in which market volume shrinks as the demand declines, snatching market shares from the competitors becomes difficult, then company requires innovating or modifying the product or to make an exit.

The assessments of the industry life cycle are based on the facts like business market share, investment, profitability and cash flow.

Competitive Position

Competitive position is derived from different segments in which Strategic Business Unit operates. It is more focused on the organization's competitive position which involves the strong strength of the product and the dispersed geographical factors means that it works in the area of product and place (Peter, 2008). Competitive position comprises of five categories that are:

Dominant: this is a rare phenomenon , as it is a near monopoly situation, appears in results of innovative out of the box product/technology is introduced in the market by a very strong brand.

Strong: market share is higher as the position of company is comparably powerful although the competitors are working aggressively.

Favorable: Company has a strong edge in certain limited segments of its competitive strengths. Strength of the product and geographical advantages are taken into consideration at this stage and need to be constantly protected.

Tenable: - The company keeps strong position in small niche, specific geographic location or very focused product differences. The force of competitors strengthens and causes difficulties for the company.

Weak: The profitability is not satisfactory making position of the company unattractive, the market share is declining though they have opportunities in order to enhance their potion in the market and becoming favorable.

How to use ADL Matrix?

Following are the steps that are involved in using the ADL Matrix (Herman, 2006):

- Identify the industry maturity category;
- Determining competitive position;
- Plot the position of the matrix.

GE MCKINSEY MATRIX

GE McKinsey Matrix is a strategy tool for a multi business corporation used in brand marketing and product management that assists a company to decide about the products to be added to its portfolio and opportunities to be prioritized in the market for investment. It is a framework that evaluates business portfolio, provides further strategic implications and helps to prioritize the investment needed for each business unit (BU).

Though it is conceptually similar to BCG analysis, but somewhat more complicated than BCG Matrix. This is so because, in BCG analysis, a two-dimensional portfolio matrix is created, while, with the GE model the dimensions are multi-factorial. One dimension comprises industry attractiveness measures; the other comprises of internal business strength measures. The GE matrix helps a strategic business unit (SBU) to evaluate its overall strength.

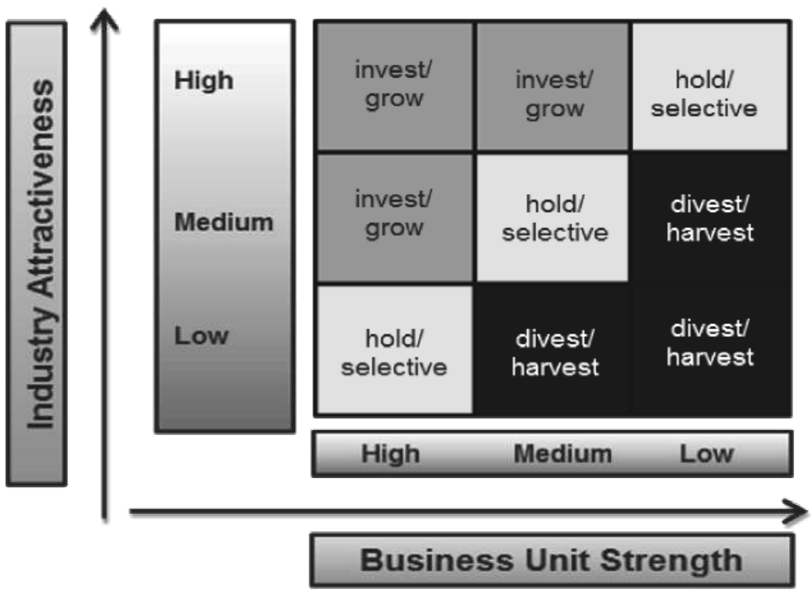
Understanding the tool

In the practical business world, the problem of resource scarcity has a bearing on the decisions made by any business organisation. Among such limited resources, as there are plenty of avenues to use such resources for many opportunities available, the crucial question remains how to use their cash best. Such a tussle takes place at every level in the company i.e. between teams, functional departments, divisions or business units.

This decision of resource allocation becomes even more crucial for a diversified businesses which are supposed to manage complex business portfolios involving as much as 50 to 100 products and services simultaneously. The products or business units are diverse in characteristics and future prospects. This makes it a tough decision to choose products/services for allocating resources.

Keeping this in mind, the BCG matrix and its improved version GE-McKinsey matrix was developed. In 1970s, General Electric was managing a huge and complex portfolio of unrelated products and was unsatisfied about the returns from its investments in the products. At the time, companies usually relied on projections of future cash flows, future market growth or some other future projections to make investment decisions, which was an unreliable method to allocate the resources. Therefore, GE consulted the McKinsey & Company and designed the nine-box framework.

The nine-box matrix plots the Business Units on 9 cells that indicate whether the company should invest in a product, harvest/divest it or do a further research on the product and invest in it if there're still some resources left. Both these tools have served the purpose by comparing the business units and dividing them in suitable groups as per their worth.



Industry Attractiveness

Industry attractiveness indicates how hard or easy it will be for a company to compete in the market and earn profits. The more profitable the industry is the more attractive it becomes. When evaluating the industry attractiveness, analysts should look how an industry will change in the long run rather than in the near future, because the investments needed for the product usually require long lasting commitment.

Industry attractiveness consists of many factors that collectively determine the competition level in it. There's no definite list of which factors should be included to determine industry attractiveness, but the following are the most common :

- Long run growth rate
- Industry size
- Industry profitability (by using Porter's Five Forces)
- Industry structure (by using Structure-Conduct-Performance framework)
- Product life cycle changes
- Changes in demand
- Trend of prices

- Macro environment factors (through use of PEST or PESTEL)
- Seasonality
- Availability of labor
- Market segmentation.

Competitive strength of a Strategic Business Unit or a Product

Along the X axis, the matrix measures how strong, in terms of competition, a particular business unit is against its rivals. In other words, managers try to determine whether a business unit has a sustainable competitive advantage (or at least temporary competitive advantage) or not. If the company has a sustainable competitive advantage, the next question is: "For how long it will be sustained?"

The following factors determine the competitive strength of a business unit:

- Total market share
- Market share growth compared to rivals
- Brand strength
- Profitability of the company
- Customer loyalty
- VRIO (Value, Rareness, Imitability, Organization) resources or capabilities
- business unit strength in meeting industry's critical success factors
- Strength of a value chain
- Level of product differentiation
- Production flexibility.

Using the tool

There are no established processes or models that managers could use when performing the analysis. Therefore, we designed the following steps to facilitate the process:

Step 1. Determine industry attractiveness of each business unit

- **Make a list of factors**: The first thing you'll need to do is to identify, which factors to include when measuring industry attractiveness. We've provided the list of the most common factors, but you should include the factors that are the most appropriate to your industries.
- **Assign weights**: Weights indicate how important a factor is to industry's attractiveness. A number from 0.01 (not important) to 1.0 (very important) should be assigned to each factor. The sum of all weights should equal to 1.0.
- **Rate the factors**: The next thing you need to do is to rate each factor for each of your product or business unit. Choose the values between '1-5' or '1-10', where '1' indicates the low industry attractiveness and '5' or '10' high industry attractiveness.
- **Calculate the total scores**: Total score is the sum of all weighted scores for each business unit. Weighted scores are calculated by multiplying weights and ratings. Total scores allow comparing industry attractiveness for each business unit.

This is a tough task and one that usually requires involving a consultant who is an expert of the industries in question. The consultant will help you to determine the weights and to rate them properly so the analysis is as accurate as possible.

Step 2. Determine the competitive strength of each business unit

'Step 2' is the same as 'Step 1' only this time, instead of industry attractiveness, the competitive strength of a business unit is evaluated.

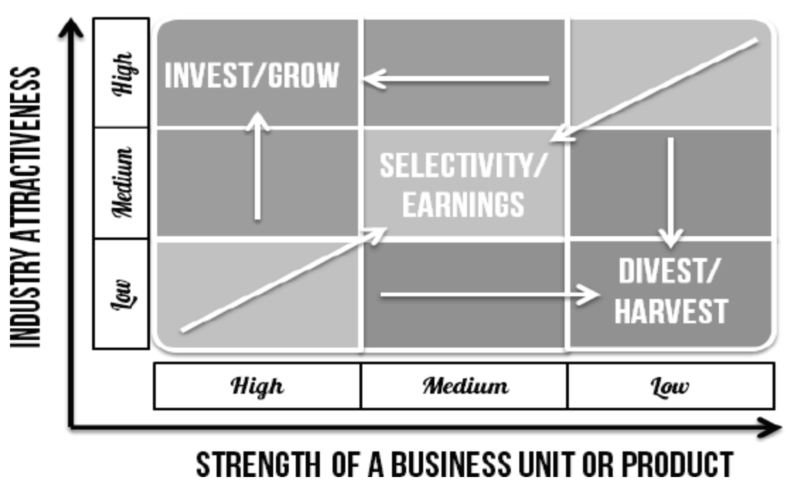
- **Make a list of factors:** Choose the competitive strength factors from our list or add your own factors.
- **Assign weights**: Weights indicate how important a factor is in achieving sustainable competitive advantage. A number from 0.01 (not important) to 1.0 (very important) should be assigned to each factor. The sum of all weights should equal to 1.0.
- **Rate the factors:** Rate each factor for each of your product or business unit. Choose the values between '1-5' or '1-10', where '1' indicates the weak strength and '5' or '10' powerful strength.
- **Calculate the total scores:** See 'Step 1'.

Step 3. Plot the business units on a matrix

With all the evaluations and scores in place, we can plot the business units on the matrix. Each business unit is represented as a circle. The size of the circle should correspond to the proportion of the business revenue generated by that business unit. For example, 'Business unit 1' generates 20% revenue and 'Business unit 2' generates 40% revenue for the company. The size of a circle for 'Business unit 1' will be half the size of a circle for 'Business unit 2'.

Step 4. Analyze the information

GE-MCKINSEY MATRIX INVESTMENT IMPLICATIONS



There are different investment implications you should follow, depending on which boxes your business units have been plotted. There are 3 groups of boxes: investment/grow, selectivity/earnings and harvest/divest boxes. Each group of boxes indicates what you should do with your investments.

Invest/Grow box. Companies should invest into the business units that fall into these boxes as they promise the highest returns in the future. These business units will require a lot of cash because they'll be operating in growing industries and will have to maintain or grow their market share. It is essential to provide as much resources as possible for BUs so there would be no constraints for them to grow. The investments should be provided for R&D, advertising, acquisitions and to increase the production capacity to meet the demand in the future.

Selectivity/Earnings box. You should invest into these BUs only if you have the money left over the investments in invest/grow business units group and if you believe that BUs will generate cash in the future. These business units are often considered last as there's a lot of uncertainty with them. The general rule should be to invest in business units which operate in huge markets and there are not many dominant players in the market, so the investments would help to easily win larger market share.

Harvest/Divest box. The business units that are operating in unattractive industries, don't have sustainable competitive advantages or are incapable of achieving it and are performing relatively poorly fall into harvest/divest boxes. What should companies do with these business units?

First, if the business unit generates surplus cash, companies should treat them the same as the business units that fall into 'cash cows' box in the BCG matrix. This means that the companies should invest into these business units just enough to keep them operating and collect all the cash generated by it. In other words, it's worth to invest into such business as long as investments into it doesn't exceed the cash generated from it.

Second, the business units that only make losses should be divested. If that's impossible and there's no way to turn the losses into profits, the company should liquidate the business unit.

Step 5. Identify the future direction of each business unit

The GE McKinsey matrix only provides the current picture of industry attractiveness and the competitive strength of a business unit and doesn't consider how they may change in the future. Further analysis may reveal that investments into some of the business units can considerably improve their competitive positions or that the industry may experience major growth in the future. This affects the decisions we make about our investments into one or another business unit.

For example, our previous evaluations show that the 'Business Unit 1' belongs to invest/grow box, but further analysis of an industry reveals that it's going to shrink substantially in the near future. Therefore, in the near future, the business unit will be in harvest/divest group rather than invest/grow box. Would you still invest as much in 'Business Unit 1' as you would have invested initially? The answer is no and the matrix should take that into consideration.

How to do that? Well, the company should consult with the industry analysts to determine whether the industry attractiveness will grow, stay the same or decrease in the future. You should also discuss with your managers whether your business unit competitive strength will likely increase or decrease in the near future. When all the information is collected you should include it to your existing matrix, by adding the arrows to the circles. The arrows should point to the future position of a business unit.

Step 6. Prioritize your investments

The last step is to decide where and how to invest the company's money. While the matrix makes it easier by evaluating the business units and identifying the best ones to invest in, it still doesn't answer some very important questions:

- Is it really worth investing into some business units?
- How much exactly to invest in?
- Where to invest into business units (to R&D, marketing, value chain) to improve their performance?

Doing the GE McKinsey matrix and answering all the questions takes time, effort and money, but it's still one of the most important product portfolio management tools that significantly facilitate investment decisions.

Advantages

- Helps to prioritize the limited resources in order to achieve the best returns.
- Managers become more aware of how their products or business units perform.
- It's more sophisticated business portfolio framework than the BCG matrix.
- Identifies the strategic steps the company needs to make to improve the performance of its business portfolio.

Disadvantages

- Requires a consultant or a highly experienced person to determine industry's attractiveness and business unit strength as accurately as possible.
- It is costly to conduct.
- It doesn't take into account the synergies that could exist between two or more business units.

STRATEGIC ALTERNATIVES

There are many strategic alternatives that can be adopted by an organisation to attain its objectives. The most famous ones are Glueck & Jauch Generic Strategic Alternative and Porter's Generic Strategies as discussed hereunder:

GLUECK & JAUCH GENERIC STRATEGIC ALTERNATIVE

While developing generic strategic taxonomies, the work of Glueck and Jauch (1984) is widely referred to. These authors developed a complex matrix involving expansion/retrenchment and stability aspects across products/ markets and functions. Using this matrix, Hitt et al. (1982) and Pearce et al. (1987) postulate that there exist four grand strategic alternatives:

- Stability;
- Internal growth;
- External acquisitive growth;
- Retrenchment.

Stability

The stability strategy involves the maintenance of the current business definition by safeguarding the existing interests and strengths. It continues to peruse its well established and tested objectives and goals and optimizes the resources committed to attain such goals. It may also change the pace of effort within its stable business definition in order to become more efficient or effective (Glueck and Jauch, 1984). Pearce et al. (1987) operationalise the stability strategy along four dimensions:

- Implemented wherein few functional changes are made in the products/markets;
- A business continues to serve existing customers in the same or similar market segment with same portfolio of products;
- Instead of a "do nothing" strategy, it is a "do nothing new" strategy;

- It has its sharp focus on incremental improvement of functional performance;
- It continues to pursue same set of objectives and goals; and
- The business adjusts the level of improvement he equivalent proportion every year;
- Involves keeping track of new developments to ensure that strategy continues to make sense.

The strategy is a substitute to growth or retrenchment strategy as goals (such as profit or growth) are not dumped, rather, returns can actually be increased, for instance by improving efficiency.

An internal growth (expansion) strategy

An internal growth strategy involves re-defining of business definition by substantially scaling the level of operations through internal development and not taking help of other corporations or businesses. Market penetration, market development and product development are emphasised to develop new products, enter new markets and embracing new technology.

- Implemented by redefining the business by adding business scope substantially, which increases the efforts of current business;
- Promising and famous strategy, which may take company along relatively less risky untraveled paths;
- Includes diversification, acquisition and mergers.

External expansion

Glueck and Jauch (1984) note that there are a number of terms used for external expansion. These include acquisitions, mergers (one business loses its identity), consolidations (both businesses lose their identity, and a new business arises) and joint ventures. The distinguishing feature of all external growth strategies, though, is that they involve another company or business.

Retrenchment

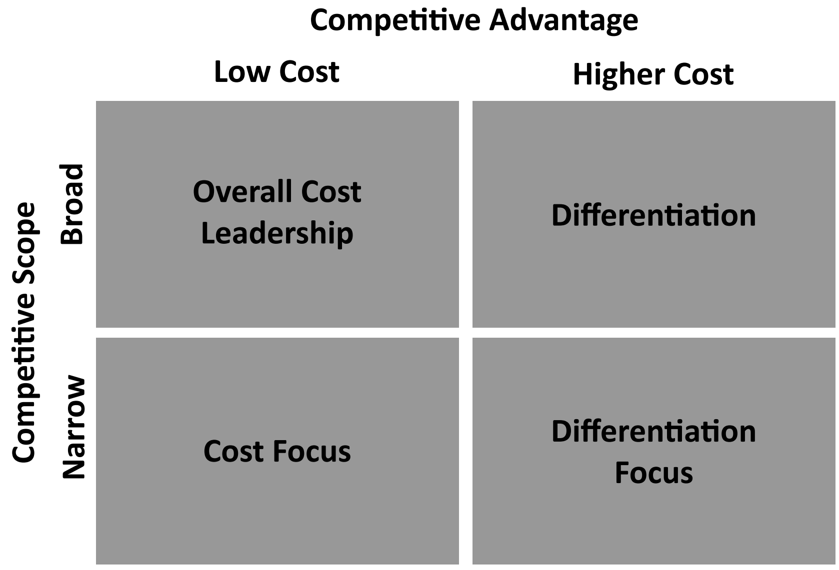
Pearce *et al.* (1987) operationalise a retrenchment strategy along three dimensions: improvement in performance by scaling down the level and/or scope of product/market objectives; cut back in costs; and reduction of the scale of operations through the divestment of some units or divisions. Glueck and Jauch (1984) also suggest that retrenchment also involves a reduction in functions. Internal retrenchment is, labelled as an operating turnaround strategy where the emphasis is on reducing costs, increasing revenues, reducing assets, and reorganising products and/or markets to achieve greater efficiency. External retrenchment constitutes a more serious form of strategic turnaround, including such measures as divestiture and liquidation. Glueck and Jauch's (1984) typology introduces the concepts of stability and external versus internal aspects of growth and retrenchment.

Combination Strategies

The above discussed strategies are not mutually exclusive but can be used in a combination to suit the needs of the organization.

PORTER'S GENERIC STRATEGIES

In 1985, in his book "Competitive Advantage: Creating and Sustaining Superior Performance" Michael Porter pronounced the three generic strategies namely "Cost Leadership" (no frills), "Differentiation" (creating uniquely desirable products and services) and "Focus" (offering a specialized service in a niche market). Thereafter, he then sub-divided the 'Focus' strategy into two parts: "Cost Focus" and "Differentiation Focus."



Porter's Generic Strategies

The Cost Leadership Strategy

This strategy also involves the firm winning market share by appealing to cost-conscious or price-sensitive customers. This is achieved by having the lowest prices in the target market segment, or at least the lowest price to value ratio (price compared to what customers receive). To succeed at offering the lowest price while still achieving profitability and a high return on investment, the firm must be able to operate at a lower cost than its rivals. There are three main ways to achieve this:

The first approach is achieving higher asset utilization. In manufacturing, it will involve production of high volumes of output. These approaches mean fixed costs are spread over a larger number of units of the product or service, resulting in a lower unit cost, i.e. the firm hopes to take advantage of economies of scale and experience curve effects.

The second dimension is achieving low direct and indirect operating costs. This is achieved by offering high volumes of standardized products, offering basic no-frills products and limiting customization and personalization of service.

The third dimension is control over the value chain including all functional groups (finance, supply/procurement, marketing, inventory, information technology etc.) to ensure low costs. Wal-Mart is known for squeezing its suppliers to price its products reasonably low.

The greatest risk in pursuing a Cost Leadership strategy is that the competitors may follow the same cost reduction strategies, therefore, the company has always to be on its toes to continuously reduce its cost. This can be done by adopting the Japanese Kaizen philosophy of "continuous improvement" among other techniques of reducing cost.

The Differentiation Strategy

A differentiation strategy is appropriate where the target customer segment is not price-sensitive, the market is competitive or saturated, customers have very specific needs which are possibly under-served, and the firm has unique resources and capabilities which enable it to satisfy these needs in ways that are difficult to copy.

Differentiation is deemed to be successful when a company is able to fetch a premium price for its products or services, has increased revenue per unit, or is able to retain loyalty of its customers. Differentiation drives profitability when the added price of the product outweighs the added expense to acquire the product or service. It can be achieved by excellent brand management which creates uniqueness in the image of the product/ service even when the actual product is the identical to competitors. Adopting this strategy, Apple could brand its i-phones, computers and i-pads; Mercedes-Benz C-Class could sell its cars as most expensive ones, Café Coffee Day could differentiate its coffee, and Nike could brand sports clothing and shoes. Fashion brands and multinational companies have to depend greatly on this strategy. However, this is not an apt strategy as it is not suitable for smaller companies but for big brands.

However, for ensuring success of its Differentiation strategy, a company must:

- Undertake high-quality research, development and innovation.
- Be able to deliver premium products/services.
- Rigorous branding and marketing about differentiated offerings.
- Need to stay agile with their new product development processes.

The Focus Strategy

The focus strategy is also known as ‘niche’ strategy. This is so because, companies adopting focus strategies focus on niche markets and, by get hold of the dynamics of such niche market and unique requirements of its customers. Based on such understanding, they develop exclusively low-cost products particularly for such niche market. Due to this, a strong brand loyalty is developed with its customers making it difficult for competitors to enter. Such a strategy is often used by small firms/companies.

Further, such companies may either use a ‘cost focus’ or a ‘differentiation focus’. While cost focus makes the firm the lowest cost producer in such niche or segment, differentiation focus creates competitive advantage through differentiation within the niche or segment.

LESSON ROUND-UP

- Strategic analysis and planning involve careful formulation of the strategies and goals taken by a company’s top management on behalf of the organization.
- A situational analysis takes into account the internal and external environment of an entity or organization and clearly identifies its own capabilities, customers, potential customers, competitors and the business environment and the impact they are going to have on the entity or organization.
- SWOT is a tool for strategic analysis of any organization, which takes into account both examination of the company’s internal as well as of its external environment.

- TOWS analysis scans opportunities and threats existing in external environment of any organization, and then generates, compares and selects strategies based on internal strengths and weakness to utilize such opportunities and reduce threats.
- PERT and CPM two complementary statistical techniques utilized in Project management. These two are network based scheduling methods that exhibit the flow and sequence of the activities and events.
- The tool to identify the strengths and weaknesses of a company is a Product Portfolio Analysis.
- The BCG Matrix was developed by the Boston Consulting Group (BCG) and is used for the evaluation of the organization's product portfolio in marketing and sales planning.
- GE McKinsey Matrix is conceptually similar to BCG analysis, but somewhat more complicated that BCG Matrix as in BCG analysis, a two-dimensional portfolio matrix is created, while, with the GE model the dimensions are multi-factorial.
- Strategic planning is an organization's process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy.
- There are many strategic alternatives that can be adopted by an organisation to attain its objectives. The most famous ones are Glueck & Jauch Generic Strategic Alternative and Porter's Generic Strategies.

GLOSSARY

Business Plan: These comprise the Corporate, Directorate, Service and Team plans, which specify the key priorities and activities to be undertaken.

Business Performance Management: A type of performance management that includes finance, covering compliance issues, competition, risk and profitability and human resources performance management encompassing employee performance appraisals and incentive compensation and other types of performance management include operational performance management and IT performance management.

Cascading: The process of developing aligned goals throughout an organization, connecting strategy to operations to tactics, allowing each employee to demonstrate a contribution to overall organizational objectives. Methods of cascading include identical (objectives and measures are identical), contributory (translated, but congruent, objectives and measures), unique (unique objectives and measures; do not link directly to parent) and shared (jointly- shared unique objective or measure).

Cause and Effect: The way perspectives, objectives, and/or measures interact in a series of cause-and-effect relationships demonstrate the impact of achieving an outcome. For example, organizations may hypothesize that the right employee training (Employee, Learning and Growth Perspective) will lead to increased innovation (Internal Process Perspective), which will in turn lead to greater customer satisfaction (Customer Perspective) and drive increased revenue (Financial Perspective).

Critical Success factor (CSF): A CSF is a business event, dependency, product, or other factor that, if not attained, would seriously impair the likelihood of achieving a business objective. This term is always included in a glossary of strategic terms.

Internal Process Perspective: The perspective used to monitor the effectiveness of key processes at which the organization must excel in order to achieve its objectives and mission.

Matrix: "A 'matrix' is "a structure that assigns specialists from functional departments to work on one or more interdisciplinary team that are led by project leaders" (Burton & Obel, 2004)."

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What is situation analysis? What is the need and timeline?
2. What are the elements of situation analysis?
3. Define SWOT.
4. Define TOWS.
5. Discuss TOWS strategies in detail.
6. What is PERT and CPM? What is the difference between the two?
7. Discuss steps in PERT/CPM.
8. What is Portfolio analysis?
9. What is BCG matrix? Discuss steps.
10. What is Ansoff Growth matrix? Discuss its four growth options.
11. What is ADL matrix?
12. Discuss GE McKinsey Matrix in detail.
13. Define strategic planning.
14. Discuss Glueck & Jauch Generic Strategic Alternative.
15. Discuss Porter's Generic Strategies in detail.

LIST OF FURTHER READINGS

- Strategic Planning For Public And Nonprofit Organizations: A Guide To Strengthening And Sustaining Organizational Achievement 5Th Edition by John M Bryson, JOHN WILEY
- Strategic Management: Planning For Domestic & Global Competition 13Th Edition by John Pearce &Richard Robinson, Mc Graw Hill India.
- Learning to Think Strategically, by Julia Sloan of Columbia University.
- Good Strategy/Bad Strategy: The Difference and Why It Matters by Richard P. Rumelt

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Competitive Positioning

Lesson 5

KEY CONCEPTS

■ Business level strategies ■ Cost leadership ■ Differentiation Strategy ■ Focus Strategy ■ Strategic Leadership ■ Transactional Leadership ■ Transformational Leadership ■ Charismatic Leadership ■ Artificial Intelligence ■ Fintech ■ Blockchain Technology

Learning Objectives

To understand:

- The various business level strategies and their pros and cons
- The strategy formulation and implementation
- Issues in Strategy Implementation
- Leadership and its forms
- E-business and Strategy; Artificial Intelligence, Fintech and Blockchain Technology

Lesson Outline

- Business Level Strategy
- Porter's Generic Strategies
- Cost Leadership Strategy
- Differentiation Strategy
- Focus Strategy
- Distinctive Features of the Generic Competitive Strategies
- Strategic Implementation
- Strategy Formulation and Implementation
- Strategy Implementation – Supporting Factors
- Issues in Strategy Implementation
- Managing Strategic Changes
- Strategic Leadership
- Leadership and its forms
- Strategic leadership and thinking skills
- E-Business and Strategy
- E-business Strategic Framework
- Artificial Intelligence
- Nine Areas for developing AI Business Strategy
- Fintech
- Blockchain Technology
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

BUSINESS-LEVEL STRATEGY

Business level strategy is a co-ordinated, integrated and a comprehensive action or plan. The purpose of business level strategy is to provide a value to customers by gaining a competitive advantage through exploiting the core competencies in specific individual product/service markets. These strategies are designed based on the firm's belief about where and how it has an advantage over its competitors.

Business level strategy is applicable in those organizations, which have different businesses-and each business is treated as Strategic Business unit (SBu). the fundamental concept in SBu is to identify the discrete independent product / market segments served by an organization.

Since each product/market segment has a distinct environment, a SBu is created for each such segment. for example, reliance Industries Limited operates in textile fabrics, yarns, fibers, and a variety of petrochemical products. for each product group, the nature of market in terms of customers, competition, and marketing channel differs.

Therefore, it requires different strategies for its different product groups. thus, where SBu concept is applied, each SBu sets its own strategies to make the best use of its resources (its strategic advantages) given the environment it faces. At such a level, strategy is a comprehensive plan providing objectives for SBus, allocation of resources among functional areas and coordination between them for making optimal contribution to the achievement of corporate- level objectives.

Such strategies operate within the overall strategies of the organization. the corporate strategy sets the long-term objectives of the firm and the broad constraints and policies within which a SBu operates. the corporate level will help the SBu define its scope of operations and also limit or enhance the SBus operations by the resources the corporate level assigns to it. there is a difference between corporate-level and business-level strategies.

***Example*:** Andrews says that in an organization of any size or diversity, corporate strategy usually applies to the whole enterprise, while business strategy, less comprehensive, defines the choice of product or service and market of individual business within the firm. In other words, business strategy relates to the 'how' and corporate strategy to the 'what'. Corporate strategy defines the business in which a company will compete preferably in a way that focuses resources to convert distinctive competence into competitive advantage.

Corporate strategy is not the sum total of business strategies of the corporation but it deals with different subject matter. While the corporation is concerned with and has impact on business strategy, the former is concerned with the shape and balancing of growth and renewal rather than in market execution.

Michael Porter (1998) has identified **business-level strategies which are cost leadership, differentiation, and focus** to achieve a sustainable competitive advantage. The strategy of cost leadership was common in 1970s. This strategy requires construction of efficient-scale facilities, cost reductions, control over expenses, and cost minimization etc. the low-cost strategy gives several advantages before rivals. It may be explained by the possibility to be more efficient than competitors. (Porter, 1998)

Hill and Jones (2007) have developed the curve which connects together the three issues in developing a successful business model.

Brown and Blackmon (2005) have defined business-unit strategy as a process of decision making at the strategic business unit (SBu) level. According to them, primarily it identifies how SBu supports organizational goals. furthermore, business-unit strategy refers to aggregated strategies of single firms or SBu within one diversified corporation (Brown, Blackmon, 2005). While corporate strategy deals with the question in what businesses the company should compete in, business unit level strategy decides on how to compete in these particular businesses. (Beard, Dess, 1981)

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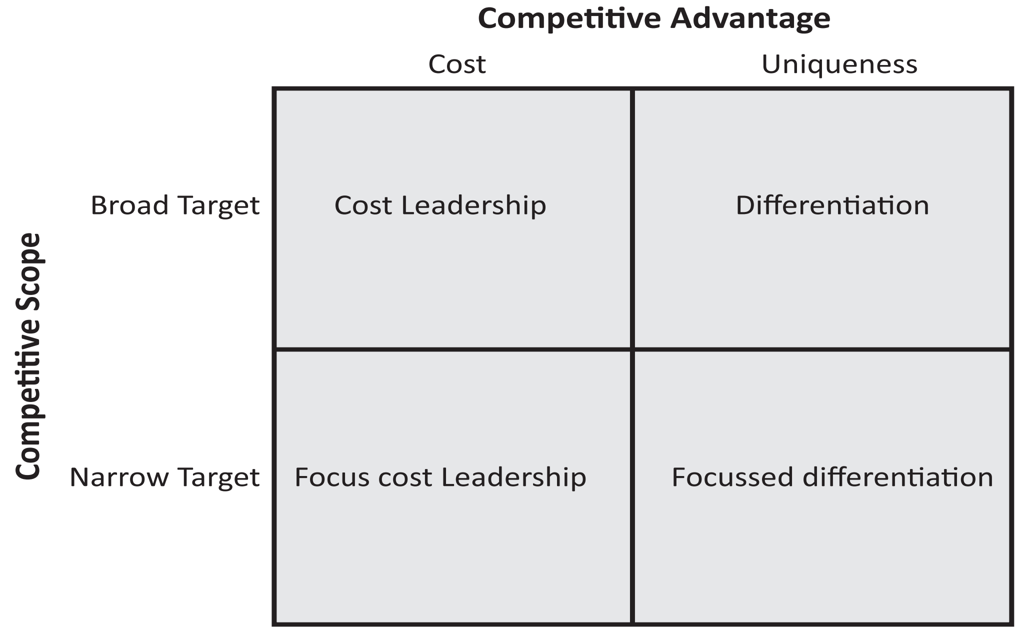

Source: Michael E. Porter, "Competitive Advantage", Free Press, New York, 1985, p.12

Cost Leadership Strategy

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The greatest risk in pursuing a Cost Leadership strategy is that the competitors may follow the same cost reduction strategies, therefore, the company has always to be on its toes to continuously reduce its cost. This can be done by adopting the Japanese Kaizen philosophy of "continuous improvement" among other techniques of reducing cost.

Example

Amazon is an excellent illustration of a cost leadership strategy. Even though their profit margin is so tiny, economies of scale allow them to remain profitable. They draw sizable crowds of customers by selling things for less money.

Ways to achieve Cost leadership

- Quick demand forecasting for the product or service.
- Effective utilization of the firm's resources to avoid wastage.
- Attaining economies of scale which results in lower per-unit cost.
- Investing in high-end technology for smart working.
- Product standardization for mass production, which leads to economies of scale.

Pros of using Cost Leadership Strategy

There are several potential benefits to using a cost leadership strategy.

1. **Low costs enable low prices**. To cut manufacturing costs, cost leaders concentrate their efforts on making production processes more efficient. They may cut prices while still turning a profit because to their cheap costs.
2. **Cost leaders are more able to withstand price wars**. Cost leaders are well-equipped to cut expenses, which can put the brakes on competitiveness. If they cannot be certain they will succeed, higher-priced competitors are less likely to want to actively compete with cost leaders.
3. **Increased market share.** Customers that are sensitive to pricing tend to favour businesses who sell products at the lowest prices.

Cons of using Cost Leadership Strategy

Using a cost leadership strategy can have several downsides. Consider the potential drawbacks to cost leadership.

1. **Risky Approach**. Cost leaders must continually come up with fresh strategies. Competitors are likely to copy an efficient cost-cutting strategy as soon as it is discovered by a corporation. Cost leaders risk suffering big losses if they are unable to maintain constant cost reduction.
2. **Difficult to maintain perceptions of quality.** When the marketing approach is based on providing the most affordable products, it becomes challenging to maintain the perception of quality. Cost leaders need to figure out how to provide affordable goods and services while also upholding a strong reputation and fostering brand loyalty.
3. **Dependent on a high volume of sales.** Cost leaders inevitably operate with thin profit margins. This means they have to maintain a high volume of sales to be successful.
4. **Cost leaders may be slow to adapt to market changes**. When your business-level strategy is centered around cost reduction, it can be challenging to keep up with consumer trends and tastes.

Differentiation Strategy

A differentiation strategy is appropriate where the target customer segment is not price-sensitive, the market is competitive or saturated, customers have very specific needs which are possibly under-served, and the firm has unique resources and capabilities which enable it to satisfy these needs in ways that are difficult to copy.

Differentiation is deemed to be successful when a company is able to fetch a premium price for its products or services, has increased revenue per unit, or is able to retain loyalty of its customers. Differentiation drives profitability when the added price of the product outweighs the added expense to acquire the product or service. It can be achieved by excellent brand management which creates uniqueness in the image of the product/service even when the actual product is the identical to competitors. Adopting this strategy, Apple could brand its i-phones, computers and i-pads; Mercedes-Benz C-Class could sell its cars as most expensive ones, Café Coffee Day could differentiate its coffee, and Nike could brand sports clothing and shoes. Fashion brands and multinational companies have to depend greatly on this strategy. However, this is not an apt strategy as it is not suitable for smaller companies but for big brands.

However, for ensuring success of its Differentiation strategy, a company must:

- Undertake high-quality research, development and innovation.
- Be able to deliver premium products/services.
- Rigorous branding and marketing about differentiated offerings.
- Need to stay agile with their new product development processes.

Pros of using Differentiation Strategy

1. **Lower Price Competition:** Companies frequently engage in pricing wars with rivals. But an organization can compete its rivals by differentiating the product or service. Even if competitors' costs are cheaper, they will struggle to compete if the quality of our product is unsurpassed.
2. **Unmatched Products and Services: W**e can make our product distinctive by using cutting-edge marketing and promotion techniques and make our products stand out from the competition.
3. **Greater Profit Margins:** Company can increase the price of goods by differentiating the offerings. It will increase in repeat business after product becomes sticky with target market. This would imply that company can generate more money even with fewer sales.
4. **Brand Loyalty:** The product carves out a special position in the consumer's mind if we differentiate the product with other ones.

Cons of Differentiation Strategy

While discussing the differentiation strategy advantages and disadvantages, we must list these disadvantages that organizations must watch out for:

1. **Increased Cost:** There is an undeniable increased cost component every time a company considers utilising a differentiated marketing strategy. There will always be an additional expense when you produce different iterations of the same kind of product. Because of this, several businesses find it challenging to differentiate their products.
2. **Inconsistency:** Companies with significantly distinct offers frequently suffer from poor communication. It's crucial to have umbrella communication, like cutting-edge technology and innovative leadership in the case of Apple Inc., even though they deal with many areas and niches, to get over this disadvantage of the differentiation strategy.

3. **Affordability:** The premium price of products reflects the intrinsic cost of differentiated marketing strategy. Such products frequently face competition from imitations of their own brand. Although such products don't have trouble sustaining their pricing point with proper packaging, design, and communication.

4. **Cannibalization:** While a few goods would have sufficed, businesses frequently produce too many differentiated offerings. This can result in brand cannibalization. It's critical to produce a small number of differentiated items in order to counteract this drawback of the differentiation strategy.

Focus Strategy

The focus strategy is also known as 'niche' strategy. This is so because, companies adopting focus strategies focus on niche markets and, by get hold of the dynamics of such niche market and unique requirements of its customers. Based on such understanding, they develop exclusively low-cost products particularly for such niche market. Due to this, a strong brand loyalty is developed with its customers making it difficult for competitors to enter. Such a strategy is often used by small firms/companies.

Further, such companies may either use a 'cost focus' or a 'differentiation focus'. While cost focus makes the firm the lowest cost producer in such niche or segment, differentiation focus creates competitive advantage through differentiation within the niche or segment.

Example: Rolls Royce is a prime illustration of this tactic. These vehicles are pricey and made to the specifications of the user. No other automaker follows this policy. Coca-Cola introduced diet coke and coke zero to appeal to consumers who are health-conscious.

Ways to achieve Focus

- Choosing a particular niche, often avoided by cost leaders and differentiators.
- Excel in catering to the specific niche.
- High-efficiency generation to serve those niche.
- Creating new ways for the value chain management.

Types of a Focus Strategy

There are two types of focus strategy, a brief about each is as follows:

Focused Low-Cost Strategy

Companies choose for this approach when they first join the market. It indicates that the business provides a unique product with additional advantages to the clients at a low cost. Yet, this does not imply that established businesses cannot or should not adopt this tactic; businesses of all stripes could do so.

The best strategy for new businesses to enter the market and engage in indirect competition is this one. Some businesses choose to join the market with their products and services at low costs in order to gain market share. They would find it challenging to carry out this plan over the long haul.

Focused Differentiation Strategy

It is a form of strategy approach that, as its name suggests, focuses on developing a product that is unique for a certain client market group. When a business adopts the differentiation strategy approach, it concentrates on reducing the size of the targeted client segment by providing unique and personalised features in the product.

A fantastic illustration of the focused differentiation strategic strategy in action is Breezes Resort. The hospitality company fulfils the needs of couples and business partners by providing them with a quiet, child-free atmosphere. Partners and couples would adore to visit this location and take advantage of their services.

Pros of using Focus Strategy

Some of the key benefits and advantages of focus strategy are as follows;

Availability of Resources: It is crucial to have the necessary financial and other resources available when organization plan to adopt the targeted strategic approach. The price of manufacturing the correct product for the particular customer market segment is higher. Yet, if a business is using scarce resources to create a rare product, it needs to ensure that those resources are available.

Competitive Edge: Gaining a competitive edge is the crucial component of putting the concentrated strategic approach into practise. When a business makes a distinctive offer to a certain client market segment, it will be easy to stand out from the competition. When organization provides its clients something worthwhile, it will be tough for your rivals to quickly imitate it.

High Growth: Companies and corporations should never forget that there is always potential for expansion. Businesses and firms who are not evolving with the times and the market find it challenging to thrive. The organization should assess the segment's growth prospects before focusing on it as a target market segment.

Increased Profitability: The smaller client market niche is simple to locate and cater to. Yet, it is important to consider whether the market niche you are aiming for is profitable. It's because making a profit is always a company or business's primary goal. Such market groupings need to be sizable enough to bring in money.

Cons of using Focus Strategy

Some of the main disadvantages and challenges of the focus strategy are as follows:

Changing Preferences: Customers' preferences and choices are always shifting, and they strive to reflect the consensus opinion. When a business provides a unique offering that matters to the customer, they will choose it and it will last longer.

High Competition: A focused strategic strategy seeks to gain a competitive edge by providing something special and worthwhile. Being ahead of the competition is challenging since they are constantly trying to get better. The organization must monitor its development and take the offering seriously. The market's increased completion reduces the company's profitability.

Distinctive Features of the Generic Competitive Strategies			
Type of Feature	***Low-Cost Leadership***	***Differential***	***Focus***
Strategic target	A broad cross-section of the market.	A broad cross-section of the market.	A narrow market niche where the buyer, needs and preferences are distinctively different from the rest of the market.
Basis of competitive advantage	Lower costs than competitors.	An ability to offer buyers something different from competitors.	Lower cost in serving the niche or an ability to offer niche buyers something customized to their requirements and tastes.

Product line	A good basic product with few frills (acceptable quality and limited selection).	Many product variations, wide selection, strong emphasis on the chosen differentiating features.	Customised to fit the specialized needs of the target segment.
Production emphasis	A continuous search for cost reduction without sacrificing acceptable quality and essential features.	Invent ways to create value for buyers.	Tailor-made for the niche.
Marketing emphasis	Try to make a virtue out of product features that lead to low cost.	• Build in whatever features buyers are willing to pay for. • Charge a premium price to cover the extra costs of differentiating features.	Communicate the focusser's unique ability to satisfy the buyer's specialized requirements.
Sustaining the strategy	• Economical prices/ good value. • All elements of strategy aim at contributing to a sustainable cost advantage — the key is to manage costs down, year after year, in every area of the business.	• Communicate the points of difference in credible ways. • Stress constant improvement and use innovation to stay ahead of imitative competitors. • Concentrate on a few key differentiating features; use them to create a reputation and brand image.	Remain totally dedicated to serving the niche better than other competitors; don't blunt the firm's image and efforts by entering other segments and adding other product categories to widen market appeal.
Source: **Arthur A. Thompson and A.J. Strickland, *op. cit.*, p. 104.**			

STRATEGIC IMPLEMENTATION

Strategy implementation is a process through which a strategy is put into action. Strategies are only 'means' to an 'end' i.e. accomplishment of organization's objectives which have to be activated through implementation. This is because both strategic formulation and strategic implementation process are intervened in real life situation. While strategic formulation is largely an intellectual process, strategic implementation is more of operational nature. A good strategy without effective implementation is futile for success of an organization.

The implementation of policies and strategies is concerned with the design and management of systems to achieve the best integration of people, structures, processes and resources in reaching organization objectives. Strategy implementation may also consist of securing resources, organizing these resources and directing the use of these resources within and outside the organization. In an action, the strategy chosen is a promise and implementation is to turn the promise into performance. These tasks of transformation warrant structural and administrative mechanism which can be compatible and workable to be established to reinforce the chosen strategic direction for action. Once the strategy has been determined; it is the job of the management to ensure that the strategy is implemented. The major task of implementation strategy is to create a fit between the company goals and its other activities. Generally two types of fits need to be created—

(i) fits between the strategy and functional policies; and

(ii) fits between the strategy and the organizational structure, process and systems.

Developing alternative strategy and making the strategic choice constitute important steps in the process of strategic management. Implementation of the strategy is a vital step in the process. A good strategy without effective implementation can hardly be expected to succeed in the performance. Implementation of strategy in an organization covers a number of inter-related decisions, choices, and a broad range of activities such as the commitments and cooperation of all units, sections and departments. There are two inter-related tasks involved in the process, i.e. differentiation and integration.

Definition of Strategic Implementation

According to **Glueck,** "Strategy implementation is the assignment or reassignment of corporate and Strategic Business Unit leaders to match the strategy. The leaders will communicate the strategy to the employees. Implementation also involves the development of functional policies about the organization structure and climate to support the strategy and help achieve organizational objectives".

Charles W.L. Hill and Gareth R. J ones define strategy implementation as "the way in which a company creates the organisational arrangements that allow it to put its strategic plan into operation most efficiently and to achieve its objectives."

In the words of **Allex Miller and Gregory G. Dess**, "Strategy implementation involves a broad range of efforts aimed at transforming strategic intentions into action. The resulting stream of actions constitutes the firm's realised strategy."

An effective implementation of strategy is significant for an organization's growth, whereas failure in effective strategy implementation may have negative consequences for an organization.

STRATEGY FORMULATION AND IMPLEMENTATION

Strategy formulation is largely an intellectual process whereas strategy implementation is more operational in character. Strategy formulation requires good conceptual, integrative and analytical skills but strategy implementation requires special skills in motivating and managing others. Strategy formulation occurs primarily at the corporate level of an organization while strategy implementation permeates all hierarchy levels. In fact, they are not supplanting each other but supplementing each other. In other words, they are not conflicting but contemporary to each other. The relation between strategy formulation and implementation can be best understood by their inter- dependence. There are two types of linkages between strategy formulation and implementation i.e. forward linkage and backward linkage.

Forward linkage is concerned with the influence of the formulation on implementation. Strategy formulation has forward linkage with implementation in the sense that total implementation activities are geared according to strategy chosen for implementation. The nature and type of organizational processes and systems are conditioned by the strategy for its successful implementation. Thus, implementation is dependent upon formulation.

Backward linkage, on the other hand, deals with the influence in the opposite direction. Strategy formulation has backward linkage with implementation as organization tends to adopt those strategies which can be implemented with the help of existing structure of resources joined with some additional efforts. The strategy is formulated in a particular environment which is dynamic. The feedback from operations, a result of strategy implementation gives notices of the changing environmental factors to which strategy should be seen in continuity rather than in discrete form.

The inter-dependence of formulation and implementation of strategy does not mean that managers are not to distinguish between the two. While interdependence helps management to take corrective action in the light of the feedback given by the implementation, the distinction between the two helps in putting right prospective on organizational resources both human and physical. When the strategy is put into action through the process of developing internal plans, the feedback mechanism stress the need to continually assess implementation of strategy and organizational performance in order to determine any change in the strategy. Thus, those who are responsible for strategy formulation are also responsible for its implementation.

Strategy Implementation – Supporting Factors

The development and selection of strategies to pursue in an organization is considered easier and less time consuming than implementing these strategies once they have been chosen. An effective implementation of strategy in an organization needs multiple supporting factors. Some of these factors include the following:

(i) *Action Planning*: Organizations to be successful in strategy implementation need to develop a detailed action plan i.e., chronological lists of action steps (tactics) which add the necessary detail to strategies and assign responsibility to specific individual or group for accomplishing those actions. They should also set a due date and estimate the resources required to accomplish each of their action steps. Thus, they translate their broad strategy statement into a number of specific work assignments.

(ii) *Organizational Structure*: Successful strategists should also give proper thought to their organizational structure and see whether the current structure is appropriate for their intended strategy because different structures suit the implementation of different strategies.

(iii) *Human Resource Factors*: Human Resource factors through framing strategic plan play a vital role in successful implementation of strategies in an organization. Strategist realize that the human resource issue is really a two part story. The consideration of human resources requires the management to think about the organization's communication needs. Further, managers successful at implementation are aware of the effects each new strategy will have on their human resource needs.

(iv) *Annual Business Plan*: Organizations successful at implementation are well aware of their need to fund their intended strategies. They think about necessary financial commitment in the planning process. For firming up their commitments to strategic plans, companies monetize their strategy. That way, they link their strategic plan to their annual business plan.

(v) *Monitoring and Control:* Monitoring and controlling the plan covers a list of options to get back on course if company should veer off. Those options include changing the schedule, changing the action steps, changing the strategy or changing the objective.

Developing an effective strategic plan is only half the battle. Getting it implemented is the other half – completing the tactics to accomplish the strategies and objectives within the plan. Monitoring the implementation of strategic plan is justified on the following grounds:

(i) It helps to assure the organization efforts conform to the plan.

(ii) It enables the organization to ensure that the results achieved correspond to our quantified objectives.

(iii) Further monitoring allows for corrective action.

(iv) Since monitoring is part of control process, it encourages improved performance.

(v) Monitoring provides the essential link between the written plan and the day-to-day operations of the business. It demonstrates to all that organization is really managing the business according to its strategic plan.

To set functional area goals, the following steps should be taken:

1. For each functional area, compare present functional goals with new enterprise, corporate and business- level goals.
2. Decide what new goal areas (functional variables) are needed for each function.
3. Set new goal levels (values for each functional area's variables).

Issues in Strategy Implementation

An organization is confronted with a number of issues in the process of strategy implementation. Some of the important issues are discussed as follows:

(i) Project implementation

Project is a highly specific program for which time schedule and specific cause are determined in advance. Projects create all necessary conditions and facilities required for the strategy implementation, the discipline of project management. A project basically passes through various phases which are given below before a set of task can be accomplished:

(a) Detailed planning related to different aspects of projects such as infrastructure design, schedules, budgets etc., has to be completed.

(b) Ideas generated during the process of strategic alternatives and choice consideration form the core of the future projects that may be undertaken by the organization.

(c) After a set of projects have been identified and arranged according to the priority, they have to be subjected to preliminary project analysis pertaining to technical, financial, marketing and economic aspects. After the screening, the viable projects are taken up and feasibility studies are conducted.

(d) Detailed engineering, awarding contracts, civil and other types of construction etc., are to be undertaken during the implementation phase leading to the testing trail and commissioning of the plant.

(e) The final phase deals with disbanding the project.

(ii) Procedural implementation

Strategy implementation also requires executing the strategy based on the rules, regulations and procedures formulated by the Government. Though many procedures are simplified with the liberalization, privatization, and globalization of the Indian economy, certain procedures are still applicable in the process of strategic implementation such as, licensing requirements, Foreign Exchange Management Act requirements, collaboration procedures, import and export requirements, incentives and benefits, requirements of Labour Laws and other Legislations.

(iii) Organisational Structure and Strategies

Organizational structure is a means for achieving organization mission and objectives. Thus, it is an important source of strategic implementation. Organizational structure refers to the method of allocating duties and responsibilities to individuals, and the ways these individuals are grouped together into units, departments and divisions. Companies form structures for their organizations based on their strategies. There are number of methods in which the organizations can be structured. A simple strategy requires simple structure whereas the growth strategies require a flexible structure and complex strategies necessarily influence to build the matrix structures.

(iv) Resource Allocation

Resource allocation involves the process of allocating organizational resources to various divisions, departments and strategic business units. It deals with the procurement, commitment and financing the physical and the human resources required to accomplish strategic tasks for the achievement of organizational objectives.

(v) Functional Policies

Functional policies describe functional guidelines to operating managers so that coordination across functional units can take place. Once the strategy of the companies is decided, modification in functional policies may become necessary to meet the demands of the new business.

(vi) Communication Strategy

Communication strategy covering the mission, objectives, market scope, technology and all the issues related to implementation, to different levels in the organization is very important for its success. This is because strategy is implemented through people who ought to be clear about their roles which they have to play in relation to each other.

(vii) Leadership

Appropriate leadership is necessary for developing effective structure and systems for the success of strategy. Leadership is the key factor for developing and maintaining right culture and climate in the organization.

(viii) Challenges to Change

The strategy implementation process generally involves a change. The change can be minor or major. The process of change may cover in freezing, moving and refreezing.

(ix) Pre-implementation Evaluation Strategy

Before the implementation of the strategy, it is advisable to go for a final scrutiny so as to avoid failure due to weaknesses in the analysis, if any and to ensure that the strategy decided for the organization is optimum.

MANAGING STRATEGIC CHANGES

The basic problem in managing change is to overcome people resistance successfully. Problems of overcoming resistance to change can be managed in the following ways:

(i) *Education and Communication:* If misinformation and lack of information create barriers to managing change, education and communication might be appropriate. It requires an atmosphere of mutual trust and confidence and respect between managers and employees.

(ii) *Participation:* Participation helps to give people in organizational change a feeling of importance. It creates the feelings among the employees that the decision is their own. They realise that the change process is a must. Those people who are directly affected by the change should be given opportunity to participate in that change before the final decisions are reached.

(iii) *Obtaining commitment:* Commitment to take part in changed programme can be obtained in private from each individual. However, getting a person to commit himself in private to a changed programme may yield fewer results than if he voluntarily and publicly gives his commitment to an idea of change.

(iv) *Leadership:* A transformational leader can use personal reasons for change without arousing resistance. An effective leader tries to change the psychological needs of his followers.

(v) *Training and Psychological Counselling:* Management can change the basic values of the people by training and psychological counseling. People should be educated to become familiar with change, its process, and working. They must be taught new skills, helped to change attitudes and indoctrinated in new relationships.

(vi) *Coercion or Edict:* Coercion or edict is the imposition of change or the issuing of directives about change. It is the explicit use of power. Coercion is the least successful style of managing change except in a state of crisis or confusion.

STRATEGIC LEADERSHIP

Strategic leadership is a type of leadership in which the leader persuades followers to support a broad vision for the success of the business. Since it prioritises the greatest sustainability initiatives, strategic leadership is now significant to the majority of firms. You may manage a company more successfully if you are aware of the different approaches to show strategic leadership. In this piece, we examine examples of strategic leadership and pinpoint the competencies that are pertinent to this type of leadership.

It takes strategic leadership to identify your organization's strengths so you can set yourself out from the competition. It necessitates a more imaginative strategy than only looking for simple answers. Future organisational growth is highly dependent on leadership.

> "Strategic leadership is defined as the ability to influence others to voluntarily make day-to-day decisions that enhance the long-term viability of the organization while maintaining its short-term financial stability". **(W. Glann Rowe, 2001).**

Leadership and its forms

Types of Strategic Leadership

There are following three well-defined types of strategic leadership:

(a) Transactional Leadership

The transactional leaders make certain that everyone is aware of the expectations for the procedures and results. They strike a balance between strategic management and leadership by gauging employee performance and inspiring them to do better. For good performance, they employ incentives like increased pay, promotions, and bonuses. But they may also discipline poor performance by cutting pay or eliminating jobs. A leadership technique like this might provide results, but not always the best ones.

Nonetheless, this kind of strategic leadership is incorporated to some level in the majority of leadership philosophies. A leader's reliance on this approach affects whether or not they meet the criteria for transactional leadership.

(b) Transformational Leadership

Transformational leaders integrate leadership and strategy, and they use their vision to direct the employees' activities and behaviours. They affect both the organisation and the people within it to change. Such a leadership tactic entails persuading people to change. The organization's advantage is the main goal of this innovative strategy. The transformative leader builds the team's confidence while helping them recognise roles and set goals. Strategic leadership of this kind encourages action and is adaptable.

According to Northouse (2001) "transformational leadership is a process that changes and transforms people. Transformational leaders can motivate people to change to improve their circumstances".

(c) Charismatic Leadership

Charismatic leaders work their charm to persuade others. Charismatic leaders have the drive and passion to get their work done. While charismatic leaders share quite a few similarities with transformational leaders, the focus of their work is a change in the status quo and not necessarily a change in the organization.

Strategic leadership skills

According to *Harvard Business Review*, strategic leadership competencies include six essential skills:

- *Anticipate*: Collect information from a wide range of sources both inside and outside your company's industry or function to predict competitors' moves and reactions to new initiatives or products.
- *Challenge*: View and reframe a problem from multiple angles to understand its underlying causes.
- *Interpret*: Exhibit curiosity and openness when testing several working hypotheses and involve others before coming to any conclusions.
- *Decide*: Weigh long-term investments for growth with short-term pressure for results, as well as the risks and trade-offs for customers and other stakeholders, when making decisions.
- *Align*: Examine stakeholders' incentives and tolerance for change and identify conflicting interests.
- *Learn*: Convey stories of success and failure to advocate learning. Course-correct decisions after they have been made if there is refuting evidence.

Strategic thinking skills

All abilities that help you apply critical thinking to solve complicated problems and make future plans are considered strategic thinking abilities. These abilities are necessary to attain professional goals, get over roadblocks, and deal with hurdles, especially if they are anticipated to take weeks, months, or even years to complete. It contains:

- **Analytical skills:** You must be able to analyse a wide range of inputs, from financial statements to market circumstances, developing business trends, and internal resource allocation, in order to come up with a plan that helps your organisation achieve its goals. To develop a plan that is in line with the present situation your firm is facing, this preliminary analysis is essential.
- **Communication skills:** Regardless of the size of your business, developing a strategy will involve effective communication. Strategic thinking is mostly based on the capacity to effectively convey complicated concepts, interact with internal and external stakeholders, forge agreement, and make sure that everyone is on the same page and pursuing the same objectives.
- **Problem-solving skills:** Strategic planning is frequently utilised to address issues or problems, such as unmet financial goals, ineffective processes, or a new rival. You must first comprehend the issue and its potential remedies in order to put into action a plan that solves the primary obstacle you are facing. From there, you can develop a plan of action to resolve it.
- **Planning and management skills:** In addition to thinking of a solution, strategy also entails its implementation. To put everything together after data analysis, problem comprehension, and solution identification, you need to have good planning and management abilities.

E-BUSINESS AND STRATEGY

An e-business strategy is a long-term plan for implementing the appropriate digital technology to enable a firm to manage all of its partners, both internally through the intranet and outside through customers, suppliers, and other partners. To put it another way, an e-business plan is a detailed strategy for implementing effective digitization so that a company may perform all of its computerised interactions with all stakeholders – both internally via the web and globally via clients, vendors, and other collaborators.

This tactic is not just applicable to online businesses. Any business that transacts online needs to have an e-business strategy. It outlines all the short-term and long-term goals that demand careful planning and expertise.

Creating a Twitter account and a business blog are two examples of good social media e-business strategy models. The blog is meant to provide readers with helpful information about the goods and services the business provides. Twitter is used to share this fresh information with followers and engage with pertinent organisations and people.

E-business Strategic Framework

The e-business strategic framework addresses three broad sets of questions. These are:

1. Where do we (as a company) want to compete?
2. What type of value do we want to create?
3. How should we set up and organize our company to deliver the desired value?

The above three areas are interlinked and cannot answer one question without considering the other two. Strategies are thus more likely to be successful if managers take into consideration all relevant dimensions.

The first broad section in the e-business strategy framework deals with a firm's external environment. The key question here is: 'Where do we want to compete?' Answering this question depends in part on the following factors:

The macro-environment: Analyzing the macro-environment helps us to gain an understanding of trends within the political, economic, social or technological spheres.

Industry structure: Porter's five forces offer a framework for figuring out how appealing a particular industry is. This involves a review of industry competition, entry obstacles, competing products, and the bargaining power of customers and suppliers. The co-opetition value net is also provided as an addendum to the five forces framework.

Markets: Consumers have varying expectations and tastes. So, it is beneficial to divide markets into several categories that correspond to the features of clients' purchasing behaviour, such as age, gender, income level, etc.

Value generation is the subject of the second section of the e-business strategy framework. What type of value do we want to produce for our consumers is the crucial query here. We address two relevant topics in order to respond to this query:

(1) the concept of value creation in e-business; and

(2) strategy options for value creation.

The concept of value creation in e-business: We first need to examine the economic value that a corporation generates in order to determine its potential to gain a competitive edge. Understanding what drives consumer benefits and what drives expenses is necessary for this.

Strategy options for value creation: A company has a variety of strategy options when choosing how to add value for its clients. These two possibilities, cost leadership and distinction, are the two most common choices. Additionally, businesses can aim to stray from conventional forms of rivalry by creating new market niches and reinventing their value propositions.

The third section of the e-business strategy framework deals with the internal organization of a firm. The key question here is: 'How should we set up and organize our firm to deliver the desired value?' In the context of the internal organization, we need to look at three dimensions:

(1) the horizontal boundaries of the firm,

(2) the vertical boundaries of the firm, and

(3) the internal organization.

Horizontal boundaries: What scale and scope should our organisation have is the first question we must address before talking about the horizontal limits. Knowing the scale and the scope can help you determine how big your company should be and how big of a market you need to succeed. How swiftly should we aim to grow is the second question, which has to do with horizontal boundaries. One of the guiding principles of the Internet boom years was growth at all costs. Early market entry and rapid growth are favoured by a number of benefits. Yet, there are a number of drawbacks that many ambitious e-business start-ups ignored.

Vertical boundaries: A lengthy discussion on how integrated a company should be in the Internet era was sparked by the concepts of deconstructing the value chain and unbundling the enterprise. During the height of the Internet boom, it was widely believed that businesses should concentrate on their core competencies (or core businesses) and contract out all other value-creating tasks to other parties. This, however, did not prove to be a miracle cure. Thus, how should we set up our company's value chain is the primary concern with respect to vertical borders.

Internal organization: This relates to how the company is structured within. Thus, the key query is: "How should we internalise our firm?" This speaks to the selection of organisational structures, distribution methods, and online consumer interactions.

Artificial Intelligence

Artificial Intelligence (AI), or machine intelligence, is the field developing computers and robots capable of parsing data contextually to provide requested information, supply analysis, or trigger events based on findings. Through techniques like machine learning and neural networks, companies globally are investing in teaching machines to 'think' more like humans.

Artificial Intelligence, or simply AI, is the term used to describe a machine's ability to simulate human intelligence. Actions like learning, logic, reasoning, perception, creativity, that were once considered unique to humans, is now being replicated by technology and used in every industry. A common example of AI in today's world is chatbots, specifically the "live chat" versions that handle basic customer service requests on company websites. As technology evolves, so does our benchmark for what constitutes AI.

The Artificial Intelligence and Business Strategy initiative explores the growing use of artificial intelligence in the business landscape. The exploration looks specifically at how AI is affecting the development and execution of strategy in organizations. The initiative researches and reports on how AI is spurring workforce change, data management, privacy, cross-entity collaboration, and generating new ethical challenges for business. It looks at new risks and threats in dependency, job loss, and security. And it seeks to help managers understand and act on the tremendous opportunity from the combination of human and machine intelligence.

Nine Areas for developing AI Business Strategy

1. **Business strategy**

   Creating an AI strategy for the sake of it won't produce great results. To get the most out of AI, it must be tied to your business strategy and your big-picture strategic goals. That's why the first step in any AI strategy is to review your business strategy. (After all, you don't want to go to all this trouble and apply AI to an outdated strategy or irrelevant business goals.)

   In this step, ask yourself questions such as:

   - Is our business strategy still right for us?
   - Is our strategy still current in this world of smarter products and services?
   - Have our business priorities changed?

2. **Strategic AI priorities**

   Now that you're absolutely clear on where your business is headed, you can begin to identify how AI can help you get there.

   In other words:

   - What are our top business priorities?
   - What problems do we want or need to solve?
   - How can AI help us deliver our strategic goals?

   The AI priorities that you identify in this phase are your use cases. To ensure your AI strategy is focused and achievable, I'd stick to no more than 3–5 AI use cases.

   Examples of AI priorities or use cases include:

   - Developing smarter products and services.
   - Making business processes and functions (such as accounts, sales and HR) more intelligent.
   - Automating repetitive or mundane tasks to free people up for more value-adding activities.
   - Automating manufacturing processes.

3. **Short-term AI adoption priorities**

   Transforming products, services or processes is never going to be an overnight task. It may take some time to deliver the use cases you've identified. For that reason, I find it helps to also identify a few (as in, no more than three) AI quick wins – short-term AI priorities that will help you demonstrate value and gain buy-in for bigger AI projects.

   Ask yourself:

   - Are there any opportunities to optimise processes in a quick, relatively inexpensive way?
   - What smaller steps and projects could help us gather information or lay the groundwork for our bigger AI priorities?

4. **Data strategy**

   AI needs lots and lots of data to work. Therefore, you need to review your data strategy in relation to each AI use case and pinpoint the key data issues.

This includes:

- Do we have the right sort of data to achieve our AI priorities?
- Do we have enough of that data?
- If we don't have the right type or volume of data, how will we get the data we need?
- Do we have to set up new data collection methods, or will we use third-party data?
- Going forward, how can we begin to acquire data in a more strategic way?

5. Ethical and legal issues

Let's not beat around the bush: the idea of super-intelligent machines freaks people out. It's therefore crucial that you apply AI in a way that's ethical and above board.

Here, you'll need to ask yourself questions like:

- How can we avoid invading people's privacy?
- Are there any legal implications of using AI in this way?
- What sort of consent do we need from customers/users/employees?
- How can we ensure our AI is free of bias and discrimination?

The ethical implications of AI is a huge topic right now. Notably, tech giants including Google, Microsoft, IBM, Facebook and Amazon have formed the Partnership on AI, a group that's dedicated to researching and advocating for the ethical use of AI.

6. Technology issues

Here you identify the technology and infrastructure implications of the decisions you've made so far. Consider:

- What technology is required to achieve our AI priorities (for example, machine learning, deep learning, reinforcement learning, etc.)?
- Do we have the right technology in place already?
- If not, what systems do we need to put in place?

7. Skills and capacity

For those companies who aren't Facebook or Google, accessing AI skills can be a real challenge. Therefore, this step is about reviewing your in-house AI skills and capabilities, and working out where you need a skills injection.

For example:

- Where are our skills gaps?
- To fill those gaps, do we need to hire new talent, train existing staff, work with an external AI provider or acquire a new business?
- Do we have awareness and buy-in for AI from leadership and at other levels in the business?
- What can we do to raise awareness and promote buy-in?

8. Implementation

Here you need to think about how you'll turn your AI strategy into reality. This might surface questions such as:

- How will we deliver our AI projects?

- What are the key next steps?
- Who is responsible for delivering each action?
- Which actions or projects will need to be outsourced?

9. Change management issues

Because people are so wary of AI, particularly what it might mean for their jobs, change management is a really important part of any AI project.

Example questions include:

- Which employees and teams will be impacted by this AI project?
- How can we communicate effectively with those people about the change?
- How should the change process be managed?
- How will AI change our company culture, and how will we manage that culture change?

In conclusion, Artificial intelligence (AI) has the potential to transform every business – in the same way (and possibly more) as the internet has utterly transformed the way we do business. From smarter products and services to better business decisions and optimised (or even automated) business processes, AI has the power to change almost everything. Those businesses that don't capitalise on the transformative power of AI risk being left behind.

Fintech

Financial technology (Fintech) is used to describe new tech that seeks to improve and automate the delivery and use of financial services. At its core, fintech is utilized to help companies, business owners and consumers better manage their financial operations, processes, and lives by utilizing specialized software and algorithms that are used on computers and, increasingly, smartphones. Fintech, the word, is a combination of "financial technology".

Broadly, the term "financial technology" can apply to any innovation in how people transact business, from the invention of digital money to double-entry bookkeeping. Since the internet revolution and the mobile internet/ smartphone revolution, however, financial technology has grown explosively, and fintech, which originally referred to computer technology applied to the back office of banks or trading firms, now describes a broad variety of technological interventions into personal and commercial finance.

When fintech emerged in the 21st Century, the term was initially applied to the technology employed at the back- end systems of established financial institutions. Since then, however, there has been a shift to more consumer- oriented services and therefore a more consumer-oriented definition. Fintech now includes different sectors and industries such as education, retail banking, fundraising and nonprofit, and investment management to name a few.

Fintech now describes a variety of financial activities, such as money transfers, depositing a check with your smartphone, bypassing a bank branch to apply for credit, raising money for a business startup, or managing your investments, generally without the assistance of a person. According to EY's 2017 Fintech Adoption Index, one- third of consumers utilize at least two or more fintech services and those consumers are also increasingly aware of fintech as a part of their daily lives. Fintech also includes the development and use of crypto-currencies such as bitcoin. That segment of fintech may see the most headlines, the big money still lies in the traditional global banking industry and its multi-trillion-dollar market capitalization.

Some of the most active areas of fintech innovation include or revolve around the following areas:

- Cryptocurrency and digital cash.
- Blockchain technology, including Ethereum, a distributed ledger technology (DLT) that maintain records on a network of computers, but has no central ledger.
- Smart contracts, which utilize computer programs (often utilizing the blockchain) to automatically execute contracts between buyers and sellers.
- open banking, a concept that leans on the blockchain and posits that third-parties should have access to bank data to build applications that create a connected network of financial institutions and third-party providers. An example is the all-in-one money management tool Mint.
- Insurtech, which seeks to use technology to simplify and streamline the insurance industry.
- Regtech, which seeks to help financial service firms meet industry compliance rules, especially those covering Anti-Money Laundering and Know Your Customer protocols which fight fraud.
- Robo-advisors, such as Betterment, utilize algorithms to automate investment advice to lower its cost and increase accessibility.
- Unbanked/underbanked, services that seek to serve disadvantaged or low-income individuals who are ignored or underserved by traditional banks or mainstream financial services companies.
- Cybersecurity, given the proliferation of cybercrime and the decentralized storage of data, cybersecurity and fintech are intertwined.

Fintech Users

There are four broad categories of users for fintech:

- B2B for banks,
- Business clients,
- B2C for small businesses, and
- Consumers.

Trends toward mobile banking, increased information, data, and more accurate analytics and decentralization of access will create opportunities for all four groups to interact in heretofore unprecedented ways. As for consumers, as with most technology, the younger you are the more likely it will be that you are aware of and can accurately describe what fintech is. The fact is that consumer-oriented fintech is mostly targeted toward millennials given the huge size and rising earning (and inheritance) potential of that much-talked-about segment. Some fintech watchers believe that this focus on millennials has more to do with the size of that marketplace than the ability and interest of Gen Xers and Baby Boomers in using fintech. Rather, fintech tends to offer little to older consumers because it fails to address their problems. When it comes to businesses, before the advent and adoption of fintech, a business owner or startup would have gone to a bank to secure financing or startup capital. If they intended to accept credit card payments they would have to establish a relationship with a credit provider and even install infrastructure, such as a landline-connected card reader. Now, with mobile technology, those hurdles are a thing of the past.

Regulation and Fintech

Financial services are among the most heavily regulated sectors in the world. Not surprisingly, regulation has emerged as the number one concern among governments as fintech companies take off.

As technology is integrated into financial services processes, regulatory problems for such companies have multiplied. In some instances, the problems are a function of technology. In others, they are a reflection of the tech industry's impatience to disrupt finance.

For example, automation of processes and digitization of data makes fintech systems vulnerable to attacks from hackers.

Recent instances of hacks at credit card companies and banks are illustrations of the ease with which bad actors can gain access to systems and cause irreparable damage. The most important questions for consumers in such cases will pertain to the responsibility for such attacks as well as misuse of personal information and important financial data.

There have also been instances where the collision of a technology culture that believes in a "Move fast and break things" philosophy with the conservative and risk-averse world of finance has produced undesirable results.

Regulation is also a problem in the emerging world of cryptocurrencies. Initial coin offerings (ICOs) are a new form of fundraising that allows startups to raise capital directly from lay investors. In most countries, they are unregulated and have become fertile ground for scams and frauds. Regulatory uncertainty for ICOs has also allowed entrepreneurs to slip security tokens disguised as utility tokens past the SEC to avoid fees and compliance costs.

Because of the diversity of offerings in fintech and the disparate industries it touches, it is difficult to formulate a single and comprehensive approach to these problems. For the most part, governments have used existing regulations and, in some cases, customized them to regulate fintech. They have established fintech sandboxes to evaluate the implications of technology in the sector. The passing of General Data Protection Regulation, a framework for collecting and using personal data, in the EU is another attempt to limit the amount of personal data available to banks. Several countries where ICOs are popular, such as Japan and South Korea, have also taken the lead in developing regulations for such offerings to protect investors.

Blockchain Technology

Blockchain is a series of data linked together. Every single transaction is linked to the chain using cryptographic principles in batches, making blocks. The blocks are connected to each other and have unique identifier codes (called hashes) that connect them to the previous and the subsequent blocks. This forms a blockchain, usually in the form of a continuous ledger of transactions. It isn't owned by any one individual. The series is managed and stored across several computer systems. Each ledger is shared, copied and stored on every computer connected in the system.

This decentralised nature of storage provides security, since changing the details of one record will cause the hash of that block to change, disconnecting it from the next one and causing the latter's hash to change, and further such disruptions. Since the data is stored on multiple systems, any person looking to change the details on one system will have to do it for every other system as well.

Importance of Blockchain

Blockchain technology has been the backbone of bitcoin and other cryptocurrencies. The transparency and the security offered by the technology are some of the main reasons why cryptocurrency has become so popular. This technology is increasingly being adopted in the retail, manufacturing and banking sectors due to its benefits, like eliminating middlemen, providing data security, reducing corruption and improving the speed of service delivery. It can be particularly useful in maintaining government data related to public transactions. For instance, if all land records are moved on a blockchain, with each subsequent buying and selling of a property being recorded as a block that can be publicly accessed, corruption can be arrested and governing will be made so much easier. Similarly, hallmarked gold jewellery can be moved on an open-source blockchain ledger, which can be maintained by jewellers and viewed by consumers.

However, blockchain technology must be adopted in a gradual manner. Bitcoin and other cryptocurrencies have seen wild fluctuations in value, due to the lack of regulatory supervision. The open nature of the technology implies that anyone can adopt it, which is partly why the government is hesitant to go ahead and use it. Scalability, transaction speed and data protection are key technological hurdles, along with the difficulty of integrating the technology into existing financial systems. Many legal and regulatory challenges are also involved.

Blockchain is a developing field and its practical uses are being explored in many areas. You may want to adopt this technology in your business, if you are a B2C company and want to improve user experience or enhance transparency. There is a possibility of some data, such as banking transactions, land records and vehicle registration details, moving on the blockchain platform in the future. Example: Even recent entrants like Uber and Airbnb are threatened by blockchain technology. All you need to do is encode the transactional information for a car ride or an overnight stay, and again you have a perfectly safe way that disrupts the business model of the companies which have just begun to challenge the traditional economy. We are not just cutting out the fee- processing middle man, we are also eliminating the need for the match-making platform.

The Three Pillars of Blockchain Technology

The three main properties of Blockchain Technology which have helped it gain widespread acclaim are as follows:

- Decentralization
- Transparency
- Immutability

Pillar 1: Decentralization

Before Bitcoin and BitTorrent came along, we were more used to centralized services. The idea is very simple. You have a centralized entity that stored all the data and you'd have to interact solely with this entity to get whatever information you required.

Another example of a centralized system is the banks. They store all your money, and the only way that you can pay someone is by going through the bank.

In a decentralized system, the information is not stored by one single entity. In fact, everyone in the network owns the information. In a decentralized network, if you wanted to interact with your friend then you can do so directly without going through a third party. That was the main ideology behind Bitcoins. You and only you alone are in charge of your money. You can send your money to anyone you want without having to go through a bank.

Pillar 2: Transparency

One of the most interesting and misunderstood concepts in blockchain technology is "transparency." Some people say that blockchain gives you privacy while some say that it is transparent.

A person's identity is hidden via complex cryptography and represented only by their public address. So, if you were to look up a person's transaction history, you will not see "Bob sent 1 BTC" instead you will see "1MF1bhsFLkBzzz9vpFYEmvwT2TbyCt7NZJ sent 1 BTC". So, while the person's real identity is secure, you will still see all the transactions that were done by their public address. This level of transparency has never existed before within a financial system. It adds that extra, and much needed, level of accountability which is required by some of these biggest institutions.

Pillar 3: Immutability

Immutability, in the context of the blockchain, means that once something has been entered into the blockchain, it cannot be tampered with.

The reason why the blockchain gets this property is that of the cryptographic hash function.

In simple terms, hashing means taking an input string of any length and giving out an output of a fixed length.

In the context of cryptocurrencies like bitcoin, the transactions are taken as input and run through a hashing algorithm (Bitcoin uses SHA-256) which gives an output of a fixed length. So basically, instead of remembering the input data which could be huge, you can just remember the hash and keep track.

The blockchain gives internet users the ability to create value and authenticates digital information. Following new business applications will result from this:

1. Smart contracts.
2. The sharing economy.
3. Crowdfunding.
4. Governance.
5. Supply chain auditing.
6. Decentralizing file storage.
7. Prediction markets.
8. Protection of intellectual property.
9. Internet of Things (IoT).
10. Neighbourhood Microgrids.
11. Identity management.
12. Anti-money laundering (AML) and know your customer (KYC).
13. Data management.
14. Land title registration.
15. Stock trading.

As revolutionary as it sounds, Blockchain truly is a mechanism to bring everyone to the highest degree of accountability. No more missed transactions, human or machine errors, or even an exchange that was not done with the consent of the parties involved. Above anything else, the most critical area where Blockchain helps is to guarantee the validity of a transaction by recording it not only on the main register but a connected distributed system of registers, all of which are connected through a secure validation mechanism.

LESSON ROUND-UP
• Business level strategy is a co-ordinated, integrated and a comprehensive action or plan. The purpose of business level strategy is to provide a value to customers by gaining a competitive advantage through exploiting the core competencies in specific individual product/service markets.

- In 1985, Michael Porter in his book “Competitive Advantage: Creating and Sustaining Superior Performance” pronounced the three generic strategies namely “Cost Leadership” (no frills), “Differentiation” (creating uniquely desirable products and services) and “Focus” (offering a specialized service in a niche market).
- The implementation of policies and strategies is concerned with the design and management of systems to achieve the best integration of people, structures, processes and resources in reaching organization objectives.
- An effective implementation of strategy in an organization needs multiple supporting factors.
- An organization is confronted with a number of issues in the process of strategy implementation.
- Structural implementation involves the designing of organizational structure and interlinking various departments and units of the organization created as a result of the organizational structure.
- Behavioural implementation is concerned with those aspects of strategy implementation which have influence on the behaviour of the people in the organization.
- Strategic leadership is defined as the ability to influence others to voluntarily make day-to-day decisions that enhance the long-term viability of the organization while maintaining its short-term financial stability.
- Effective strategic control process should ensure that an organization is setting out to achieve the right things, and that the methods being used to achieve these things are working.
- An e-business strategy is a long-term plan for implementing the appropriate digital technology to enable a firm to manage all of its partners, both internally through the intranet and outside through customers, suppliers, and other partners.
- Artificial Intelligence (AI), or machine intelligence, is the field developing computers and robots capable of parsing data contextually to provide requested information, supply analysis, or trigger events based on findings.

GLOSSARY

Business Restructuring: Business restructuring is an action taken by a company to significantly modify the financial and operational aspects of the company, usually when the business is facing financial pressures. Restructuring is a type of corporate action taken that involves significantly modifying the debt, operations, or structure of a company as a way of limiting financial harm and improving the business.

Strategy: The term strategy has been derived from Greek work “Strategies” which means general. So, the word strategy means the art of general. Thus strategy may be defined as gamesmanship or an administrative course of action designed to achieve success in the face of difficulties. It is the grand design or an overall plan, which a company chooses in order to move or reach the mission and objectives.

Emergent strategy: An unplanned strategy that evolved during the course of implementing the intended strategy.

Balanced Scorecard: Developed by Kaplan and Norton, the concept of a “balanced scorecard” stressed the need to monitor, measure and control strategic performance within four perspectives: Financial, Customer, Internal Business Process, and Learning and Growth. The main value of the balanced scorecard model lies in its emphasis on forging a balanced approach to measuring and managing strategic control factors. It remains for each organization to identify its own key strategy, strategic objectives, strategic initiatives and strategic measurements.

Baseline: The organization's actual performance level from the most recent reporting period.

Business model canvas: The Business Model Canvas is a strategic management and lean startup template for developing new or documenting existing business models. It is a visual chart with elements describing a firm's or product's value proposition, infrastructure, customers, and finances.

Cascading: Cascading is arranging strategic devices (objectives) to ensure collaboration and cooperation downward through all levels of the organizational system in a connected series or sequence, like a waterfall, so that the intended strategy is exhibited from leadership levels all the way to the customer-facing personnel.

Competitive positioning: Competitive positioning is about defining how you'll "differentiate" your offering and create value for your market. It's about carving out a spot in the competitive landscape, putting your stake in the ground, and winning mindshare in the marketplace – being known for a certain "something."

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Discuss the process of strategy formulation and implementation.
2. Discuss the issues in strategy implementation.
3. Discuss the features of generic competitive strategies.
4. What is strategic leadership? How transactional leadership differ with transformational leadership.?
5. What are the Business Level Strategies and how they are differ with Corporate Level Strategies?
6. Explain the role of cost leadership strategies for the growth of an organization.
7. How Cost leadership strategy differ with Differentiation strategy?
8. Elaborate the strategies to be used for online or e-business.

LIST OF FURTHER READINGS

- Business Strategy: Managing Uncertainty, Opportunity, and Enterprise by J C Spender The Lords of Strategy by Walter Kiechel
- Business Strategy: A Guide to Effective Decision-Making by Jeremy Kourdi Harvard Business Review
- Vikalpa of IIM Ahemadabad
- Decision of IIM Calcutta
- Business Policy and Strategic Management by P. Subba Rao
- Business Policy and Strategic Management by Francis Cherunilam

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Managing the Multi-Business Firm and Analyzing Strategic Edge

Lesson 6

KEY CONCEPTS

■ Business Process Reengineering ■ Benchmarking ■ Total Quality Management ■ Six Sigma ■ Benchmarking Wheel

Learning Objectives

To understand:

- Meaning and crucial facets of Business Process Reengineering
- Concept of Benchmarking
- Total Quality Management
- Critical facets of Six Sigma and how six sigma works
- Various Case studies from the Indian Context to establish a Strategic Mindset

Lesson Outline

BUSINESS PROCESS RE-ENGINEERING (BPR)

Also known as Business Process Redesign, Business Transformation, or Business Process Change Management, Business Process Reengineering (BPR) is an endeavour to fabricate the operations of the business on an extensive scale and the act of recreating a core business process with the goal of improving product output, quality, or reducing costs.

Adopting BPR as a change management tool requires the organizations to make an introspection about the fundamentals of the company itself i.e. 'What they do?', 'Why they do things?' and 'Why do we do things the way we do it?'.

The primary objective of BPR is to:

- Eliminate redundancies or futile layers in the whole process.
- Eliminate enterprise costs.

Business Process Reengineering- Definition

As per **Hammer and Champy (1993):** "Business Process Re-Engineering (BPR) is the fundamental rethinking and radical redesign of business processes aimed at achieving radical improvements in essential contemporary measures of performance, such as cost, quality, service and speed."

Hammer and Champy (1993) further stress "Reengineering is about business reinvention- not business improvement, business enhancement, or business modification. "Business process is another core concept in BPR which discards Adam Smith's notion of division of labour and specialization as applied in the form of breaking work into its simplest tasks and assigning each task to a specialist. Instead Hammer and Champy (1993) define business process as "a collection of activities that takes one or more kinds of input and creates an output that is of value to the customer".

Thus, reengineering should not be about making marginal changes but ensuring quantum leaps in performance. In other words, BPR is another form of process innovation because it attempts to re-create processes.

Origin

Business process reengineering became popular in the business world in the 1990s, inspired by an article called Reengineering Work: Don't Automate, Obliterate, an article in Harvard Business Review (in July–August 1990) which was published in the Harvard Business review by Michael Hammer, the then professor of Computer Science at MIT. Hammer tested BPR as an examination of the manner Information Technology was having an impact on business processes (the Economist, 2009).

The underlying principle of BPR is that the managers must demolish such components of work that do not make any value addition and further automating it if possible. At the core of BPR was viewed as a revolutionary, fast-track and drastic change process (rather than incremental one) that could trigger fundamental changes in the business process itself such as job design, organizational structures, or management systems (Hammer and Champy, 1993).

After evolution of the concept, BPR was successfully implemented by a few high-profile organisations such as Hallmark, a famous greeting card company. Hallmark completely re-engineered its new product process. Similarly, the popular company Kodak also re-engineered its black-and-white film manufacturing process and cut the firm's response time of new orders to the tune of fifty per cent. Furthermore, with the advent of enterprise resource planning (ERP) which enabled electronic communications across company business processes, BPR got more popularity (The Economist, 2009).

Objectives of Business Process Reengineering

The following are the objectives for entities to opt for BPR:

- Boost effectiveness and produce higher quality products for end customer.
- Improve efficiency in the production processes.
- Cost saving in the long run.
- Providing more meaningful work to employees.
- To be more adaptable and flexible towards future changes.
- Enable new business growth and expansion.

Typology of BPR Projects

Earl (1994) provides a four-strand typology of BPR projects which can be applied across any organization irrespective of what business it is involved in. These are:

- **Core Processes:** Core processes are central to business functioning and represent the primary value-chain activities which relate directly to external customers. Examples being order fulfillment processes.
- **Support Processes:** Support processes are back office processes which reinforce the core processes. These are typically secondary value-chain activities and relate more to internal customers. Typical examples being information technology, financial systems, and human resources systems.
- **Business Network Processes:** Business network processes are the processes which extend beyond the boundaries of the organization into other organizations such as suppliers and customers.
- **Management Processes:** Those processes through which firms plan, organize and control resources. Examples include strategy development, direction setting, and managing the organization.

Factors for Successful Implementation of BPR

As per Hammer and Champy (1993), "BPR is certainly a 'Change Management' approach that aims at bringing in fundamental improvements in the business performance of any organisation. It is a detailed blueprint of how the new processes are tested, the plan of redeployment of employees, the re-arrangement of resources and controlling and monitoring of its implementation plan." Al-Mashari and Zairi (1999) have identified five factors for a successful implementation of BPR i.e.

- Change in management
- Management competencies
- Organizational structure
- BPR project management
- IT sub-structures.

BPR is commonly termed as a bi-fold challenge viz. technical and socio-cultural (Reijersa and Mansarb, 2005). The technical challenge consists of creating radical process design to improve existing systems. The socio-cultural challenge stems from reaction against change from organisational employees. (CIPS: Achieving results through BPR and BPO). Therefore, the reasons for failure of BPR (Crowe et al., 2002 and Kotter, 1996) may be:

- Employees' resistance against change
- Communication breakdown
- Personnel turnover during transition.

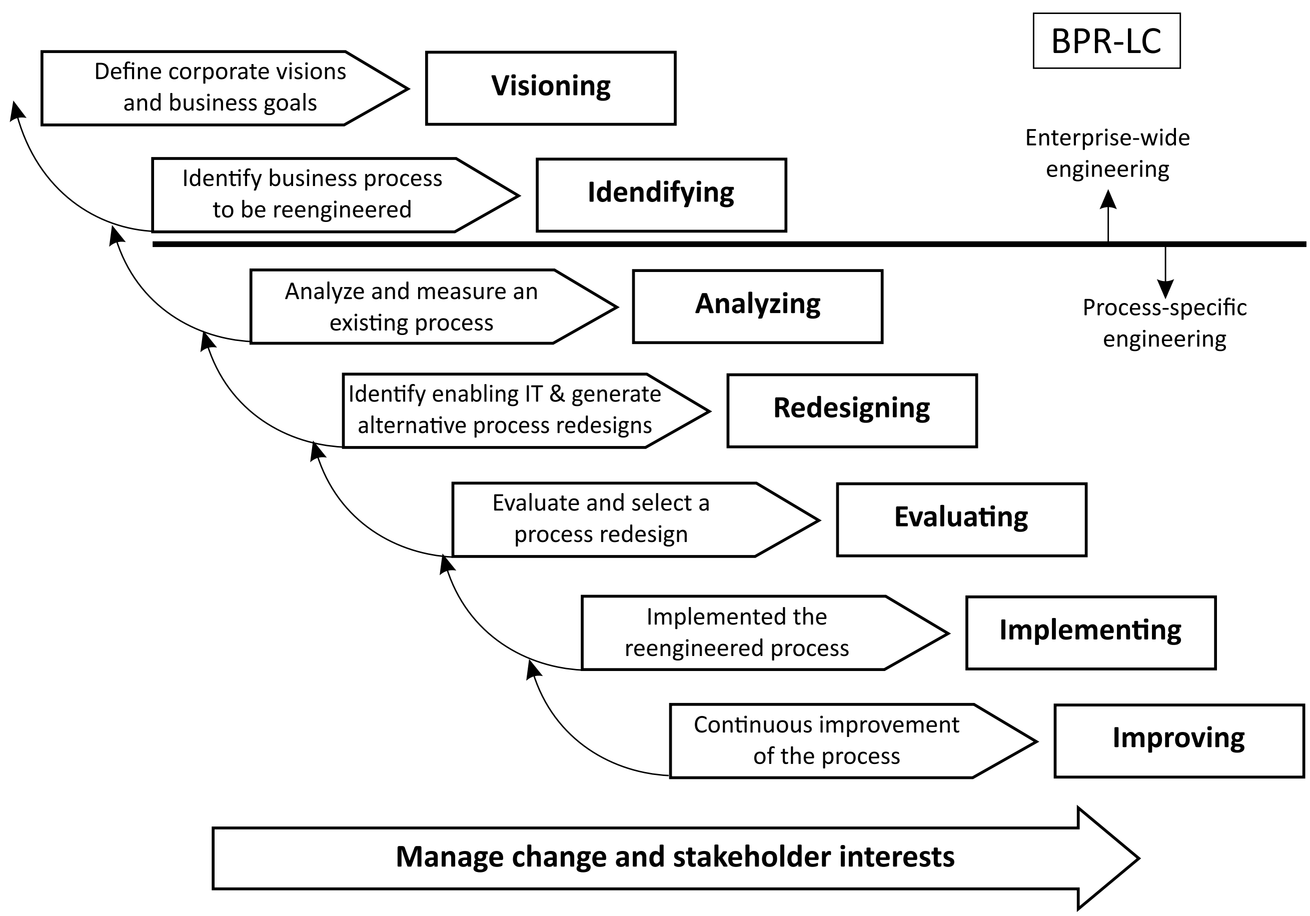
BUSINESS PROCESS REENGINEERING

Business Process Reengineering (BPR) refers to an attempt to improvise the operation of the business on a broad scale. The primary aim of BPR is to cut down process redundances and enterprise costs.

Tools	Steps
● Customer and Process Focus	1. Define Objectives and Framework
● Visualization for End Process and Benchmarking	2. Identify Customer Needs
● Change Management	3. Study the Existing Process
● Business Process Mapping	4. Formulate a Redesign Business Plan
	5. Implement the Redsign

Steps involved in Business Process Reengineering

BUSINESS PROCESS REENGINEERING LIFE CYCLE



A well-conducted execution of Business Process Reengineering can prove to be a game-changer for an organization. BPR can revive a failing entity and lead it to the path of profit maximization. However, executing BPR may not be easy as it involves enforcing a change in the entire organization. BPR comprises the following steps:

- **Define : Objectives and Framework**

  There must be a clear definition of the objectives of choosing BPR. Such objectives must be clearly laid out in qualitative and quantitative terms. After defining such objectives, the requirement for change must be communicated to the employees to apprise them about the upcoming processes. This becomes important as the willingness of the employees to adopt the change is a key for the success of BPR.

- **Identify : Customer Needs**

  The requirements and feedback of the customers must be given due importance while designing the BPR. It must be ensured that the new processes are able to deliver the added value to the customer.

- **Study: The Existing Process**

  In order to re-engineer, the company must have to analyze its existing business process. A SWOT should be carried out to have a clear view of the strengths and weaknesses of the existing processes.

- **Formulate: A Redesigned Business Plan**

  After an analysis of the prevailing business process, the modifications to be made are chalked down. These modifications form a base for the re-designing of process. Then, a plan is laid down by selecting the best alternative.

- **Implement: The Redesign**

  The last step is to implement the redesigned plan. Management should make sure that the new process is operational and adopted by the team. Such a support from the team is indeed critical to the success of BPR.

CASE STUDY

Infosys :Business process re-engineering for the commissions process

The client

An Australian corporation, which is among the top ten banking institutions and top five general insurers, has one of the highest cross-sell rates in the financial sector. The insurance activities of the company cover personal insurance, corporate coverage, and workers' compensation.

Business need

Alliances and intermediaries were key growth drivers in the long-term strategy of the client. In order to better manage the channel behavior and meet the organization's objectives, the ability to pay accurate and timely commissions was an important element. This was considered a critical competitive edge and a weak link in the client's back office capabilities.

Challenges and requirements

The following challenges were faced during implementation:

- The existing operations comprised of manual processes using band aid systems which were high-cost and presented serious risks.

- This organization paid about AUS$90 million per year in commissions, which was approximately 20 percent of its profits before goodwill and taxes. At the same time, it lost significant amount on overpayments and commission leakage.

Infosys role

Infosys studied the processes and identified improvement initiatives that would benefit the client. Infosys recommended a centralized commission management organization and articulated the desired business capabilities for a group commissions solution with the following objectives:

- Coverage of
  - Multiple businesses – insurance, wealth management, banking
  - Multiple brands
  - Different distribution models – multiple intermediary types
  - Consolidation of several existing legacy systems
  - Integration with product (Hogan, Cogen), payment (PeopleSoft), and CRM (Enterprise) systems
  - Scalability – large number of intermediaries (>5000) across BUs and 400,000 transactions per month.

Infosys assessed vendors in the enterprise incentive management space based on multiple criteria. The vendors included Callidus, Synygy, Centive, Trilogy, and Siebel. Infosys evaluated and selected a vendor as a recommended integrated commissions platform. At the same time, Infosys also built the business case for the investment as well the implementation plan for all initiatives.

Benefits

The benefits of the solution include:

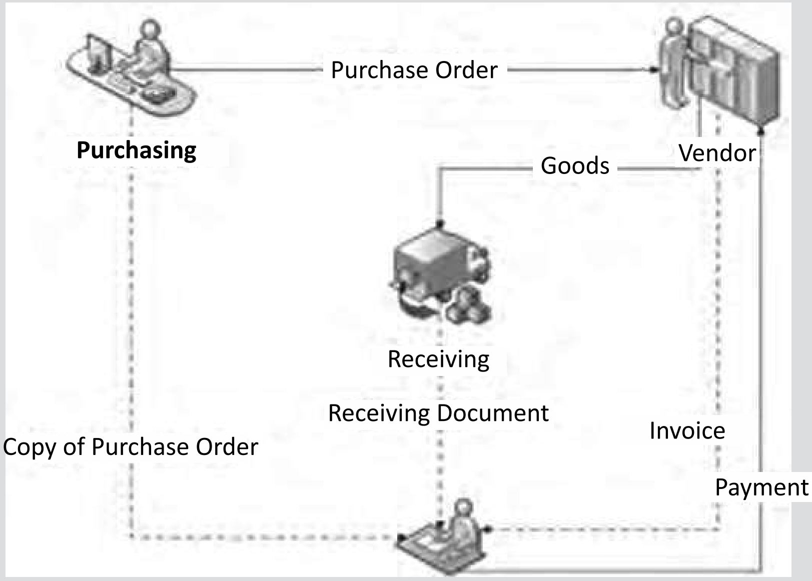
- Identification of the most suitable solution based on a list of quantifiable criteria (cost, project risk / ease of implementation timelines, functionality fit), and a complex evaluation process.
- Creation and articulation to the executive team of the business benefits arising from various initiatives including implementation of an integrated commissions platform.

Source: https://www.infosys.com/industries/insurance/case-studies/Pages/business-process-reengineering.aspx

Business Process Reengineering – The case of Ford's Accounts Payable

One of the companies that successfully utilised BPR in the initial years is Ford, for its accounts payables system. Before implementation, Ford used the accounts payable as shown in the figure below. Ford's purchasing department initially sends a purchase order for raw materials. It also sends a copy of the purchase order to the accounts payable department. After sending the raw materials, the vendor raises an invoice to the accounts payable department. The accounts payable department tallies the purchase order, received materials and invoices and makes payments to the supplier. Ford employed about 500 people to handle the entire process, whereas its competitor, Mazda, a Japanese car manufacturer has managed the same process with 100 people, a remarkably low number of employees even if the size is taken into consideration.

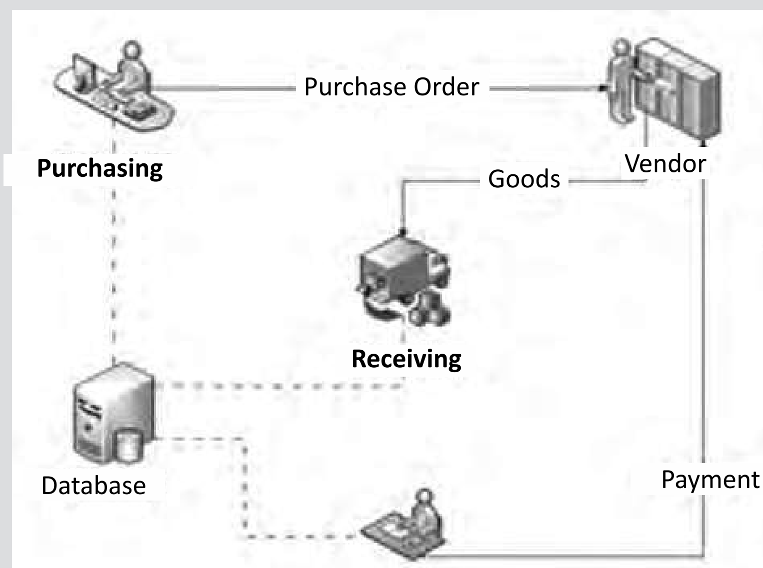
Ford Accounts Payable Process – Before Business Process Reengineering



Account payable before BRR

Instead of making minor changes to the business processes. Ford has decided to use BPR and information technology to radically change its accounts payable process. It has implemented an invoice-less process. The purchasing order will be raised by the purchasing departments and updated in the database. As soon the materials have been received a warehouse man would update the materials received and the payment will be automatically be made without waiting for the invoice to be received from the vendor.

Ford Accounts Payable Process – After Business Process Reengineering



Account payable after BRR

Through these changes in the business process, Ford had achieved a 75% reduction in employees in the administration department.

Reengineering of the Product Development Process of Airbnb

Airbnb is known for their coolness. Want to sleep in a treehouse in the Balinese jungle? It's just a few clicks away. Looking to make some secondary income on your vacation home? List it on Airbnb.

Behind the scenes, the company was struggling to find their internal identity in a design-centric Silicon Valley, and to create a sustainable, quick to deliver, product development process.

Problem Definition

The three main functions which contributed to the Airbnb product development process — designers, engineers, and researchers — worked in silos, only jumping into the process at defined times.

Those defined times weren't serving the end goal of delivering a great product on time. Designers had to wait on engineers to write code before a mock-up could be visualized on screen. In turn, engineers had to wait on researchers to validate product ideas, only to find at the very end that project assumptions were off-base.

This was less so a failure of bulldozing researchers, needy designers or overly-coveted engineers. It was a process failure. This triggered the need for more deep and consistent engagement between teams. In this regard, the company devised three solutions which are as under:

1. **Treat Geographically Dispersed Resources as they were Centralized-**

   The product development process needed to be reengineered. Not optimized or automated, but fundamentally redesigned. According to Alex Schleifer, Head of Design at Airbnb, he and about 300 other people on Airbnb's product team spent nine months doing just that.

   The solution was to create one digital environment where designers and engineers would work seamlessly together. Rather than each team working on separate systems, which meant rounds and rounds of "quasi- prototypes" and "layers of abstraction", this single digital environment enables files to show updates in real time and reflect real data.

   BPR Learning

   Treat geographically dispersed resources as though they were centralized. In Airbnb's case, the way to centralize the product development process was to centralize the internal development tool. Even if coworkers weren't able to sit in the same room, they were looking at the same product in real time. This virtual centralization supports the team in quick back and forth product development.

2. **Organize Around Outcomes, Not Tasks**

   Another part of the reengineering solution of Airbnb's product development process was to design product teams around outcomes, not features. This approach baked in an unfamiliar step into the product development process — emotions. Teams were now pushed to talk about outcomes from both a lofty, aspirational perspective, as well as a knitty gritty code perspective.

   BPR Learning

   Organize around outcomes, not tasks. This principle holds true when applied to common business processes such as Procure-to-Pay and Order-to-Cash, but also to Product Development. When individual tasks (or in Airbnb's case, features) become the organizational priority, the larger outcome is mistakenly shelved for the immediate need of the task.

3. **Link Parallel Activities instead of Integrating their Results**

   A thought emerged that what about the researchers who would come in at the end of a project and bulldoze everything designers and developers had built. Researchers became deeply embedded into teams, as equal partners of on the product team, forming strong and enduring relationships.

BPR Learning

Link parallel activities instead of integrating their results. By embedding researchers into the process, they were able to validate development stages along the way. Rather than trying to massage in research outcomes to an already existing product, Airbnb links research activities along with designer and engineering activities.(This case study was sourced from the following articles: Wired, Wired, Airbnb, Firstround.)

BENCHMARKING

Benchmarking : Definition

According to Camp, benchmarking is simply "Finding and implementing the best business practices".

Benchmarking is a strategy tool of comparison. It is used to compare the performance of the business processes and products of a company with that of the best performances of other companies inside and outside the industry which the company is a part of. Managers use the tool to identify the best practices in other companies and apply those practices to their own processes in order to improve the company's performance. Improving company's performance is, without a doubt, the most important goal of benchmarking.

Understanding the tool

In order to know the standing of one's business, it needs to be compared with the competitors. For example, your top management may be pleased with the fact that the rate of customer satisfaction for your company till they come to know that industry average for this variable is 95 per cent. In this situation, though the rate of 85 per cent seemed too brilliant initially, yet, the will look dull when compared to industry. Therefore, use of 'benchmarking' becomes obvious.

Such a type of comparison as mentioned above was not considered important management tool until late 1980s and 1990s. Then, Xerox introduced the process benchmarking technique. Such a comparison proved very valuable and Xerox, AT&T and other companies stared to compare the performance of their processes with that of the best standards in the industry. The following table shows how benchmarking evolved into a modern strategy tool:

Benchmarking history	
1950-1975	Reverse engineering
1976-1986	Competitive benchmarking
1982-1986	Process benchmarking
1988+	Strategic benchmarking
1993+	Global benchmarking

Source: J. Blakeman, University of Wisconsin-Milwaukee

Types of Benchmarking

Three major types of benchmarking were identified by Tuominen and Bogan and English:

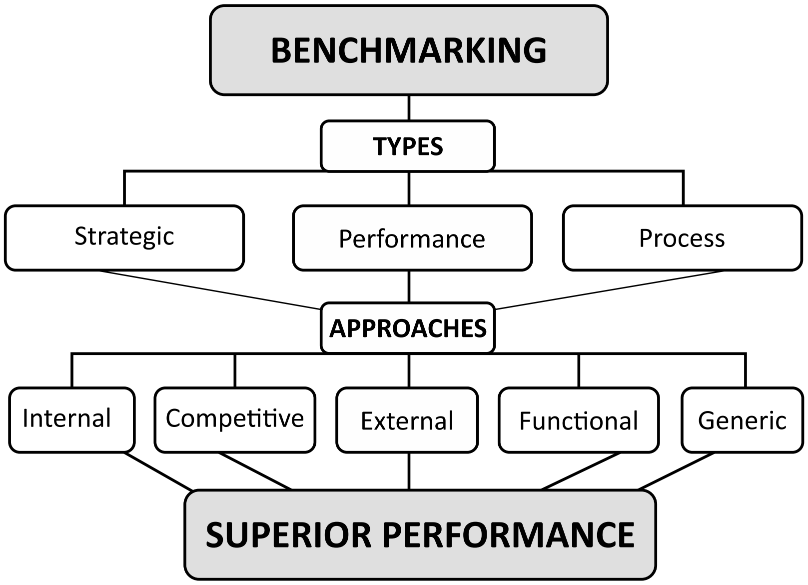
- Strategic benchmarking: This type of benchmarking is used to identify the best way to compete in the market. In this type of benchmarking, the companies identify the winning strategies (typically outside the boundaries of their own industry) used by successful companies and thereafter adopt them in their own strategic processes.

- Performance benchmarking: Performance benchmarking determines how strong a company's products and services are when compared to competition. According to Bogan and English, the tool mainly focuses on product and service quality, features, price, speed, reliability, design and customer satisfaction, but it can measure anything that has the measurable metrics, including processes.
- Process benchmarking: It requires to look at other companies that engage in similar activities and to identify the best practices that can be applied to your own processes in order to improve them. It usually derives from performance benchmarking. This is because companies first identify the weak competing points of their products or services and then focus on the key processes to eliminate those weaknesses.

Approaches

- Internal benchmarking: In large organizations that have operations in multiple geographic locations within or outside national and regional boundaries, or organsations managing plentiful products and services, duplicating functions and processes are usually performed among different teams, business units or divisions of the same organsation. Internal benchmarking is used to compare the work of such teams, units or divisions to identify the ones that are best performing and share the knowledge throughout the company to other teams to achieve higher performance.
- External or competitive benchmarking: Competitive benchmarking refers to a process when a company compares itself with the competitors inside its industry itself. External benchmarking looks both inside and outside the industry to find the best practices, thus, including competitive benchmarking.
- Functional benchmarking: Managers of functional departments find it useful to analyze how well their functional area performs compared to functional areas of other companies. It is quite easy to identify the best marketing, finance, human resources or operations departments, in other companies, that excel in what they do and to apply their practices to one's own functional area.
- Generic benchmarking: General benchmarking refers to comparisons which "focus on excellent work processes rather than on the business practices of a particular organization". For example, a company tries to improve its marketing capabilities and benchmarks itself against company 'X'. While observing company's 'X's' marketing processes, it also notices the efficiency in management of its human resources by using 'big data' analytics. This gives it an idea to implement such analytics in its own HR department to significantly improve its overall performance.

The following diagram summarizes the types and approaches to benchmarking:



Advantages

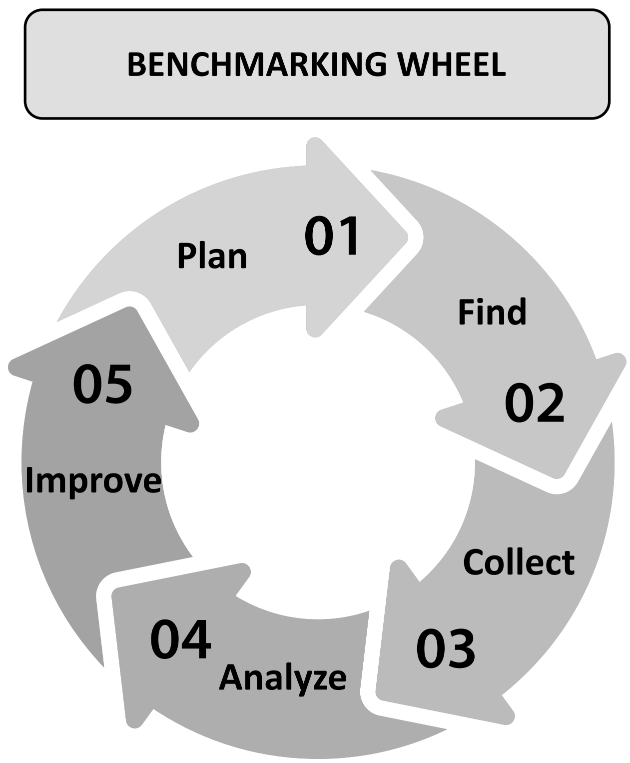
- Easy to understand and use.
- If done properly, it's a low cost activity that offers huge gains.
- Brings innovative ideas to the company.
- Provides with insight of how other companies organize their operations and processes.
- Increases the awareness of costs and level of performance compared to rivals.
- Facilitates cooperation between teams, units and divisions.

Disadvantages

- Requires identification of a benchmarking partner.
- Sometimes impossible to assign a metric to measure a process.
- Might need to hire a consultant.
- The initial costs could be huge.
- Managers often resist the changes.

Benchmarking Wheel

The benchmarking wheel model was first brought out in an article "Benchmarking for Quality". This is a five stage process that was created by analyzing more than 20 other models.



1. **Plan:** Clearly define what you want to compare and assign metrics to it.
2. **Find:** Identify benchmarking partners or sources of information.
3. **Collect:** Choose the methods and gather the data for the metrics defined.

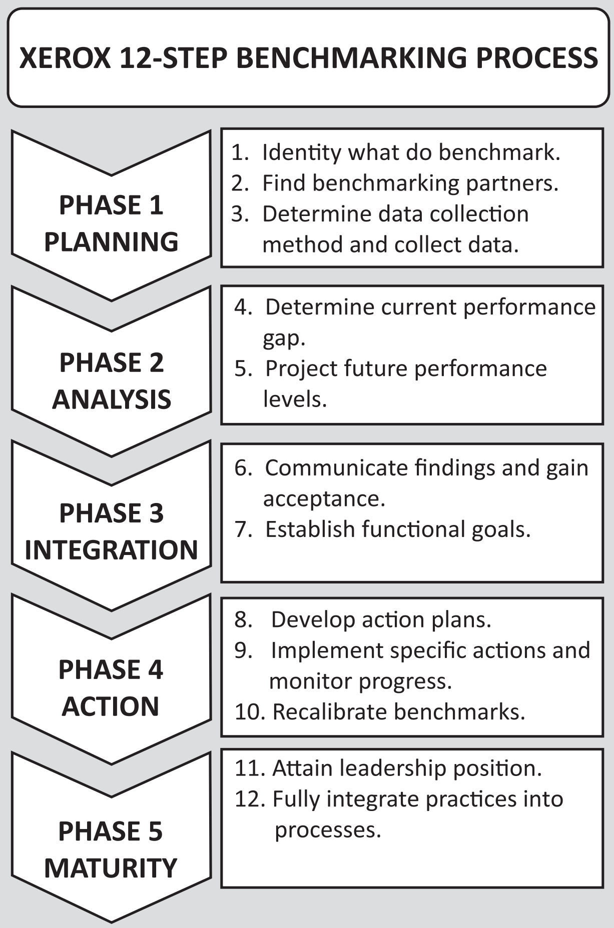
4. **Analyze:** Compare the metrics to identify the gap in performance between your company and the benchmarking partner. Provide the results and recommendations.

5. **Improve:** Implement the changes to your own products, services, processes or strategy.

CASE STUDY

Benchmarking: Xerox Process

Xerox has popularized benchmarking and was one of the first companies to introduce the process of doing it. This 5-phase and 12-step process was created by Camp, R. the manager of Xerox responsible for benchmarking.



TOTAL QUALITY MANAGEMENT

Total Quality Management (TQM) is a concept given by W. Edwards Deming. Total Quality Management is a management approach that originated in the 1950s and has steadily become more popular since the early 1980s. It was originally introduced in Japan after World War II to assist the Japanese companies to re-build their economy. The main focus of TQM was and is continuous quality improvement in the areas of product or service, employer-employee relations and consumer-business relations. Total Quality is a description of the culture, attitude and organization of a company that strives to provide customers with products and services that satisfy their needs. The culture requires quality in all aspects of the company's operations, with processes being done right for the first time to eradicate defects waste from operations.

TQM Defined

"Quality" is "a degree of excellence", it is a degree to which a product lives up to its performance, endurance, maintainability, and other attributes expected by a customer while buying that specific product. For meeting such expectations of the customer, one must instill the concept of TQM in product development process. The word "total" means the sum total of every process, every job, every resource, every output, every person, every time and every place.

Definitions

American Society for Quality Control (ASQC) defines Total Quality Management (TQM) as "a management approach to long-term success through customer satisfaction. TQM is based on the participation of all members of an organization to improving processes, products, services, and the culture they work in. TQM benefits all organization members and society. The methods for implementing this approach are found in the teachings of such quality leaders as Philip B. Crosby, W. Edwards Deming, Armand V. Feigenbaum, Kaoru Ishikawa, and J.M. Juran."

ISO defined TQM as "A management approach of an organization centered on quality, based on participation of all its members and aiming at long term benefits to all members of the organization and society."

Brockman, J. R. (1992) has defined that "TQM is a management philosophy, embracing all activities through which the need of customer, the community and the objectives of the organization are satisfied in the most effective and potential of all employees in continuing drive for improvement."

TQM is a management philosophy that views an organization as a collection of processes such as marketing, finance, design, engineering, and production, customer service, etc. thereby, focussing on meeting customer needs and organizational objectives.

The simple objective of TQM is "Do the right things, right the first time, every time." Although originally applied to manufacturing operations, TQM is now becoming recognized as a Generic Management tool and is being widely applied in a number of service and public sector organizations all over the world.

Some examples of the companies who have implemented TQM include Ford Motor Company, Phillips Semiconductor, SGL Carbon, Motorola and Toyota Motor Company.

There are a number of evolutionary strands, with different sectors creating their own versions from the common ancestor. TQM is the foundation for activities, which include:

- Commitment by senior management and all employees.
- Meeting customer requirements.
- Reducing development cycle times.
- Just in time/demand flow manufacturing.
- Improvement teams.
- Reducing product and service costs.
- Systems to facilitate improvement.
- Line management ownership.
- Employee involvement and empowerment.
- Recognition and celebration.

- Challenging quantified goals and benchmarking.
- Focus on processes / improvement plans.
- Specific incorporation in strategic planning.

This shows that TQM must be practiced in all activities, by all personnel, in manufacturing, marketing, engineering, R&D, sales, purchasing, HR, etc.

Principles of TQM

The key principles of TQM are as following:

Management Commitment	Employee Empowerment	Fact Based Decision Making
• Plan (drive, direct) • Do (deploy, support, participate) • Check (review) • Act (recognize, communicate, revise)	• Training • Suggestion scheme • Measurement and recognition • Excellence teams	• SPC (statistical process control) • DOE, FMEA • The 7 statistical tools • TOPS (Ford 8D – team-oriented problem solving)

Continuous Improvement	Customer Focus
• Systematic measurement and focus on CONQ • Excellence teams • Cross-functional process management • Attain, maintain, improve standards	• Supplier partnership • Service relationship with internal customers • Never compromise quality • Customer driven standards

Characteristics of Total Quality Management

The most practical implementations of Total Quality Management involve the following most widely principles:

- *Total involvement of employees*: The most fundamental characteristic of TQM is total employee involvement. Only empowered and valiant employees who can take a stand for their work and understand the mechanism of operations of their organization operates as a whole can achieve desired level of performance by improving their efficiency. Further, employee involvement can also be attained by adopting a culture of continuous improvement and team empowerment.
- *Customer focus*: TQM views end customers as the sole measure of quality and success. Any effort, including employee training, infrastructure upgrades, software investments, or product releases, is worthwhile only if it aims at benefitting customers.
- *Continual improvement*: Organizations who practice TQM believe that merely maintaining the same level of quality and customer satisfaction is not enough to outperform competition. Rather, top management has the responsibility for promotion of culture of innovation and creativity to customers' expectations and maintain competitiveness.
- *Process approach*: It calls for breaking all processes into a series of steps, be it internal or external. The

rationale of this is that each such step can be analyzed, measured and improved upon to attain desired results.

- *System Approach to Management*: All inter-related processes should be managed as a system to ensure that improvement efforts are focused on 'key' processes and integrated to achieve the desired results.
- *Fact-based decisions*: TQM requires organizations to collect data to improve decision-making, reach agreements on key business directions and make predictions based on historical data.
- *Leadership/strategy definition*: A strategic plan should be developed to achieve organization's vision, objectives and goals with 'quality' as a key component. Leadership is a key attribute as it establishes the direction of the organization. TQM advocates that leaders create an enabling environment for achieving business objectives.
- *Mutually beneficial relationship with suppliers*: An organization depends on its suppliers and this relationship should be strengthened to ensure that a mutually beneficial relationship is sustained.

Principles of Total Quality Management

There are eight principles of Total Quality Management which are discussed below:

- **Customer-focused**

  The customer ultimately determines the level of quality. No matter what an organization does to foster quality improvement – training employees, integrating quality into the design process, upgrading computers or software, or buying new measuring tools – the customer determines whether the efforts were worthwhile.

- **Total Employee Involvement**

  All employees participate in working toward common goals. Total employee commitment can only be obtained after fear has been driven from the workplace, when empowerment has occurred, and management has provided the proper environment. High-performance work systems integrate continuous improvement efforts with normal business operations. Self-managed work teams are one form of empowerment.

- **Process-centered**

  A fundamental part of TQM is a focus on process thinking. A process is a series of steps that take inputs from suppliers (internal or external) and transforms them into outputs that are delivered to customers (again, either internal or external). The steps required to carry out the process are defined, and performance measures are continuously monitored in order to detect unexpected variation.

- **Integrated System**

  Although an organization may consist of many different functional specialties often organized into vertically structured departments, it is the horizontal processes interconnecting these functions that are the focus of TQM.

- **Strategic and Systematic Approach**

  A critical part of the management of quality is the strategic and systematic approach to achieving an organization's vision, mission, and goals. This process, called strategic planning or strategic management, includes the formulation of a strategic plan that integrates quality as a core component.

- **Continual Improvement**

  A major thrust of TQM is continual process improvement. Continual improvement drives an organization to be both analytical and creative in finding ways to become more competitive and more effective at meeting stakeholder expectations.

- **Fact-based Decision Making**

  In order to know how well an organization is performing, data on performance measures are necessary. TQM requires that an organization continually collect and analyze data in order to improve decision making accuracy, achieve consensus, and allow prediction based on past history.

- **Communications**

  During times of organizational change, as well as part of day-to-day operation, effective communications play a large part in maintaining morale and in motivating employees at all levels. Communications involve strategies, method, and timeliness.

Continuous Improvement by TQM

TQM is mainly concerned with continuous improvement in all work, from high level strategic planning and decision- making, to detailed execution of work elements on the shop floor. It stems from the belief that mistakes can be avoided and defects can be prevented. It leads to continuously improving results, in all aspects of work, as a result of continuously improving capabilities, people, processes, technology and machine capabilities.

Continuous improvement must deal not only with improving results, but more importantly with improving capabilities to produce better results in the future. The five major areas of focus for capability improvement are:

- Demand generation,
- Supply generation,
- Technology,
- operations, and
- People capability.

Implementation Principles and Processes

Assess the organization's current reality: A preliminary step in TQM implementation is to assess an organization's current reality. Relevant preconditions have to do with the organization's history, its current needs, precipitating events leading to TQM, and the existing employee quality of working life. If an organization has a track record of effective responsiveness to the environment, TQM will be easier to implement.

However, if there is no track-record of responsiveness, there will be both employee skepticism and a lack of skilled change agents. If this condition prevails, a comprehensive program of management and leadership development may be instituted. A management audit is a good assessment tool to identify current levels of organizational functioning and areas in need of change.

An organization should be basically healthy before beginning TQM. If it has significant problems such as a very unstable funding base, weak administrative systems, lack of managerial skill, or poor employee morale, TQM would not be appropriate. However, a certain level of stress is probably desirable to initiate TQM.

A crisis, if it is not too disabling, can also help create a sense of urgency which can mobilize people to act. In the case of TQM, this may be a funding cut or threat, or demands from consumers or other stakeholders for improved quality of service. After a crisis, a leader may intervene strategically by articulating a new vision of the future to help the organization deal with it. A plan to implement TQM may be such a strategic decision. Such a leader may then become a prime mover, who takes charge in championing the new idea and showing others how it will help them get where they want to go. Finally, action vehicles are needed and mechanisms or structures to enable the change to occur and become institutionalized.

Conclusion

TQM encourages participation amongst shop floor workers and managers. There is no single theoretical formalization of total quality, but Deming, Juran and Ishikawa provide the core assumptions, as a "discipline and philosophy of management which institutionalizes planned and continuous improvement and assumes that quality is the outcome of all activities that take place within an organization; that all functions and all employees have to participate in the improvement process; that organizations need both quality systems and a quality culture."

CASE STUDY

FORD MOTOR COMPANY – TOTAL QUALITY MANAGEMENT

Ford Motor Company total quality management or TQM practices started in the 1980s when "Quality Is Job 1" was their slogan. How did TQM work at Ford and are they still standing behind this process? Jean Scheid, a Ford Dealer talks with Ford management along with some insights of her own.

When an invasion of Japanese imports threatened the American automobile industry, the Ford Motor Company led a quality revival based on the management philosophy of W. Edwards Deming, who was controversial then and is out of fashion now.

The results of the movement, known as Total Quality Management, were stunning at Ford. After racking up $3 billion in losses between 1979 and 1982, Ford hit a series of home runs, including the aerodynamic Taurus- Sable cars, and by 1986 had become the most profitable American auto company.

Now, though, Ford's hard-won reputation for quality is being tarnished by a series of setbacks, from the controversy over deadly rollovers of Ford Explorers equipped with Firestone tires to costly recalls of several models and delays on the introductions of others. Indeed, according to recent surveys by Consumer Reports and J. D. Power & Associates, overall quality and customer satisfaction for Ford cars now lag the competition.

And so, once again, the company is embracing quality as the answer to its problems. This time, it has seized on Six Sigma, a management tool that is sweeping corporate America. "It was a good way to get a common language around innovation and marketing," said Jacques Nasser, Ford's chief executive, who started the Six Sigma program in 1999.

Six Sigma was popularized by John F. Welch Jr. of General Electric in the 1990's. Adopting it does, however, point to a management problem. Too often, when it comes to management tools for improving efficiency and worker productivity, companies have to reinvent the wheel.

The customer knows best: AtlantiCare

TQM isn't an easy management strategy to introduce into a business; in fact, many attempts tend to fall flat. More often than not, it's because firms maintain natural barriers to full involvement. Middle managers, for example, tend to complain their authority is being challenged when boots on the ground are encouraged to speak up in the early stages of TQM. Yet in a culture of constant quality enhancement, the views of any given workforce are invaluable.

Profits after quality improvement strategy

One firm that's proven the merit of TQM is New Jersey-based healthcare provider AtlantiCare. Managing 5,000 employees at 25 locations, AtlantiCare is a serious business that's boasted a respectable turnaround for nearly two decades. Yet in order to increase that margin further still, managers wanted to implement improvements across the board. Because patient satisfaction is the single-most important aspect of the healthcare industry, engaging in a renewed campaign of TQM proved a natural fit. The firm chose to adopt a 'plan-do-check-act' cycle, revealing gaps in staff communication – which subsequently meant longer patient waiting times and more complaints. To tackle this, managers explored a sideways method of internal communications. Instead of information trickling down from top-to-bottom, all of the company's employees were given freedom to provide vital feedback at each and every level.

AtlantiCare decided to ensure all new employees understood this quality culture from the onset. At orientation, staff now receive a crash course in the company's performance excellence framework – a management system that organises the firm's processes into five key areas: quality, customer service, people and workplace, growth and financial performance. As employees rise through the ranks, this emphasis on improvement follows, so managers can operate within the company's tight-loose-tight process management style.

After creating benchmark goals for employees to achieve at all levels – including better engagement at the point of delivery, increasing clinical communication and identifying and prioritising service opportunities – AtlantiCare was able to thrive. The number of repeat customers at the firm tripled, and its market share hit a six-year high. Profits unsurprisingly followed. The firm's revenues shot up from $280m to $650m after implementing the quality improvement strategies, and the number of patients being serviced dwarfed state numbers.

SIX SIGMA

Six Sigma is a disciplined, statistical-based, data-driven quality control program. It is a methodology for continuous cycle time improvement (the reduction of manufacturing defects to a level of no more than 3.4 per million) by eliminating defects in any product, process or service. Developed by Motorola in middle 1980's, Six Sigma is based on quality management fundamentals. Due to its accuracy and merits, the approach became popular at General Electric (GE) in the early 1990's. Today, thousands of organisations across the globe have adopted Six Sigma. Six Sigma is:

- *A Business Strategy*: Using Six Sigma Methodology, a business can strategize its plan of action and drive revenue increase, cost reduction and process improvements in all parts of the organization.
- *A Vision*: Six Sigma Methodology helps the Senior Management create a vision to provide defect free, positive environment to the organization.
- *A Benchmark*: Six Sigma Methodology helps in improving process metrics. Once the improved process metrics achieve stability; we can use Six Sigma methodology again to improve the newly stabilized process metrics. For example: The Cycle Time of Pizza Delivery is improved from 60 minutes to 45 minutes in a Pizza Delivery process by using Six Sigma methodology. Once the Pizza Delivery process stabilizes at 45 minutes, we could carry out another Six Sigma project to improve its cycle time from 45 minutes to 30 minutes. Thus, it is a benchmark.
- *A Goal*: Using Six Sigma methodology, organizations can keep a stringent goal for themselves and work towards achieving them during the course of the year. Right use of the methodology often leads these organizations to achieve these goals.

- *A Statistical Measure*: Six Sigma is a data driven methodology. Statistical Analysis is used to identify root- causes of the problem. Additionally, Six Sigma methodology calculates the process performance using its own unit known as Sigma unit.
- *A Robust Methodology*: Six Sigma is the only methodology available in the market today which is a documented methodology for problem solving. If used in the right manner, Six Sigma improvements are bullet-proof and they give high yielding returns.

Six Sigma can also be thought of as a measure of process performance. once the current performance of the process is measured, the goal is to continually improve the sigma level striving towards 6 sigma. Even if the improvements do not reach 6 sigma, the improvements made from one sigma level to other will still diminish costs and augment customer satisfaction.

Why Six Sigma

With the budding costs cost of resources and rise in other factors such as competition, the organizations are forced to look around for alternative methods which add to efficiency. Adoption of Six Sigma methodology helps in improving efficiency in any organization as it meticulously identifies defects and minimizes the variations within a process. This is because, each Six Sigma project is supposed to follow a defined sequence of steps and includes specific improvement targets. Some examples could include:

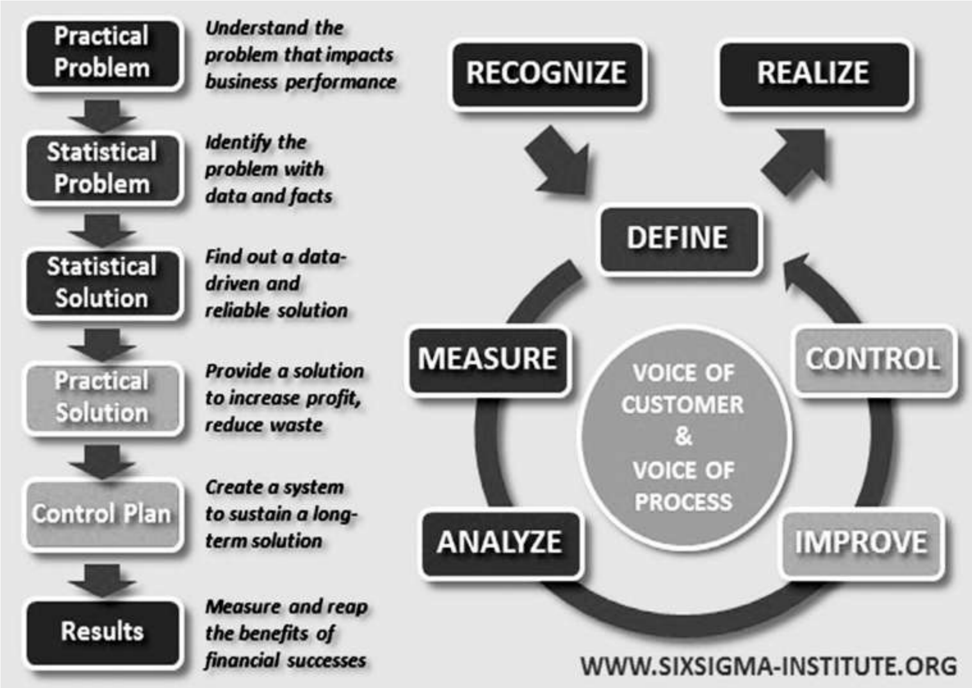
- Decrease in process cycle time.
- Decrease of scrap generated by a process.
- Growing customer satisfaction.
- Decline in the number of factory defects.
- Decrease or elimination of costly reworks.

The scope of Six Sigma is not curtailed to the manufacturing industry rather the tools and techniques of Six Sigma are presently being used to improve processes in all type of business organizations, routine office operations, business processes and customer service processes.

How does 6 Sigma work?

A typical Six Sigma project determines the existing state and enhances the performance of the business process to a new and statistically significant improved state with the use of statistical tools. There can be two situations: First, the process already existing but it is not working "reasonably" well; second, there is no process in existence at all.

Situation 1: The process already existing but it is not working "reasonably" well. This scenario focuses on use of DMAIC (which stands for Define, Measure, Analyze, Improve and Control):



1. Define problem statement process goals in terms of key critical parameters on the basis of customer requirements or Voice Of Customer (VOC) and setting project boundaries.
2. Measure a complete picture of the current state of the process and establishes a baseline through measurement of the existing system in context of goals and collecting the data regarding possible causal factors.
3. Analyze the current scenario in terms of causes of variations and defects and determining the root cause.
4. Improve the process by systematically reducing variation and eliminating defects and root causes.
5. Control future performance of the process and support and maintain the gains realized.

Situation 2: This is the situation when there is no process in existence at all and it has to be designed using Design For Six Sigma (DFSS) approach. DFSS approach typically requires IDOV:

1. Identify process goals in terms of critical parameters, industry & competitor benchmarks, Voice Of Customer (VOC).
2. Design involves enumeration of potential solutions and selection of the best.
3. Optimize performance by using advanced statistical modeling and simulation techniques and design refinements.
4. Validate that design works in accordance to the process goals.

Note, sometimes a DMAIC project may turn into a DFSS project because the existing process may require complete re-design making room for a new process due to lack of effectiveness of existing system. Such a development may be discovered during 'improvement phase' of DMAIC.

It is extremely important to remember that Six Sigma is not just about quality of the product but has also to take in account the customers and the market. For instance, in the year 1988, Polaroid had a sale of over US$ 2 billion, and was an excellent player in stock exchange. In the year 1997, it became a Six Sigma company. However, in late 2001, it had to file bankruptcy because it just kept on focussing on improvement of quality of their products and completely failed to assess the customer needs.

Illustration

Consider a pizza delivery shop that guarantees the order delivery within 30 minutes from the time of accepting an order. In the event of a delivery time miss, the customer is refunded 100% money. It implies that such pizza shop will have to make 99.9997% deliveries within 30 minutes to be called a six sigma shop. There are certain parameters called a Critical To Quality (CTQ) and its example with reference to pizza shop will be:

- CTQ Name: Timely Pizza delivery.
- CTQ Measure: Time in Minutes.
- CTQ Specification: Delivery within 30 minutes from the order acceptance time.

Defect: Delivery that takes longer than 30 minutes.

The Six Sigma Training and Certification Levels

The Six Sigma training and certification levels are emulated from the martial arts. "Six Sigma" management has several levels of certification i.e. Champion, Yellow Belt, Green Belt, Black Belt, and Master Black Belt. Each level of certification is described below.

Champion

A Six Sigma Champion is the most basic form of Six Sigma certification. A Champion understands the theory of Six Sigma management, but does not yet have the quantitative skills to function as an active Six Sigma project team member.

A Yellow Belt

A Six Sigma Yellow Belt is an individual who has passed the Green Belt certification examination but has not yet completed a Six Sigma project. A Yellow Belt should have a basic understanding of Six Sigma, statistical tools and DMAIC methodology. However, executives in Six Sigma organizations function as champions of Six Sigma projects.

Green Belt

A Six Sigma Green Belt is an individual who works on projects part-time either as a team member for complex projects, or as a project leader for simpler projects. Green belts are the "work horses" of Six Sigma projects. Green Belts receive training on DMAIC methodology, statistical tools, proper data collection and analysis of the data collected. Most managers in a mature Six Sigma organization are green belts.

Black Belt

A Black Belt receives the highest level of training in the statistical tools of Six Sigma. Black Belts, as a rule, develop the plans for Six Sigma project implementation. Their responsibilities include creating project plans, leading cross- functional projects and directing team members, including Green and Yellow Belts. Black Belts usually train other team members on the proper use of Six Sigma tools and techniques, such as control charts, histograms and Root Cause Analysis (RCA).

Master Black Belt

A Master Black Belt is classically trained in statistical tools, Six Sigma methodology and management processes. Master Black Belts mentor and direct groups of Black Belts and Six Sigma teams through various problems that need to be reviewed.

CASE STUDY

Six Sigma Implementation in Ford Motor Company

Ford Motor Company, an American Multinational automaker considered as the world's, largest and most successful automakers is famous for introducing revolutionary products. The company is known for its innovative and dynamic approach to manufacturing by using Total Quality Management approach to achieve its vision "Quality Is Job 1". It has employed such manufacturing concepts as standardization, assembly lines, which came to be known as Fordism. Ford was ranked 'seventh' in terms of quality in automobile world in 2001, the position which was soon elevated to third in the year 2003, which was viewed as a remarkable improvement over this two-year period. The credit of such improvement was awarded to quality initiatives taken by Ford in 1999, significant among which was the Six Sigma techniques such as a data-driven problem-solving process, to devise solutions to waste issues. Six Sigma saved Ford from its deep-rooted problems. These issues include inadequate productivity, poor use of resources, low customer satisfaction, and environmental unfriendliness.

Carrying Out the Six Sigma Approach

To actualize the vision of becoming a consumer products company, Ford Motor Company implemented Six Sigma in late 1990s with the twin goals of enhancing vehicle quality and improving the level of customer satisfaction. The initiative was called 'Consumer-driven Six Sigma'. Ford was the first major automobile company in the world to go for Six Sigma initiative in a big way. In Ford's view, there existed about 20,000 opportunities for defects in manufacturing a car. Through Six Sigma, Ford aimed at attaining its defect rate to just one for every 14.8 vehicles.

Reasons to adopt Six Sigma in Ford Motor Company

- Cost Reduction
- Quality Improvement
- Improve Customer Satisfaction
- Reduce solvent consumption to lower the environment impact

Roadblocks in Implementing Six Sigma

- Employee Commitment
- Resource challenge (time, money and productivity)
- Infrastructure to fully run the Six Sigma Initiative as it required enormous data and internal measures.

FORD's improvement after implementation of Six Sigma

- Elimination of more than $2.19 billion of wastage of resources since 2001.
- An increasingly dramatic impact on operations of the enterprise. After adopting six sigma, Ford has completed more than 9,500 projects savings $1.7 billion worldwide, including $731 million in 2003.
- Increase in customer satisfaction to five percentage points as disclosed by company's internal customer satisfaction survey.

A Comparison of Business Process Reengineering vs. Six Sigma

Features	*BPR*	*Six Sigma*
General Tendency	Radical redesign	Align and maintain
Business drivers	Recession and changing market needs	Service bundling and internet
Goals	Streamlining	Process alignment
Tools	Process maps	Statistical analysis
Method	Challenge process fundamentals	Prioritize by COPQ (Cost of Poor Quality) and Capability
Deployment	Top-down	Top-Bottom-middle
Key feature	Outside consultants	Internal experts
Impact	Short and medium term	Short, medium and long-term
Role of technology	Enabler	Enabler
Risk/return	High-low	Medium-high

Source: www.sixsigma-institute.org

CASE STUDIES FROM THE INDIAN CONTEXT TO ESTABLISH A STRATEGIC MINDSET

CASE STUDY-1

A BETTER BUSINESS MODEL FOR FASHION FROM ZARA

One of the most well-known brands in the world and a major player in the global fashion industry is Zara. They are a division of Inditex and the third-largest brand in the clothing sector. Its headquarters are in Spain, and their flagship line of chain stores. In 1975, the first Zara store was established in Spain. Galicia is where the company is headquartered. In the world, there are more than 2600 stores spread across 73 nations. The majority of the parent company's revenues come from the Zara apparel line.

Zara is recognised for developing items quickly rather than taking an eternity. They have a reputation for developing items in about two weeks and producing 10,000 new designs annually (which is an industry record). Instead of moving their whole manufacturing to Third World or Developing countries, they have defied the trend by producing in Europe. Yet, because some of their clothing has a longer shelf life, some of it is produced in Asia. Since they operate numerous facilities in both Spain and Portugal, they produce the majority of their goods domestically or in other European nations. They also don't have to depend on anyone else as they can get everything done by themselves.

Zara is distinctive in that it focuses on opening new stores rather than spending money on marketing. They have earned a reputation as one of the most creative shops in the world because to their daring efforts. When Zara first started off, its products were cheap knockoffs of expensive apparel. Due to the success of this decision, Zara was able to grow by adding more stores in Spain. The corporate management also managed to shorten the time it required to generate new designs and came up with the term "instant fashions" which allowed them to capitalise on new trends fairly rapidly. Instead than employing lone designers, Zara is renowned for using design teams.

H&M, Gap, and Benetton are fierce competitors for Zara on the global market. Luckily Zara is believed to be more fashionable than the rest of the brands despite the fact that its pricing is cheaper than Benetton and Gap. Although being similarly stylish as Zara, H&M is nonetheless more affordable. Less stylish and more expensive brands include Gap and Benetton.

The fundamental tenet of Zara's business strategy is that it can offer "moderately priced, fashionable goods." Fundamentally, Zara's successful business strategy relies heavily on vertical integration and the capacity to respond quickly; otherwise, they would not be where they are now. The Zara process has been created in a way that includes all of the different business system tasks, including designing, sourcing, production, distribution, and retailing. They do all of things themselves and that is one reason why their growth is at a good rate. Yet, everything that goes up must eventually fall down, and Zara is not immune to the world's issues. Due to the model they are now using, their methods of operation may potentially prove to be their downfall. They have their own manufacturing facility and distribution centre, which is a major weakness.

The management at Zara has identified four key success factors: a quick turnaround time for product development, a small quantity per product (and not too much of the same stock), a wide variety of products every season (so that customers can choose easily), and a significant investment in ICT to help them stay on track.

Zara doesn't lose money since they only order a small number of each item they think is fashionable and will be harder to find seasonally. For instance, due of Europe's brief summer season, miniskirts in this design will only be available for a limited time. Other clothing that can be worn all year long and whose trends don't fluctuate is outsourced to Asia because the price isn't as high. The fact that these clothing have a longer shelf life makes the outsourcing process more practical. The preparation of the clothing does not require much time; the entire procedure, from design to finished product in the stores, only takes around 4 weeks.

Zara has a significant advantage over their competitors since they are aware of the market trends and are quick to adapt their business plan to keep up with changes in the fashion sector. They can quickly alter their schedule to take into account changes in market patterns. For any typical retailer, it typically takes 8 to 12 months to predict trends, develop a style, and send it for production. They lose badly because they are unable to compete with Zara's abilities. Even if a certain style doesn't do well, Zara can still offer the items at a discount. The fact that they lost a lot since there were so few clothing produced. They have a very small number of discount sales each year, compared to a high rate for the rest of the market, because to their low volume approach.

They do not have to worry about having greater stockpiles, but this results in higher expenses, which is a drawback. With this approach, low inventories and large profit margins are possible. They incur no cost savings here, yet they nevertheless make the most of their clothes line. As Zara controls everything, it is difficult for them to expand or migrate because they must remain in one spot or the entire operation will suffer, increasing the cost of distributing the items.

A great aspect of Zara's business strategy is that they have a very fashion-forward range since they know which trends to capitalise on. They appear to possess the Midas touch, turning anything they touch into gold. It is their policy to hire a crew that is primarily youthful and stylish so that they can serve as trend setters. For instance, if a certain item at a store does well, the management may decide to sell it in additional stores. The key is that people believe there is a shortage of most products because they are in short supply, which leads them to want to buy more.

The fact that Zara has acquired its goods from the correct regions is a major contributor to its success. They have established offices for procurement in a few chic global locations. As a result, they may see the trends for themselves and swiftly devise a remedy of their own. They hire one of the procurement departments of their parent group to handle all of their purchasing instead of buying all the raw materials themselves. One wise decision made by them is that they purchase the majority of their cloth in grey to allow for more flexibility. The process of preparing the fabric is quick.

The fact that they have vertical integration, however, gives them the greatest advantage because it enables them to make and market their own products independently of suppliers. It is not challenging to move any of their items as they have their own railway network which allows them to move goods quickly to its distribution hub. Even though shipment only happens twice a week, the goods are sent out right away once they are ready. While other locations receive the goods in two days, European stores receive them sooner (between 24 and 36 hours). They have been able to reach a very high level of accuracy in their shipments because to this technique. Another plus is that once the new clothing arrives at the stores, it doesn't take them long to display it, allowing them to exhibit new merchandise to their patrons. In order for the employees to know where to put the clothing, they are also color-coded. Customers now find it simpler to browse for things that match the colours they want to purchase.

CASE STUDY-2

MCDONALD'S MARKETING TACTICS

The largest chain of fast-food restaurants in the world is McDonald's. There are more than 30,000 of them spread throughout more than 100 nations. In comparison to 2006, more than one billion additional clients were serviced in 2007. Although McDonald's sales increased 6.8% and revenue reached a record high of $23 billion in 2007, net profitability fell by $1.1 billion. The System, which refers to the firm, its franchisees, and suppliers collectively, is what has made McDonald's successful over the years. The company's business approach enables it to continually provide consumers with relevant dining experiences and to play a significant role in the communities it serves.

Plan to Win refers to McDonald's entire strategic framework. Becoming the biggest fast-food restaurant business is not their primary goal; instead, they are more concerned with being the greatest. By the implementation of numerous initiatives centered around the five factors of great customer experiences — people, products, place, price, and promotion — McDonald's "strategic alignment behind this approach has delivered superior McDonald's experiences." Also, McDonald's uses geographically-based strategy planning. The strategic priorities of McDonald's in the United States are still breakfast, chicken, beverages, and convenience. These are the main metropolitan regions in the US. McDonald's has introduced the Southern Style Chicken Sandwich for lunch and dinner as well as the Southern Style Chicken Biscuit for breakfast. McDonald's began rolling out fresh hot specialty coffee options market by market in the beverage industry. McDonald's employs a tiered menu strategy in Europe. This menu offers upscale options, classic dishes, and regularly priced items. Also, they "supplement these with fresh merchandise and transient food specials." McDonald's strategy plan is centered on value, convenience, breakfast, core menu additions, and the Middle East, Asia, and Africa. McDonald's should start to experience better financial results thanks to its overall strategy plan and its geographic strategic plan.

McDonald's uses a variety of organisational techniques. Better restaurant operations, putting the client first, offering a variety of food and drinks, convenience and daypart development, and continual restaurant reinvestment are a few organisational initiatives. In 2008 and beyond, McDonald's plans to "continue to drive success by leveraging key consumer insights and our global experience, while relying on our strengths in developing, testing and implementing initiatives surrounding our global business drivers of convenience, branded affordability, daypart expansion and menu variety." McDonald's must increase restaurant operations' efficiency while prioritising the needs of the customer as one strategy to achieve a positive net income. McDonald's is aiming for higher revenue and visitor counts by strategically focusing on beverage options and menu variety. McDonald's hopes to boost productivity at its drive-thru pick-up window with their convenience and daypart expansion plan. The corporation is also remaining open later to accommodate individuals who need a quick meal after midnight. Also, McDonald's has outlets that are locally owned and run, which "are at the heart of their competitive edge and makes them not just a worldwide brand but a locally relevant one," according to the company. They are currently updating and modernising their franchises. Also, the business is opening a McCafe's in hopes that it will help it get closer to its long-term objective of tripling sales at its current U.S. restaurants. Affordability and staff development, which begins with hiring and training and progresses all the way up to leadership and management, are two other organisational concepts.

McDonald's marketing initiatives are being influenced by their strategic plan through enhancing brand transparency. They aim for worldwide recognition of their brand. They are improving the clientele's encounter. "They are making it simpler for customers to have a wonderful McDonald's experience in all of their markets. In China and Russia, they are bringing drive-thrus to the more mobile people, while in the United States and Canada, more efficient drive-thrus and double drive-thru lanes allow them to quickly serve even more customers. McDonald's has a rebranding campaign in Germany that includes expanding by roughly 100 McCafes. Also, they are setting up new kitchen operational systems to maintain their ability to produce high-quality meals. Almost 10,000 McDonald's locations have already undergone renovations worldwide. They desire for their eateries to represent their brand. With new menu options, the business is also giving the customer more value. "They generate value for customers and satisfy their demand for choice and diversity by presenting a locally relevant balance of innovative goods, premium salads and sandwiches, traditional menu favourites, and everyday cheap choices around the world."

Longer operation hours, everyday value meals, and drive-thru efficiency optimization are all examples of the marketing mix types used by McDonald's to fulfil their marketing objectives. McDonald's employs marketing initiatives as well. In 2007, McDonald's offered kids the option of milk, fruit, or veggies as part of their Happy Meal by referencing the Shrek movie. In addition to their dedication to working with kids, McDonald's is enhancing the perception of their brand "through innovative marketing that transports ideas across borders and uses i'm lovin' it to strengthen their connection with customers who love their cuisine and the distinctive McDonald's experience." McDonald's served the Beijing Burger, Carmel and Banana Sundae, and Rice Sticks at the Beijing Olympics in 2008. On their package, they have nine Olympians and Paralympians. The name of McDonald's new hamburger was up for public vote as part of a marketing drive in Australia. Backyard Burger was selected as the winner. McDonald's is attempting to improve the perception of its brand with marketing initiatives like these.

Creating stronger relationships of trust by being approachable and keeping an open communication with customers and important stakeholders is another organisational and marketing strategy. The corporation is investing about $1.9 billion in its restaurants, mainly to remodel current locations and construct new ones. McDonald's is also transitioning to a less capital-intensive, heavily franchised business model. However, this is not permitted in some nations, including China, due to official regulations.

Due to McDonald's emphasis on the five components of excellent customer service and expanding global brand recognition, their revenues and net income should rise. The consumer will have a more welcoming and pleasant dining experience thanks to the initiative to renovate and upgrade current franchisees. McDonald's marketing strategy for the 2008 Olympics made them feel like a vital part of the event, which only improved the company's reputation. This will enable McDonald's to reduce its already high turnover percentage through recruitment and training activities for current workers or potential future hires.

CASE STUDY-3

SWOT ANALYSIS : THE FULCRUM OF STRATEGIC DECISION MAKING

Gujarat Cooperative Milk Marketing Federation Ltd. (GCMMF) is India's largest food product marketing organisation. It is the apex organisation of the Diary Cooperatives of Gujarat popularly known as AMUL which aims to provide remunerative returns to the farmers and also serve the interest of consumers by providing quality products. AMUL is considered as one of the most well recognized and iconic brands in the country. It operates through 61 sales offices and has a network of 10000 dealers and 10 lakh retailers. Its product range comprises milk, milk powder, health beverages, ghee, butter, cheese, Pizza Cheese, Ice cream, Paneer, chocolates and traditional Indian sweets etc.

Based on the above information, do the SWOT analysis of AMUL is placed below:

SWOT Analysis of a Renowned Dairy Business - AMUL

Following is the SWOT analysis of AMUL, a strong and dominant brand in the dairy business.

Investment in Technology; Market Share, Production Capacity, Quality, Brand value, Large Consumer Base **Strength**	High Operational Costs, Lack of success in portfolio expansion, legal issues **Weakness**
High Milk Consumption, Global Expansion, Product Portfolio Expansion **Opportunities**	Increasing Competition, growing trends of veganism **Threats**

Strengths of AMUL

Investment in Technology

Amul has experienced exponential growth in the last few decades. The company is continually investing in adaptive and revolutionary technologies within the dairy industry.

Market Share

Amul has transformed itself into the market leader of milk and dairy products in the country. Amul has expanded its ice cream product and business portfolio by opening standalone Amul ice cream stores all over the country.

Production Capacity

Amul is one of the largest manufacturers of milk and dairy products in the world. The company is managed by the Gujarat Co-operative Milk Marketing Federation Limited, which is a dairy producers cooperative which supplies the company with almost 18 million liters of milk daily.

Quality

One of the primary reasons for Amul being one of the most trusted brands in Indian and having a strong and loyal consumer base is its quality. Amul has never faced any significant issues pertaining to its quality within the Indian market. The company has also maintained transparency concerning its quality control practices.

Strong Brand Value

Amul is one of the most recognizable and valuable brands in India. The Amul girl, the company's mascot which features on its advertisements is one of the oldest and most iconic brand mascots which Amul uses even today.

Large Consumer Base

The company has a large consumer base which spreads across the urban and rural regions of the country.

This wide-reaching consumer base has allowed the company to maintain distinct leverage over its competitors.

Weaknesses of AMUL

High Operational Cost

Amul has a high operational cost due to its massive size and complex structure. This can become problematic for the company if the company experiences fall in demand.

The company also heavily depends on the dairy unions and communities for its supply of milk. As the needs of the dairy community are changing with them demanding higher prices for their produce. These issues can add up to the operational cost of the company and lower its profit margins.

Lack of Success in Certain Areas of Portfolio Expansion

Amul has expanded its product portfolio to add products such as butter, ghee, buttermilk, flavored milk, ice cream, chocolates, cheese, creams, sweets and more.

However, not every product of Amul within its portfolio has same amount of success.

Frequent Legal Issues

The company has faced legal issues in the recent past wherein Amul chose to advertise its products while disparaging the brand and products of its rivals. This caused the company a lot of embarrassment and has also contributed to tarnishing the public image of the company.

Opportunities for AMUL

High per capita Milk consumption

India is a high milk consuming nation with milk and dairy products being an essential component of the Indian diet. India has 130 crore population which is only increasing. This growth in population and high milk consumption opens up opportunities for AMUL to expand its production capacities and acquire new consumers.

International Expansion

AMUL can serve global markets. The brand can expand into overseas markets such as the Middle-East and the Asian markets by aggressively targeting Indian expats living in these countries.

Expansion of Product Portfolio

AMUL can invest in research and development or adopt a mergers and acquisition strategy to expand its product line. AMUL has an extensive distribution network which can be used to sell its new products into the market, and the substantial brand value and trust of the consumers will also enable easier acceptance from the consumers.

Threats for AMUL

Increasing Competition

AMUL is facing increasing competition in milk and dairy products sector from brands such as Mother Dairy, Kwality Ltd, HUL and other local players. AMUL is also facing increasing competition within the ice cream market from Kwality Walls, Baskin Robins, Havmor, London Dairy and other domestic brands.

Growing trend of Veganism in India

Many people in India are turning towards veganism, which implies that these people do not consume dairy or dairy products. This can impact the demand for Amul's milk and dairy products if the popularity of veganism increases and spreads across different parts of the country.

Findings of SWOT Analysis of AMUL

As per the SWOT analysis of AMUL, the company can easily identify and analyse the internal and external factor which help it to take the strategic decisions. The company can achieve a dominant global position by maintaining its quality standards, investing in advertising and promotions and localizing products as per the taste of the international markets. Thus, it has the opportunity to go 'Glocal', i.e. *think globally but act locally*.

What are the quick tips, you will suggest for a successful SWOT analysis?

Following are the tips for a successful SWOT analysis

- Keep SWOT short and simple, but remember to include important details. For example, if the staff in an organisation is a strength, include specific details, such as specific skills and experience possessed by the concerned staff members, as well as why they are strengths and how they can help to meet the goals of the organisation.
- When SWOT analysis is completed, prioritise the results by listing them in order of the most significant factors that affect the business to the least.
- Obtain multiple perspectives for those SWOT analysis that have been given a final shape and implemented; Ask for input from various stakeholders like employees, suppliers, customers and partners.
- Apply SWOT analysis to a specific issue, rather than to the entire business. Then after conduct separate SWOT analysis on individual issues and combine them.
- Look at where business is now and think about where it might be in the future.
- Consider the competitors and have a realistic assessment of the organisation's competitive strength in the industry.
- Think about the factors that are essential to the success of an organisation and the products or any other services, like superior after sale services, free delivery, warranty / guarantee etc. an organisation can offer customers that may exert an impact on the competitors, in order to have a competitive advantage. It is essential to take into consideration the factors relating to competitive advantage while conducting the SWOT analysis.
- Use goals and objectives from overall business plan in SWOT analysis.

Conclusion

The business world is highly competitive, traditional industries are getting shocked by the rise of the technology businesses, thousands of start-ups blooming every day while thousands of businesses withering every day. The key to the survival of the business is the strategy an organisation adopts and implements.

SWOT analysis helps the organisation to specify the objectives of the business venture or project and identifying the internal and external factors that are favourable and unfavourable to achieve that objectives. Identification of **SWOT** is important because they may be of immense assistance in chalking out the business plan to meet the objectives of the business.

The significance of SWOT analysis is that it provides a good way for companies to examine both positive and negative attributes within a single analysis, determining how best to compete in the market at large. SWOT assists the management to map out the best possible opportunity well in advance which helps business to begin planning to deliver a quality solution and to make a marketing plan.

CASE STUDY-4

FUNCTIONAL LEVEL STRATEGIES – AN EFFECTIVE TOOL TO ACHIEVE ORGANIZATIONAL GOALS

In 2017, a chain of coffee retailer, closed a decade of astounding financial performance. Sales had increased from $700 million to $8 billion and net profits from $40 million to $600 million. In 2017, The Company' was earning a return on invested capital of 25 %, which was impressive by any measure, and the company was forecasted to continue growing earnings and maintain high profits through to the end of the decade. How did this come about?

Thirty years ago Company was a single store in its local Market selling premium roasted coffee. Today it is a global roaster and retailer of coffee with more than 12,000 retail stores, some 3,000 of which are to be found in 40 countries outside its Home Country. The Company set out on its current course in the 1980s when the company's director of marketing, Srinivas Santharaman, came back from a trip to Italy enchanted with the Italian coffeehouse experience. Srinivas Santharaman, who later became CEO, persuaded the company's owners to experiment with the coffeehouse format – and the Coffee House experience was born.

Santharaman basic insight was that people lacked a "third place" between home and work where they could have their own personal time out, meet with friends, relax, and have a sense of gathering. The business model that evolved out of this was to sell the company's own premium roasted coffee, along with freshly brewed espresso- style coffee beverages, a variety of pastries, coffee accessories, teas, and other products, in a coffeehouse setting. The company devoted, and continues to devote, considerable attention to the design of its stores, so as to create a relaxed, informal and comfortable atmosphere.

Underlying this approach was a belief that Santharaman was selling far more than coffee— it was selling an experience. The premium price that the Company charged for its coffee reflected this fact.

From the outset, Santharaman also focused on providing superior customer service in stores. Reasoning that motivated employees provide the best customer service, Company executives developed employee hiring and training programs that were the best in the restaurant industry. Today, all Company's employees are required to attend training classes that teach them not only how to make a good cup of coffee, but also the service oriented values of the company. Beyond this, Company provided progressive compensation policies that gave even part- time employees stock option grants and medical benefits – a very innovative approach in an industry where most employees are part time, earn minimum wage, and have no benefits.

Unlike many restaurant chains, which expanded very rapidly through franchising arrangement once they have established a basic formula that appears to work, Santharaman believed that Company needed to own its stores. Although, it has experimented with franchising arrangements in some countries, and some situations its home country such as at airports, the company still prefers to own its own stores wherever possible.

This formula met with spectacular success in the Country, where Company went from obscurity to one of the best known brands in the country in a decade. As it grew, Company found that it was generating an enormous volume of repeat business.

Today the average customer comes into a Company' store around 20 times a month. The customers themselves are a fairly well- healed group – their average income is about $85,000.

As the company grew, it started to develop a very sophisticated location strategy. Detailed demographic analysis was used to identify the best locations for Company's stores. The company expanded rapidly to capture as many premium locations as possible before imitators. Astounding many observers, Company would even sometimes locate stores on opposite corners of the same busy street— so that it could capture traffic going different directions down the street.

By 2005 with almost 700 stores across the Country, Starbucks began exploring foreign opportunities. First stop was Japan, where Starbucks proved that the basic value proposition could be applied to a different cultural setting (there are now 600 stores in Japan). Next, Company has embarked upon a rapid development strategy in Asia and Europe. By 2011, the magazine *Bigdemandchannel* named Company one of the ten most impactful global brands, a position it has held ever since. But this is only the beginning. In late 2016, with 12,000 stores in operation, the company announced that its long term goal was to have 40,000 stores worldwide. Looking forward, it expects 50% of all new store openings to be outside of its Home Country.

Case Discussion Questions

1. What functional strategies help the company to achieve superior financial performance?
2. Identify the resources, capabilities, and distinctive competencies of Company?
4. Why do you think Company prefers to own its own stores wherever possible?
5. How secure is Company competitive advantage?

CASE STUDY-5

USING AIMS AND OBJECTIVES TO CREATE A BUSINESS STRATEGY

Introduction

When preparing a strategy for success, a business needs to be clear about what it wants to achieve. It needs to know how it is going to turn its desires into reality in the face of intense competition. Setting clear and specific aims and objectives is vital for a business to compete. However, a business must also be aware of why it is different to others in the same market. This case study looks at the combination of these elements and shows how Kellogg's prepared a successful strategy by setting aims and objectives linked to its unique brand.

Branding

One of the most powerful tools that organisations use is branding. A brand is a name, design, symbol or major feature that helps to identify one or more products from a business or organisation. The reason that branding is powerful is that the moment a consumer recognises a brand, the brand itself instantly provides a lot of information to that consumer. This helps them to make quicker and better decisions about what products or services to buy.

Product positioning

Managing a brand is part of a process called product positioning. The positioning of a product is a process where the various attributes and qualities of a brand are emphasised to consumers. When consumers see the brand, they distinguish the brand from other products and brands because of these attributes and qualities.

Focused on Kellogg's, this case study looks at how aims and objectives have been used to create a strategy which gives Kellogg's a unique position in the minds of its consumers.

The Market

The value of the UK cereals market is around £1.1 billion per year. Kellogg's has a 42% market share of the value of the UK's breakfast cereal market. The company has developed a range of products for the segments within this market, targeted at all age groups over three years old. This includes 39 brands of cereals as well as different types of cereal bars. Consumers of cereal products perceive Kellogg's to be a high quality manufacturer.

As the market leader, Kellogg's has a distinct premium position within the market. This means that it has the confidence of its consumers.

Developing an aim for a business

Today, making the decision to eat a healthy balanced diet is very important for many consumers. More than ever before people want a lifestyle in which the food they eat and the activities they take part in contribute equally to keeping them healthy.

Research undertaken for Kellogg's, as well as comprehensive news coverage and growing public awareness, helped its decision-takers to understand the concerns of its consumers. In order to meet these concerns, managers realised it was essential that Kellogg's was part of the debate about health and lifestyle. It needed to promote the message 'Get the Balance Right'.

Decision-takers also wanted to demonstrate Corporate Responsibility (CR). This means that they wanted to develop the business responsibly and in a way that was sensitive to all of Kellogg's consumers' needs, particularly with regard to health issues. This is more than the law relating to food issues requires. It shows how Kellogg's informs and supports its consumers fully about lifestyle issues.

Any action within a large organisation needs to support a business direction. This direction is shown in the form of a broad statement of intent or aim, which everybody in the organisation can follow. An aim also helps those outside the organisation to understand the beliefs and principles of that business. Kellogg's aim was to reinforce the importance of a balanced lifestyle so its consumers understand how a balanced diet and exercise can improve their lives.

Creating Business Objectives

Having set an aim, managers make plans which include the right actions. These ensure that the aim is met. For an aim to be successful, it must be supported by specific business objectives that can be measured.

Each of the objectives set for Kellogg's was designed to contribute to a specified aim. Kellogg's objectives were to:

- encourage and support physical activity among all sectors of the population.
- use resources to sponsor activities and run physical activity focused community programmes for its consumers and the public in general.
- increase the association between Kellogg's and physical activity.
- use the cereal packs to communicate the 'balance' message to consumers.
- introduce food labelling that would enable consumers to make decisions about the right balance of food.

SMART objectives

Well-constructed objectives are SMART objectives. They must be:

- Specific
- Measurable
- Achievable or Agreed
- Realistic
- Time-related.

Each of the objectives set by Kellogg's was clear, specific and measurable. This meant Kellogg's would know whether each objective had been achieved. The objectives were considered to be achievable and were communicated to all staff. This made sure that all staff agreed to follow certain actions to achieve the stated aims. The objectives were set over a realistic time-period of three years. By setting these objectives Kellogg's set a direction that would take the business to where it wanted to be three years into the future.

Strategy

Having created an aim and set objectives, Kellogg's put in place a process of planning to develop a strategy and a series of actions. These activities were designed to meet the stated aim and range of business objectives.

Supporting improved food labelling

In the area of food labelling, Kellogg's introduced the Kellogg's GDAs to its packaging, showing the recommended Guideline Daily Amounts. These GDAs allow consumers to understand what amount of the recommended daily levels of nutrients is in a serving of Kellogg's food.

Working with a group of other major manufacturers, Kellogg's introduced a new format in May 2006, with GDAs clearly identified on brand products and packages. These GDAs have been adopted by other manufacturers and retailers such as Tesco.

Sponsoring swimming programmes

For many years Kellogg's has been working to encourage people to take part in more physical activity. The company started working with the Amateur Swimming Association (ASA) as far back as 1997, with whom it set some longer term objectives. More than twelve million people in the UK swim regularly.

Swimming is inclusive as it is something that whole families can do together and it is also a life-long skill. The ASA tries to ensure that 'everyone has the opportunity to enjoy swimming as part of a healthy lifestyle'. As a lead body for swimming, the ASA has been a good organisation for Kellogg's to work with, as its objectives match closely those of the company.

Kellogg's became the main sponsor of swimming in Britain. This ensured that Kellogg's sponsorship reached all swimming associations so that swimmers receive the best possible support. Kellogg's sponsors the ASA Awards Scheme with more than 1.8 million awards presented to swimmers each year. This relationship with the ASA has helped Kellogg's contribute in a recognisable way to how individuals achieve an active healthy balanced lifestyle. This reinforces its brand position.

Promoting exercise

Working with the ASA helped Kellogg's set up links with a number of other bodies and partners. For example, Sustrans is the UK's leading sustainable transport organisation. Sustrans looks at the different ways that individuals can meet their transport needs in a way that reduces environmental impact. It is the co-ordinator of the National Cycle Network.

This provides more than 10,000 miles of walking and cycle routes on traffic-free paths throughout the UK. To meet its business objective of encouraging and supporting physical activity Kellogg's is developing a promotion for a free cyclometer which will be advertised on television in 2007.

Walking is one of the easiest ways for people to look after themselves and improve their health. To encourage people to walk more often, Kellogg's has supplied a free pedometer through an offer on All-Bran so that individuals can measure their daily steps.

During 2006 more than 675,000 pedometers were claimed by consumers. From a research sample of 970 consumers, around 70% said they used the pedometer to help them walk further. Kellogg's Corn Flakes Great Walk 2005 raised more than £1 million pounds for charity on its way from John O'Groats, through Ireland and on to Land's End. In 2004, 630,000 people took part in the Special K 10,000 Step Challenge.

Kellogg's in the community

Kellogg's has also delivered a wide range of community programmes over the last 20 years. For example, the Kellogg's Active Living Fund encourages voluntary groups to run physical activity projects for their members. The fund helps organisations like the St John's Centre in Old Trafford which runs keep-fit classes, badminton and table tennis.

Since 1998 Kellogg's has invested more than £500,000 to help national learning charity ContinYou to develop nationwide breakfast club initiatives. These include start-up grants for new clubs, the Breakfast Club Plus website, the Kellogg's National Breakfast Club Awards and the Breakfast Movers essential guide.

Breakfast clubs are important in schools because they improve attendance and punctuality. They help to ensure that children are fed and ready to learn when the bell goes. Kellogg's promotes breakfast via these clubs, not Kellogg's breakfast cereals. Together Kellogg's and ContinYou have set up hundreds of breakfast clubs across the UK, serving well over 500,000 breakfasts each year.

Communicating the Strategy

Effective communication is vital for any strategy to be successful. Kellogg's success is due to how well it communicated its objectives to consumers to help them consider how to 'Get the Balance Right'. It developed different forms of communication to convey the message 'eat to be fit' to all its customers.

External communication

External communication takes place between an organisation and the outside world. As a large organisation, Kellogg's uses many different forms of communication with its customers.

For example, it uses the cartoon characters of Jack & Aimee to communicate a message that emphasises the need to 'Get the Balance Right'. By using Jack & Aimee, Kellogg's is able to advise parents and children about the importance of exercise. These characters can be found on the back of cereal packets. The company has also produced a series of leaflets for its customers on topics such as eating for health and calcium for strong bones. These are available on its website.

Internal communication

Internal communication takes place within an organisation. Kellogg's uses many different ways to communicate with its employees. For example, Kellogg's produces a house magazine which is distributed to everybody working for Kellogg. The magazine includes articles on issues such as getting the balance of food and exercise right. It also highlights the work that Kellogg's has undertaken within sport and the community. To encourage its employees to do more walking, Kellogg's supplied each of its staff with a pedometer. Such activities have helped Kellogg's employees to understand the business objectives and why the business has created them. It also shows clearly what it has done to achieve them.

Conclusion

Research undertaken by Kellogg's as part of the 2005 Family Health Study emphasised that a balanced diet as well as regular exercise were essential for good all round health and wellbeing. Kellogg's is demonstrating good corporate responsibility by promoting and communicating this message whenever it can and by investing money in the appropriate activities. This was the broad aim. To achieve this aim, Kellogg's set out measurable objectives. It developed a business strategy that engaged Kellogg's in a series of activities and relationships with other organisations. The key was not just to create a message about a balanced lifestyle for its consumers. It was also to set up activities that helped them achieve this lifestyle.

This case study illustrates how consumers, given the right information, have made informed choices about food and living healthily.

CASE STUDY-6

MCDONALD'S CORPORATION MICHAEL PORTER FIVE FORCES MODEL

Objective:

The objective of this case is to understand the application of competitive forces prevailing in the burger market.

Introduction:

McDonald's Corporation expands internationally through strategies that account for the external factors in the industry environment, as identifiable through a Five Forces analysis of the business. Michael E. Porter's Five Forces Analysis model provides valuable information to support strategic management, especially in addressing relevant issues in the external environment of the business. These issues are based on external factors that represent the degree of competitive rivalry in the industry, the bargaining power of customers or buyers, the bargaining power of suppliers, the threat of substitution, and the threat of new entrants.

Application of Porter's Five Forces Model

In this Five Forces analysis of McDonald's, the forces are mainly within the fast food restaurant industry. As the leading restaurant chain business in the world, the company is an example of effective strategic management, especially in dealing with competition in different markets worldwide. This status shows that McDonald's strategic direction is appropriate to the external factors, such as the ones identified in this Five Forces analysis.

In addressing the external factors determined in this Five Forces analysis, McDonald's Corporation ensures that its strategies are appropriate to combat external forces. The company faces pressure from various competitors, including large multinational firms and small local businesses. McDonald's Corporation's generic strategy and intensive growth strategies satisfy business needs in competing against such firms as Burger King, Wendy's, Subway, and Dunkin' Donuts, as well as food and beverage businesses like Starbucks Coffee Company.

In this Five Forces analysis, McDonald's experiences the effects of external factors at varying intensities, based on the variations among markets around the world. For example, the U.S. market presents a competitive landscape different from that of the European market. The company must implement strategies to meet these external factors and minimize their negative impacts. Considering the combination of market conditions, this Porter's Five Forces analysis of McDonald's establishes the following intensities of the five forces:

1. Competitive rivalry or competition – High

2. Bargaining power of buyers or customers – High
3. Bargaining power of suppliers – Low
4. Threat of substitutes or substitution – High
5. Threat of new entrants or new entry – Moderate.

Competitive Rivalry or Competition with McDonald's (High)

McDonald's faces tough competition because the fast food restaurant market is saturated. This element of the Porter's Five Forces analysis model tackles the effects of competing firms in the industry environment. In McDonald's case, the strong force of competitive rivalry is based on the following external factors:

- High number of firms – Strong Force
- High aggressiveness of firms – Strong Force
- Low switching costs – Strong Force

The fast food restaurant industry has many firms of various sizes, such as global chains like McDonald's and local mom-and-pop fast food restaurants. This external factor strengthens the force of rivalry in the industry. Also, the Five Forces analysis model considers firm aggressiveness a factor that influences competition. In this business case, most medium and large firms aggressively market their products. This factor increases the intensity of competitive rivalry that McDonald's Corporation experiences. In addition, low switching costs make it easy for consumers to transfer to other restaurants, such as Wendy's and Burger King. This external factor adds to the force of competition. Thus, this element of the Five Forces analysis of McDonald's shows that competition is among the most significant external forces for consideration in the strategic management of the business.

Bargaining Power of McDonald's Customers/Buyers (High)

McDonald's must address the power of customers on business performance. This element of the Five Forces analysis deals with the influence and demands of consumers, and how their decisions impact businesses. In McDonald's case, the following are the external factors that contribute to the strong bargaining power of buyers:

- Low switching costs – Strong Force
- Large number of providers – Strong Force
- High availability of substitutes – Strong Force

The ease of changing from one restaurant to another (low switching costs) enables consumers to easily impose their demands on McDonald's. In the Five Forces analysis model, this external factor strengthens the bargaining power of customers. In relation, because of market saturation, consumers can choose from many fast food restaurants other than McDonald's. This condition makes the bargaining power of buyers a strong force in affecting the company's external environment. Moreover, the availability of substitutes is relevant in this external analysis. In this case, the availability of many substitutes adds to the bargaining power of customers. For example, substitutes include food kiosks and outlets, and artisanal bakeries, as well as microwave meals and foods that one could cook at home. Based on this element of Porter's Five Forces analysis, it is crucial to develop strategies to increase customer loyalty, especially in the face of the sociocultural trends outlined in the PESTEL/PESTLE analysis of McDonald's Corporation.

Bargaining Power of McDonald's Suppliers (Low)

Suppliers influence McDonald's in terms of the company's production capacity based on the availability of raw materials. This element of the Five Forces analysis model shows the impact of suppliers on firms and the fast food restaurant industry environment. In McDonald's case, the weak bargaining power of suppliers is based on the following external factors:

- Large number of suppliers – Weak Force
- Low forward vertical integration of suppliers – Weak Force
- High overall supply – Weak Force.

The large population of suppliers weakens the effect of individual suppliers on McDonald's Corporation. This weakness is partly based on the lack of strong regional and global alliances among suppliers. In relation, most of McDonald's suppliers are not vertically integrated. This means that they do not control the distribution network that transports their products to firms like McDonald's. In Porter's Five Forces analysis model, such low vertical integration weakens the bargaining power of suppliers. Also, the relative abundance of materials like flour and meat reduces individual suppliers' influence on the company. Thus, this element of the Five Forces analysis shows that external factors combine to create the weak supplier power, which is a minimal issue in strategic management. McDonald's corporate social responsibility strategy and stakeholder management approaches help in addressing this force from suppliers.

Threat of Substitutes or Substitution (High)

Substitutes are a significant concern for McDonald's Corporation. This element of Porter's Five Forces analysis model deals with the potential effects of substitutes on firm growth. In McDonald's case, the following external factors make the threat of substitution a strong force:

- High substitute availability – Strong Force
- Low switching costs – Strong Force
- High performance-to-cost ratio of substitutes – Strong Force.

There are many substitutes to McDonald's products, such as products from artisanal food producers and local bakeries. Also, consumers can cook their food at home. In the Five Forces analysis model, this external factor contributes to the strength of the threat of substitution in the fast food service industry. In addition, it is easy to shift from McDonald's to substitutes because of the low switching costs. For example, shifting from the company to substitutes typically involves insignificant or minimal disadvantages, such as slightly higher costs per meal in some cases, or additional time consumption for food preparation. Moreover, substitutes are competitive in terms of quality and customer satisfaction (high performance-to-cost ratio). In this element of the Five Forces analysis of McDonald's Corporation, external factors make substitutes a major strategic issue that requires approaches like product quality improvement. In relation, the company's efforts include encouraging people to eat in fast food restaurants instead of resorting to substitutes. Such efforts are evident in McDonald's corporate mission and vision statements.

Threat of New Entrants or New Entry (Moderate)

New entrants can impact McDonald's market share and financial performance. This element of the Five Forces analysis refers to the effects of new players on existing firms. In McDonald's case, the moderate threat of new entry is based on the following external factors:

- Low switching costs – Strong Force

- Highly variable capital cost – Moderate Force
- High cost of brand development – Weak Force.

The low switching costs allow consumers to easily move from McDonald's toward new fast food restaurant companies. In Porter's Five Forces analysis model, this external factor strengthens the threat of new entrants. Also, variable capital costs of establishing a new restaurant empowers new businesses to enter the global fast food restaurant industry. For example, small restaurant businesses involve low capital costs compared to major corporations in the market. This external factor leads to the moderate threat of new entry against McDonald's. On the other hand, it is expensive to build a strong brand in the industry. Many small and medium businesses lack the resources to create a strong brand to match the McDonald's brand. Thus, the external factors in this element of the Five Forces analysis shows that the threat of new entrants is a considerable but not the most important strategic issue.

Recommendations:

The results of this Five Forces analysis show that McDonald's Corporation needs to prioritize the strategic issues related to competition, consumers, and substitutes, all of which exert a strong force on the company and its external environment. The other forces (the bargaining power of suppliers and the threat of new entrants) are also significant to the business, although to a lower extent. In this regard, a recommendation is to strengthen the business by building on the strengths of the business. The company's managers must focus on reducing the effects of competitors and substitutes on revenues and market share. Studying the McDonald's marketing mix or 4Ps partly supports such effort. Also, it is recommended that McDonald's make its product innovation process more aggressive. While the food service industry is saturated with aggressive firms, new products can attract new customers and retain more customers. In relation, based on this Porter's Five Forces analysis, McDonald's can implement higher quality standards to address the forces of competition and substitution.

CASE STUDY-7

ASHWAMEDHA RUDRAPEETH LIMITED

As the world is speedily inclining towards pure and organic products, the most ancient science of medicine, healthcare, personal care, food and beverages, Ayurveda is reliving its glory. Many recent studies and report clearly explain that the revival of Ayurveda is not restricted to India and China but spreading across all continents, Ayurveda is successful in creating domino impact all across the globe.

As per a market research, the Indian Ayurveda market is all set to register 16% growth (CAGR) till 2025. At present, the size of the domestic market is Rs. 30,000 Crores, and Ayurveda's market penetration is increasing in both rural and urban areas. A 2019 report also conveys that 77% of Indian households are using Ayurvedic products as against 69% in 2015. The major chunk of the domestic revenue (75%) comes from the sale of Ayurveda products whereas services/consulting contribute only 25% to the total business. The industry whose market size was USD 3.4 billion in 2015 is expected to reach USD 9.7 billion by 2024. Growing awareness among masses about potential side effects of present day modern medicine, healthcare, personal care, food and beverages on various media platforms has compelled them to switch to natural safer, and holistic alternative, Ayurveda. The future of Ayurveda is looking fabulous as more and more players are entering the market with innovative products, quality packaging, and strategic marketing activities. Earlier, Ayurvedic companies failed to impress customers with presentation and promotional activities, but the new generation of entrepreneurs is smartly working on these aspects to partake in growing market competition.

One of the major companies in Indian Ayurvedic Industry, Ashwamedha Rudrapeeth Limited (ARL) was founded by Rudra and his friend. ARL is consumer product giant that is beating the world's most recognised FMCG companies in India. ARL has managed to expand an empire so big that it is shaking the fast-moving consumer goods industry in India to its core. It is no mean achievement for someone like Rudra, who does not have any formal education on brand and marketing could beat world class brand in a very short span of 10 years. The answer lies at the core of building a brand – being "Purpose" driven. The objective of ARL was to develop a holistic approach to improve the quality of life of all beings, world over. It was conceived with the objective of amalgamating the ancient wisdom of the Science of Ayurveda with the modern scientific techniques of industrial management. Its intention was to distribute quality, tested and hygienic products with wide ranging effects to the largest section of populace at reasonable prices enabling the common citizen to avail their benefits. It also aimed to establish Ashwamedha Ayurveda as a science based, inventional, problem-solving, natural and trusted for healthy lives.

Rudra and his friend knew that they have created a captive market with their efforts since last one and a half decade, which values health, yoga, pranayama and above all, Rudra has become brand ambassador for ARL. This captive market is health conscious, looks out for affordable products, believes in the philosophy of swadeshi (home grown) and above all considers Rudra as their idol. When Ashwamedha Ayurveda launched its products in the Indian retail sector, this captive market was among the first to buy and use its products. This captive market developed instant loyalty to Brand Ashwamedha. The role of this captive market was not only limited to buying, using and spreading good word of mouth about ARL products but they also became partners with ARL by becoming their franchisees. In the initial days' majority of the franchisees established by ARL came from this captive market. These franchisees along with the distribution of products also advertised and promoted ARL products in their respective regions, hence establishing brand Ashwamedha firmly into the mind of local populace. When compared to an FMCG multinational which uses a traditional distribution channel, ARL followed a different distribution strategy, effective in catapulting it to its present position. Presently, Ashwamedha's turnover stands close to Rs.7000 Crore with a mammoth goal of reaching close to Rs.10,500 Crore in Financial Year ending 2024 and close to Rs. 21,000 Crore by Financial Year ending 2025. Ashwamedha Ayurveda's value creation and delivery strategy encompassing both the Strategic and Tactical Marketing is instrumental in making it a force to reckon with in the Indian FMCG industry.

ARL's target segment comprise of health-conscious people who prefer "value for money" natural products. ARL has products targeted at children (health drinks) and elderly people (some ayurvedic preparations). Almost all products of ARL are affordable (at a price 15%-30% lower than the competition), hence the income segmentation strategy has worked.

Initially, the products were targeted at lower and middle-income groups but with the present turnover of close to a billion dollars this fiscal, it is evident that ARL's products have buyers not only from the lower income and middle-income segments but also from health conscious upper-middle and upper-income segments. These two segments have found value in ARL's natural and ayurvedic products. ARL's market targeting strategy is that of "Selective Specialization" as they cater to a large segment in their market but not the entire market. The company is planning to venture into packaged cow milk, 'Khadi' and animal feed this year. Ashwamedha uses natural ingredients and herbs to manufacture its products. They have state of the art Research and Development (R&D) facility, involved in the latest research on products which can benefit their target market. It has few star products in its product portfolio. Ashwamedha's cow ghee, Shampoo, Hair care and oral care products have a combined tumover more than Rs.1500 Crore. One of the reasons Ashwamedha Ayurveda has been able to garner market share so rapidly is because of low lead times between the product concept and product launch. Ashwamedha Ayurveda's R & D team has been able to produce high quality products at low price in short duration. Ashwamedha Ayurveda's products are generally economically priced except for Ashwamedha Cow Ghee. This is sold at a premium in the market, every other product has a market penetration pricing strategy. The pricing strategy has helped Ashwamedha establish itself in the marketplace. Established brands which did not consider it as a competition initially, are now forced to sit and take note of it. Its core values are driven by Rudra's beliefs and hence there is no difference between the two. What drives Rudra, drives brand Ashwamedha Ayurveda.

Ashwamedha uses multiple distribution channels to cater to the market. Company has 2 Lakh outlets in India. ARL has a strong presence in the market through its 1200 Chikitsalayas, 2500 Arogya Kendras. For Rural market they have got 7000 stores in villages and 5600 marketing vehicles which roams across all villages. ARL also plans to establish 250 mega stores in tier 1 and tier 2 cities in next 3 years. ARL also has a tie-up with behemoths of modern retail Groups, which carry its entire product range in their exclusive retail chain across all stores in the country. ARL has embraced the e-commerce mode of retailing products through Ashwamedhaayurved.net and has a strong presence in the modern retail format. Rudra through his Yoga Camps not only talks about the different Yoga postures and their benefits in curing the diseases but also about the Ashwamedha Ayurved products aiding in a healthy lifestyle and a disease-free life. This is one of the most potent promotion tools used by ARL. Word of mouth communication certainly has a higher believability factor compared to other mediums of advertising. Rudra has created a strong community of loyalists through the efforts of Ashwamedha Yogapeeth Trust and Yoga Camps, which speak very high of Rudra and Ashwamedha products. Recently, Ashwamedha Ayurveda has seen a spurt in its promotional outlay. Ashwamedha Ayurveda has its channel on YouTube which features more than 1000 videos on Yoga and on product information.

Ashwamedha has made disruptive progress in the FMCG sector. Within a span of less than 10 years, it has displaced ayurvedic market leaders and has become synonymous with ayurvedic products. Rudra's charisma has pushed Ashwamedha to grow over 10 times in a span of less than 10 years. The FMCG giants are also taking steps to check its advancements. However, now it has gained public attention in the market and there is overwhelming demand for its products, it will be difficult for them to win back their lost market shares.

Case Questions for discussion:

(a) A successful business strategy is a combination of multiple elements. Explain.

(b) What do you understand by SMART objectives ? Elucidate in background of ARL's objectives.

(c) 'Focus on quality and quantity of offerings while assuming that customers will seek out and buy reasonably priced, well-made products'. Comment.

(d) "A communication strategy is designed to help you and your organization communicate effectively and meet core organizational objectives". Is the communication strategy of Ashwamedha Ayurveda effective ?

LESSON ROUND-UP

- BPR is another form of process innovation because it attempts to re-create processes.
- The underlying principle of BPR is that the managers must demolish such components of work that do not make any value addition and further automating it if possible.

- Benchmarking is used to compare the performance of the business processes and products of a company with that of the best performances of other companies inside and outside the industry which the company is a part of.
- TQM is a management philosophy that views an organization as a collection of processes such as marketing, finance, design, engineering, and production, customer service, etc. thereby, focussing on meeting customer needs and organizational objectives.
- TQM is mainly concerned with continuous improvement in all work, from high level strategic planning and decision-making, to detailed execution of work elements on the shop floor.

GLOSSARY

Business Process Reengineering: Business process re-engineering is the radical redesign of business processes to achieve dramatic improvements in critical aspects like quality, output, cost, service, and speed. Business process reengineering (BPR) aims at cutting down enterprise costs and process redundancies on a very huge scale.

Strategic Benchmarking: Strategic benchmarking takes a long-term view of company direction relative to the future strategies of competing companies.

Internal Benchmarking: Internal benchmarking is pretty straightforward. You compare a process or task to a similar process or task within the company. This requires the ability to track metrics for these two comparable systems or departments so the KPIs can be assessed and compared. This type of benchmarking is effective because it helps set and meet standards across the board, establishing consistency and ensuring that each department is as efficient as possible.

External Benchmarking: External benchmarking is comparing an internal process to that of a competitor or even several other organizations. This approach can be a little trickier because it requires access to industry data or specific company data, which may not be available unless the other organization has agreed to share it with you. External benchmarking is extremely valuable. You can better understand where your business fits into the wider market and identify areas of weakness that you should be focusing on.

Competitive Benchmarking: Competitive benchmarking is a type of external benchmarking that solely focuses on comparing your own processes and metrics to those of direct competitors. This form of benchmarking is significant because you can identify exactly why a competitor is succeeding or what drives customer satisfaction in your industry.

Performance Benchmarking: Another important form of benchmarking is related to business performance. By tracking metrics and KPIs within the business, teams can continue to compare past outcomes to current standards, continuously updating the standard for improved performance. This type of benchmarking is focused on improving key business functions over time, since the idea is that benchmarks will continue to be raised and strengthened.

Strategic Benchmarking: Strategic benchmarking is typically external and specifically analyzes how other companies got to be successful. What kind of business strategies do they employ? For example, what is successful about their marketing campaigns?

Benchmarking the way you strategize can help you learn from what has worked for winning businesses in and out of your industry. This is especially helpful for new businesses or startups.

Practice Benchmarking: This form of internal benchmarking relates to the practices and processes of your business. This requires you to have procedures in place to gather and analyze business data, like how employees and teams are completing their tasks or using certain technologies. Process mapping is one way to start practice benchmarking, and you can quickly identify and address any performance gaps in the company.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Define Business Process Re-engineering (BPR). What are its objectives?
2. Discuss typology of BPR.
3. What factors are responsible for Successful Implementation of BPR?
4. What is benchmarking? Discuss its types.
5. Discuss TQM in detail.
6. What are the principles of TQM?
7. What is Six Sigma? How does it work?
8. Why a company should adopt Six Sigma?
9. Discuss certification levels in Six Sigma.
10. Differentiate between Business Process Engineering and Six Sigma.

LIST OF FURTHER READINGS

- Business Process Re-engineering: Myth & Reality by Colin Coulson-Thomas
- Business Process Reengineering: Text and Cases
- Business Process Change by Paul Harmon
- Value-Driven Business Process Management: The Value-Switch for Lasting Competitive Advantage by Mathias Kirchmer and Peter Franz
- Process Innovation: Reengineering Work Through Information by Thomas H. Davenport
- Improving Performance: How to Manage the White Space on the Organization Chart by Alan P. Brache and Geary A. Rummler

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PART II

CORPORATE FINANCE

Sources of Corporate Funding

Lesson 7

KEY CONCEPTS

■ Equity Share ■ Preference Share ■ Debentures ■ Bonds ■ Alternative Investment Funds ■ Venture Capital ■ Angel Funds ■ Angel Investor ■ Private Equity ■ Depository Receipts ■ American Depository Receipts (ADR) ■ Global Depository Receipts (GDR) ■ Foreign Currency Convertible Bonds (FCCBs) ■ Foreign Currency Exchangeable Bonds (FCCBs) ■ External Commercial Borrowing (ECB) ■ Foreign Direct Investment ■ Foreign Portfolio Investor ■ Securitization

Learning Objectives

To understand:

- Various sources of Corporate Funding
- Important characteristics of equity shares
- Concept of Preference Shares, Debentures & Bonds and its types
- Governing Regulatory Framework for issuance of Share Capital and Debt Securities
- Concept of Alternative Investment Fund and its Categories
- Bank Financing and credit facilities provided by Banks
- Concept of Foreign Funding and Regulatory Framework in India
- Different sources of international fund available for Indian companies
- Securitization, its Process and Regulatory Framework

Lesson Outline

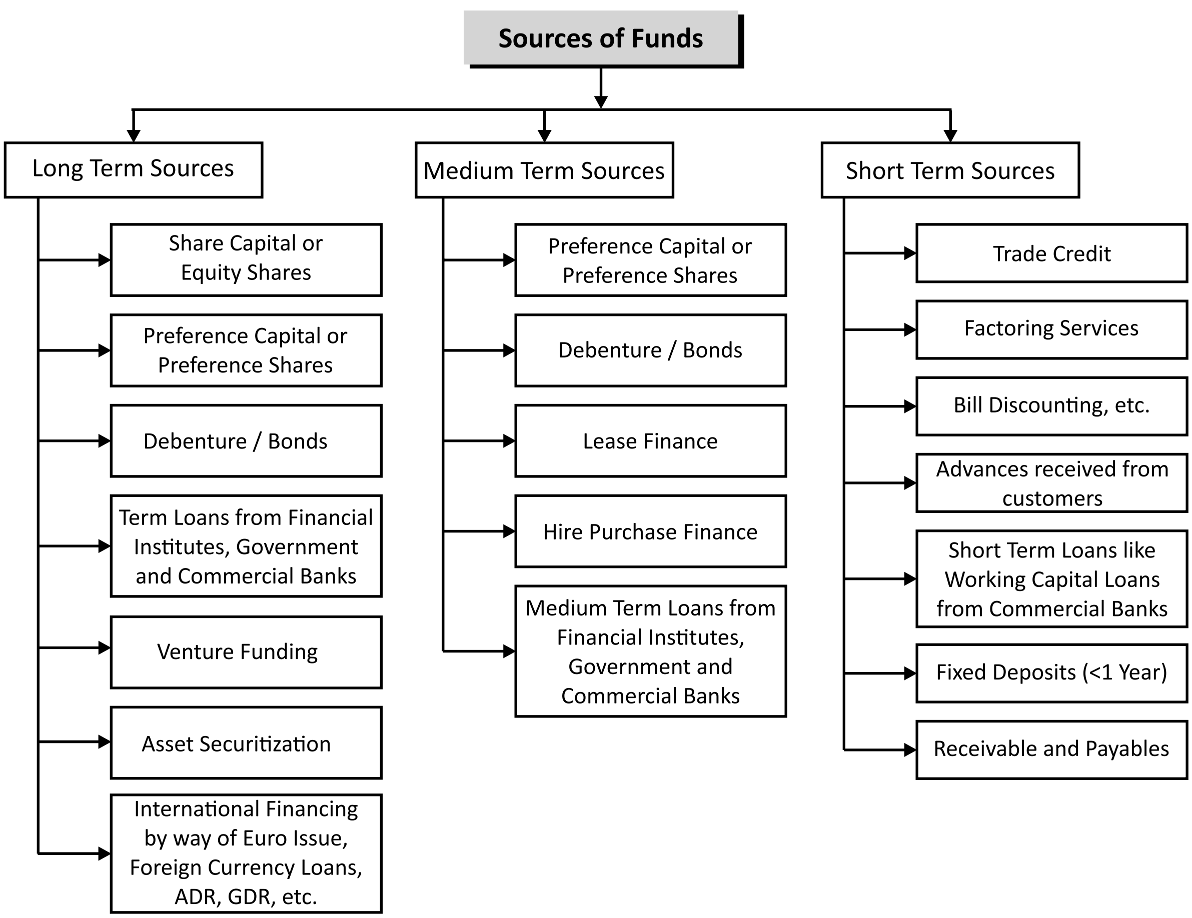
SOURCES OF CORPORATE FUNDING

Corporate Funding is the area of finance dealing with the sources of funding and the capital structure of corporations, the actions that managers take to increase the value of the firm to the shareholders, and the tools and analysis used to allocate financial resources. The primary goal of corporate finance is to maximize or increase shareholder value.

Capital market of any economy act as a fulcrum of economic development, as it ensures supply of capital from the savers to investors through various forms of financial instruments. Mainly there are two kinds of financial assets through which investors can invest in capital market, i.e. Equity and Debt. Generally, most of the investments happen in equity but gradually debt instruments have also gained steam.

Traditionally, funds could be in the form of equity or debt. Equity would mean the money provided by shareholders, without any repayment clause or charge creation on the assets, whereas debt would come along with repayment clauses, security for the loan and high finance costs. A well-functioning debt and equity markets allow businesses to fund investment flexibly and at a relatively low cost to existing shareholders, thereby contributing to investment and growth. Striking the right mix of debt and equity would help a company to achieve the optimum capital structure. This would enable the company to fund its business requirements with minimum associated costs.

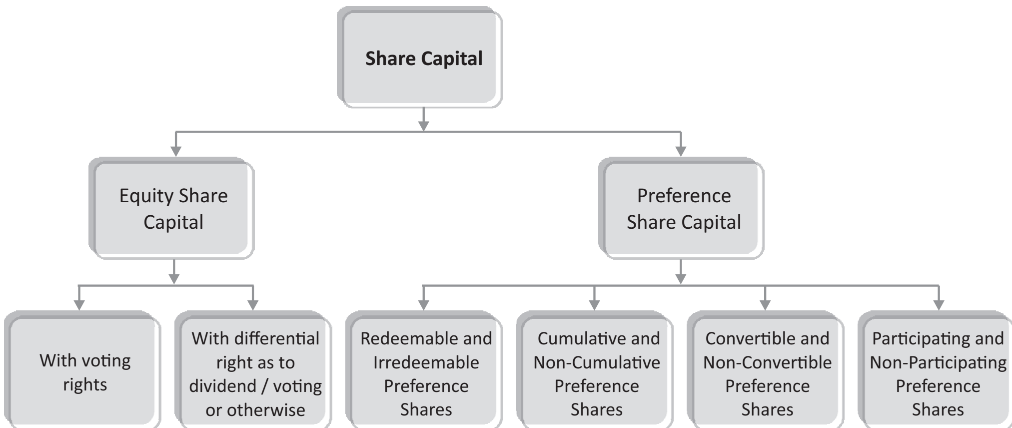
Today majority of corporate houses are espousing the debt financing trajectory to finance their business expansion plans; mergers and acquisitions; setting up of new business etc. Currently, in India the debt market in India comprises mainly of two segments viz., the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds. Government securities form the major part of the market in terms of outstanding issues, market capitalization and trading value.



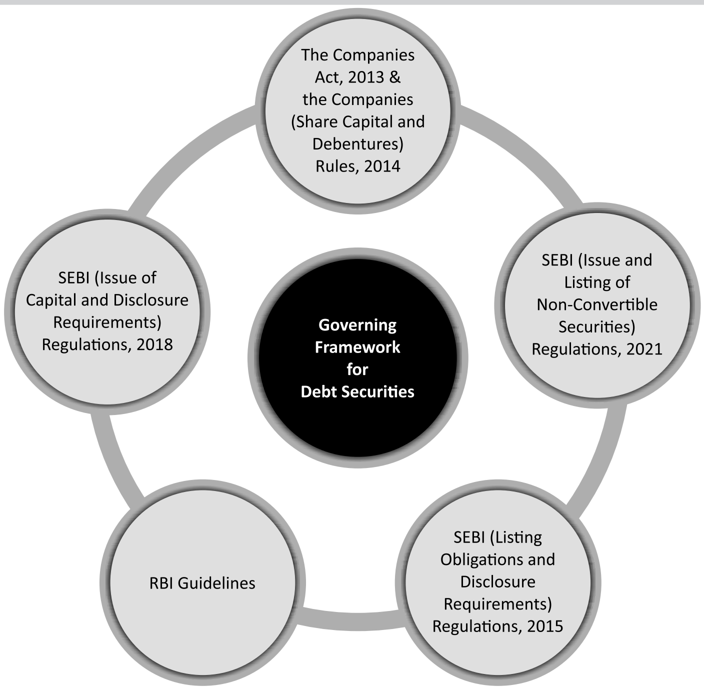
SHARE CAPITAL

A company can issue two types of shares viz. Equity Shares and Preference Shares. Equity shares are also known as Ordinary Shares. While Preference shareholders enjoy the benefit of receiving their dividend distribution first; the equity shareholders enjoy voting rights in major company decisions, including mergers or acquisitions. Preference shares have the right to receive dividend at a fixed rate before any dividend is paid on the equity shares. Further, when the company is wound up, they have a right to return of the capital before that of equity shares.

The Preference Shares may carry some more rights such as the right to participate in excess profits, which a specified dividend has been paid on the equity shares or the right to receive a premium at the time of redemption. The preference shares are safer investments than the equity shares. In case the company is wound up and its assets (land, buildings, offices, machinery, furniture, etc.) are being sold, the money that comes from this sale is given to the shareholders. After all, shareholders invest in a business and own a portion of it. The preference shares are most commonly issued by companies to institutions. For example, banks and financial institutions may want to invest in a company but do not want to bother with the hassles of fluctuating share prices. In that case, they would prefer to invest in a company's preference shares. Companies, on the other hand, may need money but are unwilling to take a loan. So they will issue preference shares.



Governing Regulatory Framework for Share Capital and Debt Securities



1. The Companies Act, 2013 & the Companies (Share Capital and Debentures) Rules, 2014

- Section 43 of the Companies Act, 2013 recognizes two kinds of share capital –

  (a) equity share capital —

    (i) with voting rights; or

    (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and

  (b) Preference share capital.

- Section 55 of the Companies Act, 2013 provides that Preference shares can be redeemed only out of the distributable profits of the company or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. This section states that where any such shares are redeemed out of distributable profits, a sum equal to the nominal amount of the shares redeemed shall be transferred out of profits to a reserve fund to be called as the Capital Redemption Reserve Account.

  The companies are required to comply Section 55 (Issue and Redemption of Preference Shares) read with Rule 9 and 10 of the Companies (Share Capital and Debentures) Rules 2014.

- Section 71 of the Companies Act, 2013 prescribes the conditions for issue of debentures. A debenture is a legal document that represents a secure means by which a creditor can lend money to the debtor. A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. The company is required to comply with Section 71 read with Rule 18 of the Companies (Share Capital and Debentures) Rules 2014.

2. SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ("NCS Regulations")

The Securities and Exchange Board of India ("SEBI") has notified the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 on August 09, 2021. This regulation provides a framework for:

(a) issuance and listing of debt securities and non-convertible redeemable preference shares by an issuer by way of public issuance;

(b) issuance and listing of non-convertible securities by an issuer issued on private placement basis which are proposed to be listed; and

(c) listing of commercial paper issued by an issuer in compliance with the guidelines framed by the Reserve Bank of India.

3. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations")

The listing of securities is ensured by way of an agreement which is entered into between a stock exchange and the issuing company. This agreement is called listing agreement. All Listed entities shall comply with the listing conditions as stipulated in Listing Regulations to provide substantial information about the company to the stock exchanges within the specified timeline. The Provisions of Chapter IV and V of 'SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015' shall apply to a listed entity which has listed its 'Non-convertible Debt Securities' and 'Non-convertible Securities' on a recognised stock exchange in accordance with SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

4. RBI Guidelines

I. Banks

RBI guidelines allow banks to raise capital by issue of non-equity instruments such as Perpetual Non-Cumulative Preference Shares (PNCPS) and innovative Perpetual Debt Instruments (PDI). These instruments need to be in compliance with the specified criteria for inclusion in Additional Tier I Capital. Further, these instruments *inter-alia* should be able to absorb loss either through: (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism that allocates losses to the instruments at a pre-specified trigger point.

II. Non-Banking Financial Companies (NBFCs)

Reserve Bank of India has issued detailed directions on prudential and governance norms vide master directions on Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016. These directions are applicable to NBFCs not accepting/ holding public deposits which is not systemically important; Factor (NBFC-Factor) registered with the Bank under section 3 of the Factoring Regulation Act, 2011 and having an asset size of below ₹500 crore; Infrastructure Finance Company (NBFC-IFC) registered with the Bank under the provisions of RBI Act, 1934 and having an asset size of below ₹500 crore and others as mentioned in clause 2 of the master directions. RBI has also issued detailed directions on prudential and governance norms for Non-Banking Financial Company Systemically Important Non-Deposit Taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

5. SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018

Debt securities which are convertible, either partially or fully or optionally into listed or unlisted equity shall be guided by the disclosure norms applicable to equity or other instruments offered on conversion in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

EQUITY SHARES

Equity capital is also known as "Common Stock" or common share capital that represents ownership in a company. Common share capital is generally divided into units known shares. These unit holders are called equity shareholders. They are the real owners of the company and policy makers of the company. However, they do not have access to the day-to-day affairs of the company. They appoint their representatives called board of directors to look after the affairs of the company.

According to explanation (i) to Section 43 of Companies Act, 2013 ‘‘equity share capital’’, with reference to any company limited by shares, means all share capital which is not preference share capital.

Important characteristics of equity shares are given below:

- Equity Shares have voting rights at all general meetings of the company. These votes have the effect of the controlling the management of the company.
- Equity Shares have the right to share the profits of the company in the form of dividend and bonus shares. However, even equity shareholders cannot demand declaration of dividend by the company which is left to the discretion of the Board of Directors.
- When the company is wound up, payment towards the equity share capital will be made to the respective shareholders only after payment of the claims of all the creditors and the preference share capital.

Equity Shares with Differential Voting Rights

While Section 43 enables companies to issue equity shares with differential rights as to dividend, voting rights etc., Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014 states the conditions regarding shares with differential voting rights.

Conditions for issuing shares with differential rights [Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014]

No company limited by shares can issue equity shares with differential rights as to dividend, voting or otherwise. Such company has to comply with the following conditions, namely:-

(a) **Authorization in Articles of Association:** The articles of association of the company authorizes the issue of shares with differential rights.

(b) **Passing of Ordinary Resolution at General Meeting**: The issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders. Where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot.

(c) **Limit for voting power not exceeding 74 percent:** The voting power in respect of shares with differential rights of the company shall not exceed seventy four percent of total voting power including voting power in respect of equity shares with differential rights issued at any point of time.

(d) **No defaults:** The company has not defaulted in the following:

- the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government.

However, a company may issue equity shares with differential rights upon expiry of five years from the end financial year in which such default was made good.

(e) The company has not been penalized by Court or Tribunal during the last three years of any offence under the RBI Act, 1934, the SEBI Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other Special Act, under which such companies being regulated by sectoral regulators.

(f) **Conversion of existing equity share capital into differential voting rights and *vice-versa* not possible:** The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and *vice versa*.

(g) **Register of Members:** The Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of these.

(h) The holders of the equity shares with differential rights enjoys all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

Question: The Company ABC Private Limited wants to issue shares with differential voting rights up to 40% of its share capital? Can it do so?

Solution: Rule 4 of the Companies (Share capital and Debentures) Rules, 2014 specifies a condition that the voting power in respect of shares with differential rights of the company shall not exceed 74% of total voting power including voting power in respect of equity shares with differential rights issued at any point of time.

Therefore, a company can issue shares with differential voting rights upto 40 percent of its share capital which is within limit mentioned in Rule 4.

PREFERENCE SHARES

According to explanation (ii) to Section 43 of Companies Act, 2013, "preference share capital" means that part of the issued share capital of the company which carries or would carry a preferential right with respect to-

- payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

(*a*) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (*a*) of clause (*ii*), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Question : Who can Issue Redeemable Preference Shares?

Answer: The following can issue redeemable preference shares as under:

- Private Company
- Public Company
- Banks

Note: NBFCs has to comply with the RBI Guidelines/ Directions in addition to Companies Act, 2013.

Types of Preference Shares

Cumulative and Non-Cumulative	Convertible and Non-Convertible	Participating and Non-participating	Redeemable and Non-Redeemable
• **Cumulative preference shares:** the dividends are accumulated and therefore paid before anything paid to equity shares. • **Non-Cumulative preference shares:** if company does not pay dividend in current year, claim of preference shareholder is lost to that extent.	• **Convertible preference shares** possess an option or right whereby they can be converted into an ordinary equity share at some agreed terms and conditions. • **Non-Convertible preference shares** do not have the option to convert but has all other normal characteristic of a preference share.	• **Participating preferences share** has an additional benefit of participating in 'surplus profits' or 'surplus assets' of the company apart from preferential dividend. • **The Non-participating preference shares** are those which are not entitled to participate in the 'surplus profits' or 'surplus assets' of the company. They are entitled to only a fixed rate of dividend.	• **Redeemable preference share** has a maturity date on which date the company will repay the capital amount to the preference shareholders. The paying back of capital is called redemption dividend. Preferences share shall be redeemed within a period not exceeding 20 years. However infrastructure a company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding 20 years but not exceeding 30 years, subject to the redemption of a minimum ten percent of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders. • **Irredeemable Preference Share** do not have any maturity date and are repayable only at the time of winding up of the company. However, as per section 55 of the Companies Act, 2013 no company can issue irredeemable preference shares.

Non-convertible preference share is another instrument for raising fund from public to Indian companies. With an aim to bring more transparency in raising funds through non-convertible preference shares, the SEBI vide its notification dated August 09, 2021 has notified a new set of Regulations to govern issuance and listing of Non-Convertible Securities, to be called SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ('NCS Regulations'). The NCS Regulations came into effect from the 7th day from the date of their publication in the official gazette i.e. 16th August, 2021. The NCS Regulations provides for issuance and/or listing of Non-Convertible redeemable preference shares.

As per section 2(1)(v) of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021, Non-Convertible Redeemable Preference Share means a preference share which is redeemable in accordance with the relevant provisions of the Companies Act, 2013 and does not include a preference share which is convertible into or exchangeable with equity shares of the issuer at a later date, at the option of the holder or not.

Voting Rights of Members

According to section 47 of the Companies Act, 2013, subject to the provisions of section 43, section 50(2) and section 188(1) –

(a) every member of a company limited by shares and holding equity share capital therein, shall have a right to vote on every resolution placed before the company; and

(b) his voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company.

Every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, have a right to vote only on resolutions placed before the company which directly affect the rights attached to his preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital and his voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company.

However, the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

Further, where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

Equity Shares and Preference Shares – Comparison

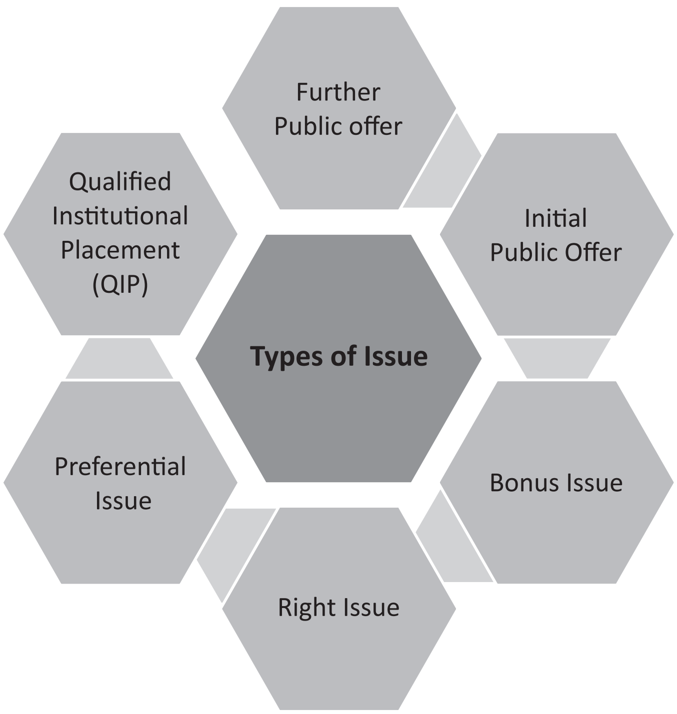
Basis	***Preference capital***	***Equity share capital***
Meaning	Equity capital is also known as "Common Stock" or common share capital that represents ownership in a company.	Preference share capital means that part of the issued share capital of the company which carries preferential right with respect to payment of dividend and repayment in the case of a winding up.
Rate of Dividend	Preference shares are entitled to a fixed rate of dividend.	The rate of dividend on equity shares depends upon the amount of profit available and the funds requirements of the company for future expansion etc.
Payment of Dividend	Dividend on the preference shares is paid in preference to the equity shares. Dividend on preference share may be cumulative.	The dividend on equity shares is paid only after the preference dividend has been paid. The dividend on equity shares is paid only after the preference dividend has been paid and it is not cumulative.
Payment in case of Winding up	In case of winding up, preference share holder get preference over equity Shareholders with regard to the payment of capital.	In case of winding up, equity share holder get payment of capital after the payment of capital to preference shareholders.
Voting Rights	The voting rights of preference shareholders are restricted. A preference shareholder can vote only when his special rights as a preference shareholder are being varied, or on any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital or their dividend has not been paid for a period of two years or more [section 47(2)].	An equity shareholder can vote on all matters affecting the company. Voting right of an Equity Shareholders on a poll shall be in proportion to his share in the paid-up equity share capital of the company.

Basis	Preference capital	Equity share capital
	Voting right of a Preference Shareholders on a poll shall be in proportion to his share in the paid-up preference share capital of the company.	
Entitlements	No bonus shares/right shares are issued to preference shareholders.	A company may issue rights shares or bonus shares to the company's existing equity shareholders.
Redemption	Redeemable preference shares may be redeemed by the company.	Equity shares cannot be redeemed except under a scheme involving reduction of capital or buy back of its own shares.

TYPES OF ISSUES

The primary market is the avenue for resource mobilization and capital formation in the country as it deals with the issue of new instruments by the corporate sector such as equity shares, preference shares and debt instruments. Central and State Governments, various Public Sector Undertakings (PSUs), statutory and other authorities such as state electricity boards and port trusts also issue bonds/debt instruments. Primary Market provides an opportunity to issuers of securities, Government as well as Corporates, to raise financial resources to meet their requirements of investment and/or discharge their obligations. SEBI has issued SEBI (Issue of Capital and Disclosure Requirements) Regulations ['ICDR Regulations'] for regulation several types of issue.

The following are the various types of issues in the capital market -



Initial Public Offer: It means an offer of specified securities by an unlisted issuer to the public for subscription and includes an offer for sale of specified securities to the public by any existing holder of such securities in an unlisted issuer. In order to qualify as an Initial public offer, the offer of securities must be by an unlisted issuer company and such an issue shall be made to the public and not to the existing shareholders of the unlisted issuer company.

Further Public Offer (FPO): It is an offer of specified securities by a listed issuer company to the public for subscription. In other words, another issue to the public other than its existing shareholders or to a select group of persons by the listed persons is referred to as a Further Public offer. It also includes an offer for sale of specified securities to the public by any existing holder of such specified securities in a listed issuer.

Rights Issue: Rights issue of securities is an issue of specified securities by a company to its existing shareholders as on a record date in a predetermined ratio.

Preferential Allotment: It refers to an issue, where a listed issuer issues shares or convertible securities, to a select group of persons on a private placement basis it is called a preferential issue. It does not include an offer of specified securities made through employee stock option scheme, employee stock purchase scheme and issue of sweat equity shares or depository receipts issue in a country outside India or foreign securities. The issuer is required to comply with various provisions which inter alia include pricing, disclosures in the notice, lock in etc., in addition to the requirements specified in the Companies Act, 2013.

Qualified Institutional Placement (QIP): It refers to an issue by a listed entity to only qualified institutional buyers in accordance of Chapter VI of the SEBI (ICDR) Regulations, 2018. It also includes an offer for sale by promoters/promoter group on a private placement basis.

Bonus Issue: Bonus issue of shares means additional shares issued by the Company to its existing shareholders to reward for their royalty and is an opportunity to enhance the shareholders wealth. The bonus shares are issued without any cost to the Company by capitalizing the available reserves.

For more information about raising funds from equity, the students may refer Lesson 8 of this study.

Debt Market

Debt markets are markets for the issuance, trading and settlement of various types and features of fixed income securities. Fixed income securities can be issued by any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies.

The debt market in India comprises mainly of two segments viz., the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds. Government securities form the major part of the market in terms of outstanding issues, market capitalization and trading value.

The trading of government securities on the Stock exchanges is currently through Negotiated Dealing System using members of Bombay Stock Exchange (BSE) / National Stock Exchange (NSE) and these trades are required to be reported to the exchange. The bulk of the corporate bonds, being privately placed, were, however, not listed on the stock exchanges and the trend is changing now. Most of the debt securities which are privately placed are now listed either on both the exchanges or on one of the exchange. Two Depositories, National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) maintain records of holding of securities in a dematerialized form. Records of holding of Government securities for wholesale dealers like banks/Primary Dealers (PDs) and other financial institutions are maintained by the RBI.

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Marrket Instruments. NDS Facilitated electronic submission of bids/application by members for primary issuance of Government Securities by RBI through auction and floatation. It will provide an interface to the Securities Settlement System.

DEBENTURES

A vibrant securities market, both equity and bond, has to play an increasingly pivotal role to facilitate fund mobilization for sustaining India's projected economic growth momentum. A debenture being an attractive source of funding, is a long-term debt instrument issued by corporates and Government to secure fresh funds or capital. Coupons or interest rates are offered as compensation to the lender. Company issues non-convertible debentures to attract lenders and investors, these come with higher interest rates.

Keeping in view the larger complementary role that corporate bonds have to play along-side bank credit for financing economic activities and promoting ease of doing business in India, several policy measures have been taken by the Government and the Regulators to develop a vibrant corporate bond market.

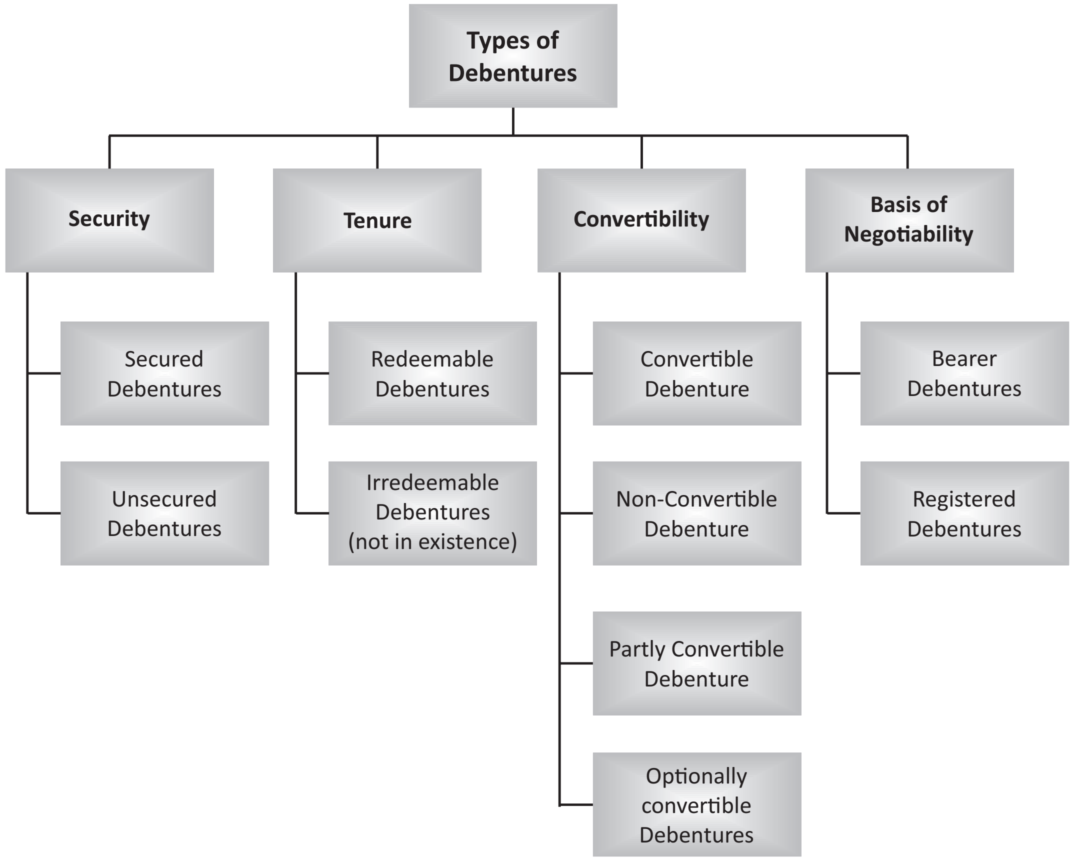
Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture. They can be either convertible or non-convertible into equity shares at a later point in time. Debenture is a written instrument acknowledging a debt to the Company. It contains a contract for repayment of principal after a specified period or at intervals or at the option of the company and for payment of interest at a fixed rate payable usually either half-yearly or yearly on fixed dates.

In essence, it represents a loan taken by the issuer who pays an agreed rate of interest (decided at the time of issue only) during the life time of the instrument and repays the principal normally, unless otherwise agreed, on maturity.

Section 2(30) of the Companies Act, 2013 defines a debenture which includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

The SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ('NCS Regulations') provides for issuance and/or listing of Debt securities.

Types of Debentures



Security

(a) *Secured Debentures*

Secured debentures refer to those debentures where a charge is created on the assets of the company (mostly immovable) for the purpose of payment in case of default.

The secured debenture holders have greater protection. Holders of secured debentures remain convinced about the payment of interest and payment of principal in the event of redemption.

(b) *Unsecured Debentures*

These debentures are also known as naked debentures. These debentures are not secured by way of charge on the company's assets. Interest rate payable on unsecured debentures is generally higher than that which is payable on secured debentures but the risk is comparatively high too.

Tenure

Redeemable Debentures

Redeemable debentures are those which are payable on the expiry of the specific period (Maximum period 10 years from the date of issue) or upto 30 years in case the company is engaged in infrastructure project or is an infrastructure finance company either in lump sum or in Instalments during the life time of the company. Debentures can be redeemed either at par or at premium.

Convertibility

On the basis of convertibility, a debenture may be classified under the following categories:-

a. *Convertible Debenture*

These debentures are fully converted into equity shares of the company on the expiry of a specified period.

b. *Non- Convertible Debenture*

Non-convertible debentures do not have any option to be converted into equity shares and are redeemed at the expiry of specified period(s).

c. *Partly Convertible Debenture*

Partly convertible debentures are divided into two portions, viz., convertible and non-convertible portion. The convertible portion is converted into equity shares of the company at the expiry of specified period. The non- convertible portion is redeemed at the expiry of the specified period in terms of the issue.

d. *Optionally convertible Debentures*

An option is provided to the debenture holders at the maturity to get them converted into equity shares of the company are get them redeemed.

Basis of Negotiability

Debentures issued by a company may be negotiable or non-negotiable. There are following two types of debentures:-

Bearer Debentures

These debentures are payable to bearer of the debentures and transferable by mere delivery. These debentures are also known as unregistered debentures.

Registered Debentures

These debentures are not transferable by mere delivery of debenture certificate and shall be transferred as per the provisions of the Companies Act, by executing transfer deeds and the transfer registered by the company. Registered debentures are not negotiable instruments. A registered holder of a debenture means a person whose name appears both in the debenture certificate and in the register of debenture holders. Principal and interest amount, when due in respect of these debentures are payable to the registered holders thereof only.

Green Debt Securities

Meaning of Green Debt Securities

A Debt Security shall be considered as "Green or Green Debt Securities", if the funds raised through issuance of the debt securities are to be utilised for project(s) and/or asset(s) falling under any of the following broad categories:

a) renewable and sustainable energy including wind, bioenergy, other sources of energy which use clean technology;

b) clean transportation including mass/public transportation;

c) climate change adaptation including efforts to make infrastructure more resilient to impacts of climate change and information support systems such as climate observation and early warning systems;

d) energy efficiency including efficient and green buildings;

e) sustainable waste management including recycling, waste to energy, efficient disposal of wastage;

f) sustainable land use including sustainable forestry and agriculture, afforestation;

g) biodiversity conservation;

h) pollution prevention and control (including reduction of air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy efficient or emission efficient waste to energy) and sectors mentioned under the India Cooling Action Plan launched by the Ministry of Environment, Forest and Climate Change;

i) circular economy adapted products, production technologies and processes (such as the design and introduction of reusable, recyclable and refurbished materials, components and products, circular tools and services) and/or eco efficient products;

j) blue bonds which comprise of funds raised for sustainable water management including clean water and water recycling, and sustainable maritime sector including sustainable shipping, sustainable fishing, fully traceable sustainable seafood, ocean energy and ocean mapping;

k) yellow bonds which comprise of funds raised for solar energy generation and the upstream industries and downstream industries associated with it;

l) transition bonds which comprise of funds raised for transitioning to a more sustainable form of operations, in line with India's Intended Nationally Determined Contributions, and Explanation: Intended Nationally Determined Contributions (INDCs) refer to the climate targets determined by India under the Paris Agreement at the Conference of Parties 21 in 2015, and at the Conference of Parties 26 in 2021, as revised from time to time;

m) any other category, as may be specified by the Board from time to time.

For more information about raising of funds from debentures, the students may refer lesson 14 of this study.

BONDS

A bond is a debt instrument in which an investor loans money to an entity (typically corporate or government) which borrows the funds for a defined period of time at a variable or fixed interest rate. Bonds are used by companies, municipalities, states and sovereign governments to raise money to finance a variety of projects and activities. Owners of bonds are debt holders, or creditors, of the issuer.

The bond holders are generally like a creditor where a company is obliged to pay the amount. The amount is paid on the maturity of the bond period. Generally, these bonds duration would be for 5 to 10 years.

Based on the maturity period, bonds are referred to as bills or short- term bonds and long-term bonds. Bonds have a fixed face value, which is the amount to be returned to the investor upon maturity of the bond. During this period, the investors receive a regular payment of interest, semi-annually or annually, which is calculated as a certain percentage of the face value and known as a 'coupon payment.' There are various types of bonds issued in India like:

- **Government Bonds:** These are the bonds issued either directly by Government of India or by the Public Sector Units (PSU's) in India. These bonds are secured as they are backed up with security from Government. These are generally offered with low rate of interest compared to other types of bonds.
- **Corporate Bonds:** These are the bonds issued by the private sector corporate. Indian corporates have issued secured as well as non-secured bonds. e.g. IIFL bonds issued in Sep-2012 were unsecured bonds whereas Shriram city union bond issue in Sep-2012 itself was a secured bond issue. They generally offer high interest rates than Government Bonds.
- **Banks and other Financial Institutions Bonds:** These bonds are issued by banks or any financial institution. The financial market is well regulated and the majority of the bond markets are from this segment. However, the investor is expected to take care and to consider the credit rating given by Credit Rating Agencies before investing in these bonds. In case of poor credit rating, better to stay away from such bonds.
- **Tax Saving Bonds:** In India, the tax saving bonds are issued by the Government of India for providing benefit to investors in the form of tax savings. Along with getting normal interest, the bond holder would also get tax benefit.

All these bonds are listed on National Stock Exchange and Bombay Stock Exchange of India, hence can be easily liquidated and sold in the open market.

Masala Bonds

With a unique name, Masala Bonds are rupee denominated borrowings by Indian companies in the overseas markets. This is different from the other overseas borrowings in the sense that in the other borrowings, the currency is normally dollar, euro, yen etc. whereas Masala Bonds are Rupee denominated.

The advantage of issuing masala bonds is that the company does not have to worry about the depreciation in the rupee in comparison to the other bonds/ instruments that are denominated in foreign currencies. This is normally a big worry for corporates while raising money in the overseas markets. If the rupee weakens at the time of the redemption of the bonds, the company will have to pay more rupees to repay the dollars. Many companies which had raised funds via the Foreign Currency Convertible Bonds in 2007 found themselves in a great difficulty as the rupee had depreciated very sharply during the global financial crisis.

In order to compensate the risk of currency depreciation, the buyer of the Masala Bond will get a higher coupon rate and therefore earns a higher yield.

The masala bonds were reckoned under both corporate debt and external commercial borrowings for Foreign Portfolio investment. The Reserve Bank of India recently amended the Regulations and currently treats Masala Bonds under the ECB category only, where a borrower just needs to seek the RBI's approval to sell those securities.

The provisions in respect of maturity period, all-in-cost ceiling and recognized lenders (investors) of Masala Bonds as under:

i. **Maturity period:** Minimum original maturity period for Masala Bonds raised upto USD 50 million equivalent in INR per financial year should be 3 years and for bonds raised above USD 50 million equivalent in INR per financial year should be 5 years.

ii. **All-in-cost ceiling:** The all-in-cost ceiling for such bonds will be 300 basis points over the prevailing yield of the Government of India securities of corresponding maturity.

Normal Bonds *vis-a-vis* Masala Bonds

As against Normal Bonds, Masala Bonds are considered a safer way of raising funds from international investors by Indian Corporates as they are rupee denominated bonds. Whereas the investor gets the benefit of a slightly high rate of interest as against normal bonds, issuer enjoys safety in terms of decrement in the rupee value against foreign currencies.

iii. **Recognised investors:** Entities permitted as investors under the provisions of paragraph 3.3.3 of the Master Direction No.5 dated January 1, 2016 but should not be related party within the meaning as given in Ind-AS 24.

Municipal Bonds

Municipal bonds are also referred to as 'muni bonds'. The urban local government and agencies issue these bonds. Municipal bonds are issued when a government body wants to raise funds for projects such as infra-related, roads, airports, railway stations, schools, and so on. SEBI issued guidelines in 2015 for the urban local bodies to raise funds by issuing municipal bonds. Municipal bonds exist in India since the year 1997. Bangalore Municipal Corporation is the first urban local body to issue municipal bonds in India. Ahmedabad followed Bangalore in the succeeding years. The municipal bonds lost the ground after the initial investors' attraction it received and failed to raise the desired amount of funds. To revive the municipal bonds, SEBI came up with guidelines for the issue of municipal bonds in 2015.

For more information about Bonds, students may refer lesson 14 of this study.

ALTERNATIVE INVESTMENT FUNDS

Indian entrepreneurs need private equity and debt products to meet the capital needs of their growth, restructuring, turn around or start-up plans. The main providers of this form of capital are private equity and venture capital funds which are channelled through Alternative Investment Funds (AIFs). Given that such capital is in short supply in India, a favourable policy and regulatory environment is essential. AIFs in India are regulated by the Securities and Exchange Board of India (SEBI). Other government agencies which play an important role are the Ministry of Finance and sector regulators in the pension and insurance areas as well as the Reserve Bank of India.

SEBI had earlier framed the SEBI (Venture Capital Funds) Regulations, 1996 ("VCF Regulations") to encourage investments into start-ups and mid-size companies. Since the introduction of the VCF Regulations, it was observed by SEBI that the venture capital route was being used by several other categories of funds such as private equity funds, real estate funds etc. Further, since registration as a Venture Capital Fund ("VCF") was not mandatory under the VCF Regulations, not all private equity or other categories of funds were registering with the SEBI.

While these funds did not enjoy certain exemptions that were available to VCFs, they were not subjected to any investment restrictions. SEBI noted the need for comprehensive regulations to deal with investments that are sourced from diverse parts of the private pool of capital. Accordingly, SEBI notified the Alternative Investment Fund (AIF) Regulations to govern unregulated entities and create a level playing ground for existing venture capital investors.

The Securities and Exchange Board of India ("SEBI") has notified the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations') on 21 May, 2012 - a comprehensive regulatory framework for regulating private pools of capital or Alternative Investment Funds, thus bringing various funds investing in Indian securities under a unified regulatory umbrella.

The AIF Regulations aim to regulate funds involved in the pooling or raising of private capital from Institutional Investors or High Networth Investors ("HNI") with a view to invest such funds in accordance with a defined investment policy for benefit of the investors and the manager of such fund, irrespective of their legal domicile. These regulations provide that an entity, seeking to pool and manage such private pool of capital for investing in securities or acting as an Alternative Investment Fund ("AIF"), should be registered with the SEBI under these regulations.

What is an Alternate Investment Fund ("AIF")?

Alternative Investment Fund or AIF means any fund established or incorporated in India which is a privately pooled investment vehicle which collects funds from sophisticated investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors.

SEBI (Alternative Investment Fund) Regulations, 2012

According to Section 2(1)(b), **"Alternative Investment Fund" (AIF)** means any fund established or incorporated in India in the form of a **trust** or a **company** or a **limited liability partnership** or a **body corporate** which-

(i) is a **privately pooled investment vehicle** which collects funds from investors, whether **Indian or foreign**, for investing it in accordance with a **defined investment policy** for the benefit of its investors; and

(ii) is **not covered** under the **SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999** or any other regulations of the SEBI to regulate fund management activities.

The following shall not be considered as Alternative Investment Fund for the purpose of these regulations, -

(i) family trusts set up for the benefit of 'relatives' as defined under Companies Act, 2013;

(ii) ESOP Trusts set up under the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 or as permitted under Companies Act, 2013;

(iii) employee welfare trusts or gratuity trusts set up for the benefit of employees;

(iv) ‘holding companies’ as defined under sub-section 46 of section 2 of Companies Act, 2013;

(v) other special purpose vehicles not established by fund managers, including securitization trusts, regulated under a specific regulatory framework;

(vi) funds managed by securitisation company or reconstruction company which is registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; and

(vii) any such pool of funds which is directly regulated by any other Regulator in India.

Key Aspects pertaining to AIFs under SEBI (Alternative Investment Funds) Regulations, 2012

- All AIFs must state its **investment strategy, investment purpose and its investment methodology** in its placement memorandum to the investors. In case the AIF decides to **alter the fund strategy**, it shall be made only **with the consent of at least 2/3rd of the unit holders** by value of their investment in the AIF.
- The AIF, in all categories, may raise funds from any investor whether Indian, foreign or non-resident Indians only by way of issue of **units.**
- **Minimum Corpus of an AIF- ₹ 20 crores.**
- **Minimum Investment from an Individual - ₹ 1 crore (₹ 25 lakhs in case of employees or directors of the AIF fund/Manager).**
- Corpus of Manager/Sponsor- 2.5% or ₹ 5 Crore whichever is lower. (In case of Category I and II) Double in case of Category –III.
- Not more than **1000 investors.**
- Raise funds only by way of **Private Placement.**

Categories of AIFs

Basis	***Category I***	***Category II***	***Category III***
Introduction	Invest in **Start ups, SMEs and such projects** which are **economically and socially desirable.**	Which are not covered under Category –I and III.	Employ **diverse and complex trading strategies.**
Investment in securities of companies	Yes, generally unlisted companies.	Yes, primarily unlisted company.	Yes, both listed and unlisted.
Investment in units of other AIF	Yes, but not more than 25% of the investable funds in an Investee Company directly or through investment in the units of other Alternative Investment Funds.	Yes, but not more than 25% of the investable funds in an Investee Company directly or through investment in the units of other Alternative Investment Funds.	Yes, not more than ten per cent of the investable funds in an Investee Company, directly or through investment in units of other Alternative Investment Funds.

Basis	*Category I*	*Category II*	*Category III*
Borrow funds	No, except for temporary fund requirements. Max 30 days. Max. 4 times in a year. Max 10 % of the investible funds.	Same as of Category -I.	Yes, with the consent of investors.
Tenure	Minimum tenure of 3 years closed ended fund Tenure can be extended for 2 years by approval from investors (2/3 in value).	Same as of Category -I.	No minimum Tenure Open ended or close ended Tenure can be extended for 2 years by approval from investors (2/3 in value).

Special Alternate Investment Fund under Regulation 19 of SEBI (AIF) Regulations is added. Regulation 19 prescribed that SEBI may lay down framework for AIFs other than the funds falling in the categories specified in SEBI (AIF) Regulations, 2012.

For more details about AIFs, the students may refer lesson 11 of this study.

VENTURE CAPITAL

Venture Capital is one of the innovative financing resource for a company in which the promoter has to give up some level of ownership and control of business in exchange for capital for a limited period, say, 3-5 years.

Venture Capital is generally equity investments made by venture capital funds, at an early stage in privately held companies, having potential to provide a high rate of return on their investments. It is a resource for supporting innovation, knowledge based ideas and technology and human capital intensive enterprises.

According to Section 2(1)(z), "venture capital fund" means an Alternative Investment Fund which invests primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property right based activities or a new business model and shall include an angel fund as defined under Chapter III-A.

A venture capital company is a group of investors who pool investments focused within certain parameters. The participants in venture capital firms can be institutional investors like pension funds, insurance companies, foundations, corporations or individuals.

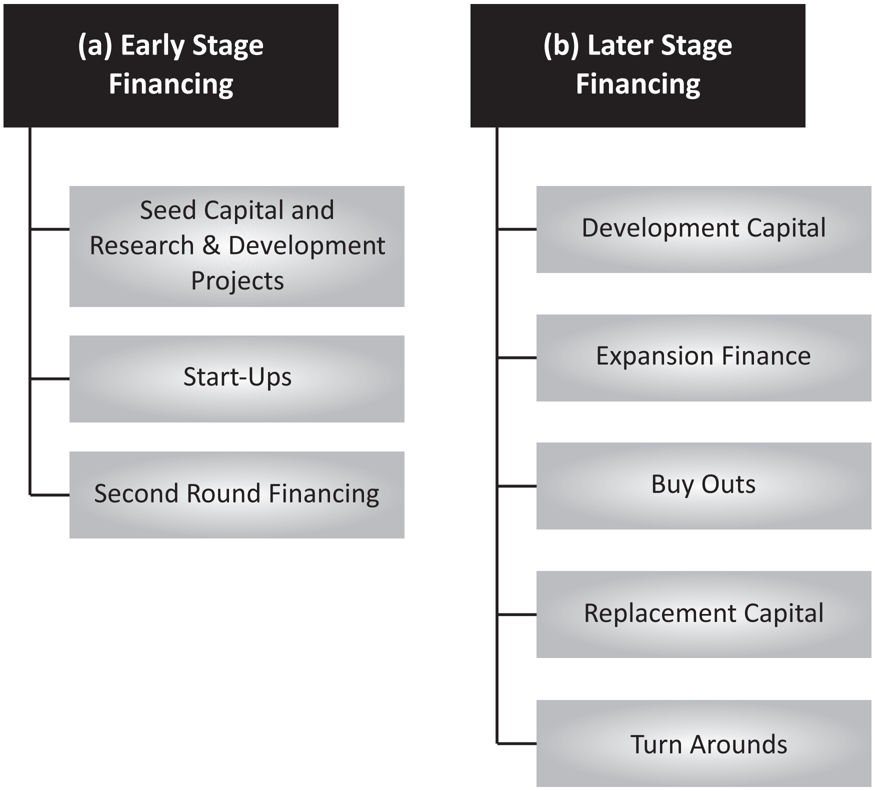
Unlike banks, which seek their return through interest payments, venture firms seek for capital appreciation. Generally, venture capital firms look for a return of five to ten times the original investment.

Areas of Investment

Different venture groups prefer different types of investments. Some specialize in seed capital and early expansion while others focus on exit financing. Biotechnology, medical services, communications, electronic components and software companies seem to be the most likely attraction of may venture firms and receiving the most financing. Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability.

In India, software sector has been attracting a lot of venture finance. Besides media, health and pharmaceuticals, agri-business and retailing are the other areas that are favored by a lot of venture companies.

Stages of Investment Financing



Early Stage Financing

- **Seed Capital and R&D Projects:** Venture capitalists are more often interested in providing seed finance i. e. making provision of very small amounts for finance needed to turn into a business. Research and Development activities are required to be undertaken before a product is to be launched.
- **Start-Ups:** The most risky aspect of venture capital is the launch of a new business after the Research and Development activities are over. Start-ups may include new industries/businesses set up by the experienced persons in the area in which they have knowledge, specialization and proficiency.
- **Second Round Financing:** It refers to the stage when product has already been launched in the market but has not earned enough profits to attract new investors.

Later Stage Financing

- **Development Capital:** It refers to the financing of an enterprise which has overcome the highly risky stage and have recorded profits but cannot go public, thus needs financial support.
- **Expansion Finance:** Venture capitalists perceive low risk in ventures requiring finance for expansion purposes either by growth implying bigger factory, large warehouse, new factories, new products or new markets or through purchase of existing businesses.
- **Buy Outs**: It refers to the transfer of management control by creating a separate business by separating it from their existing owners.
- **Turnarounds:** Such form of venture capital financing involves medium to high risk on a time scale of

three to five years. It involves buying the control of a sick company which requires specialized skills in finance.

ANGEL FUNDS

As per SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations), Angel Fund means a sub-category of Venture Capital Fund under Category I - Alternative Investment Fund that raises funds from angel investors and invests in accordance with the provisions of Chapter III-A of the AIF Regulations.

Angel Investor

'Angel Investor' means any person who proposes to invest in an angel fund and satisfies one of the following conditions, namely-

- an individual investor who has net tangible assets of at least **two crore rupees excluding value of his principal residence**, and who:
  - has **early stage investment experience**, or
  - has **experience as a serial entrepreneur**, or
  - is a **senior management professional with at least ten years of experience.**
- a body corporate with a net worth of at least ten crore rupees; or
- an Alternative Investment Fund registered under SEBI AIF Regulations or a Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations, 1996.

Early stage investment experience shall mean prior experience in investing in start-up or emerging or early-stage ventures and 'serial entrepreneur' shall mean a person who has promoted or co-promoted more than one start-up venture.

Regulatory Framework

The provisions of Chapter III-A of the AIF Regulations, 2012 and all other provisions of the AIF Regulations, except clauses (a), (b), (c), (d) and (f) of regulation 10, regulation 12, regulation 14, clauses (a), (c) and (e) of sub-regulation (1) of regulation 15, clause (b) of sub-regulation (1) of regulation 16 and sub-regulation (2) of regulation 16 of the AIF Regulations, and the guidelines and circulars issued under the AIF Regulations unless specifically excluded, shall apply to angel funds, their sponsors and managers and angel investors.

PRIVATE EQUITY

Private equity is a type of equity (finance) and one of the asset classes that are not publicly traded on a stock exchange. Private equity is essentially a way to invest in some assets that is not publicly traded, or to invest in a publicly traded asset with the intention of taking it private. Unlike stocks, mutual funds, and bonds, private equity funds usually invest in more illiquid assets, i.e. companies. By purchasing companies, the firms gain access to those assets and revenue sources of the company, which can lead to very high returns on investments. Another feature of private equity transactions is their extensive use of debt in the form of high-yield bonds. By using debt to finance acquisitions, private equity firms can substantially increase their financial returns.

Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet. The major of private equity consists of institutional investors and accredited investors who can commit large sums of money for long periods of time.

Private equity investments often demand long holding periods to allow for a turnaround of a distressed company or a liquidity event such as IPO or sale to a public company. Generally, the private equity fund raise money from investors like Angel investors, Institutions with diversified investment portfolio like – pension funds, insurance companies, banks, funds of funds etc.

Types of Private Equity

Private equity investments can be divided into the following categories:

Leveraged Buyout (LBO): This refers to a strategy of making equity investments as part of a transaction in which a company, business unit or business assets is acquired from the current shareholders typically with the use of financial leverage. The companies involved in these type of transactions that are typically more mature and generate operating cash flows.

Venture Capital: It is a broad sub-category of private equity that refers to equity investments made, typically in less mature companies, for the launch, early development, or expansion of a business.

Growth Capital: This refers to equity investments, mostly minority investments, in the companies that are looking for capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business.

For more details about Venture Capital, Angel Funds and raising of funds from Private Equity, students may refer Lesson 11 of this study.

REAL ESTATE INVESTMENT TRUSTS (REITs)

A real estate investment trust ("REIT") is a collective investment scheme that owns, operates or finances income producing real estate. REITs provide all investors the chance to own valuable real estate, present the opportunity to access dividend-based income and total returns, and help communities grow, thrive, and revitalize. REITs allow anyone to invest in portfolios of real estate assets the same way they invest in other industries – through the purchase of individual company stock or through a mutual fund or exchange traded fund (ETF). The stockholders of a REIT earn a share of the income produced through real estate investment – without buying any finance property.

REITs are similar to mutual funds and shares and they provide income by way of Dividend to its shareholders and Capital Appreciation as REIT stocks are listed in BSE and NSE. Recently, the SEBI has notified Small and medium REIT framework to facilitate greater growth of the real estate sector and all related sectors of the economy.

For more details about REITs, students may refer Lesson 9 of this study.

INFRASTRUCTURE INVESTMENT TRUSTS (INVITS)

Considering the importance of infrastructure sector with an aim to provide a suitable platform for financing / refinancing infrastructure projects and allow the investors to participate in the growth story of infrastructure, the Government introduced a new investment vehicle named Infrastructure Investment Trusts ('InvITs') in 2014.

The primary objective of InvITs is to promote the infrastructure sector of India by encouraging more individuals to invest in it. Typically, such a tool is designed to pool money from several investors to be invested in income-generating assets. The cash flow thus generated is distributed among investors as dividend income. When compared to Real Estate Investment Trust or REITs, the structure and operation of both are quite similar.

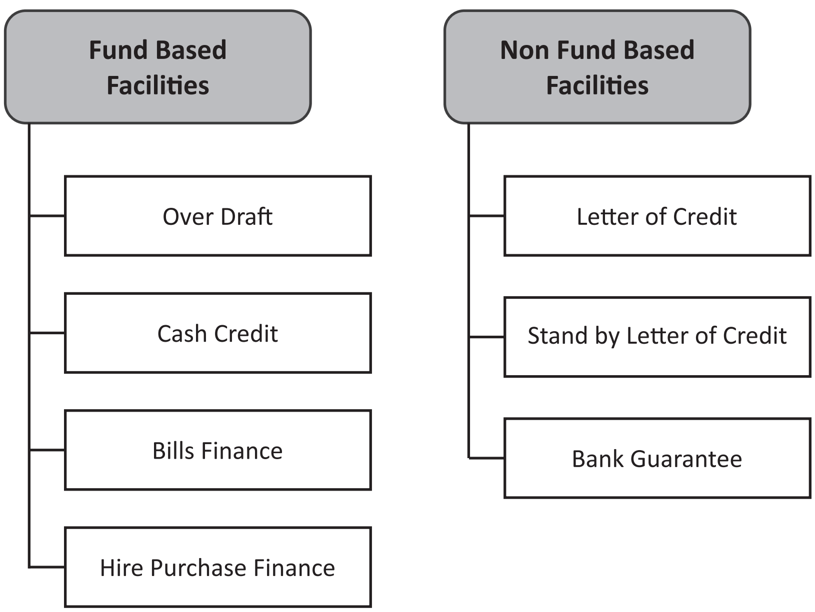
For more details about InvITs, students may refer Lesson 10 of this study.

BANK FINANCE - MOST COMMON WAY OF FUNDING FOR CORPORATES

Banking Regulation Act, 1949 classifies bank finance into secured loans and unsecured loans. Secured loan means loans granted by the banks on the backing of some tangible security, while Unsecured loan is one for which the banker has to rely upon the personal security of the borrower. Unsecured advances are not popular in India as they impose a huge risk of money loss in case of default by the borrower. Most of the bank advances are secured ones. Only a small portion of about 11% to 15% of the total bank advance is unsecured that usually take form of Overdrafts and Cash Credit Facilities.

Bank's finance their customers not only in the form of loans, but through other types of credit facilities also. The other types of bank finance are tailor made to suit the needs of customers. The loans and advances wherein immediate flow of funds is available to borrowers, are called funds based facility. In non-fund based facilities like issuance of letter of guarantee, letter of credit etc., banks get income in the form of fee for making available the facility and there is no immediate outflow of funds from bank. Some of the credit facilities which are different from loans are described here-under.

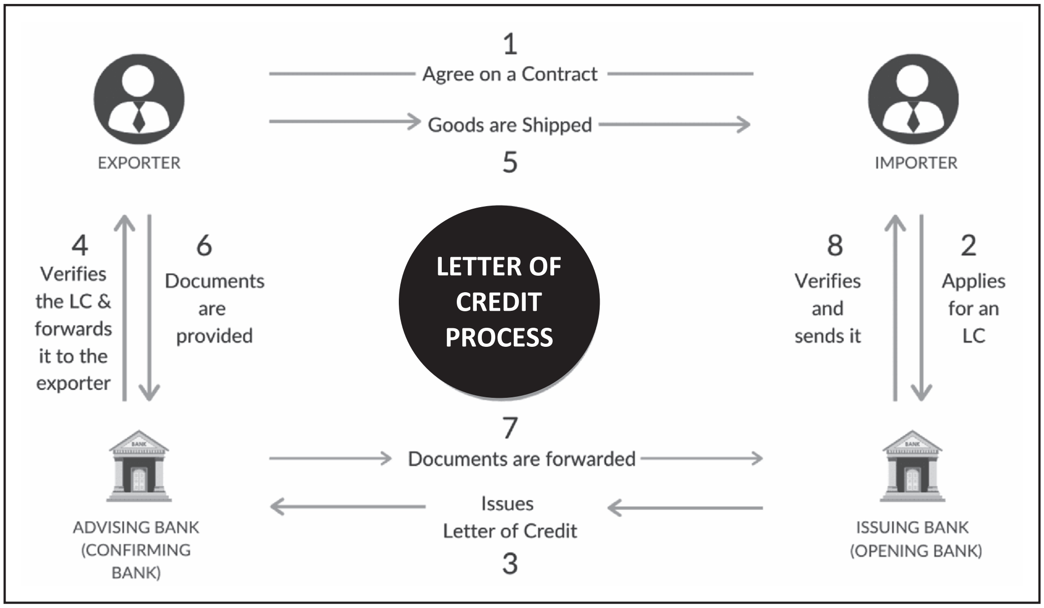
Credit Facilities Provided by the Banks



Letter of Credit

A letter of credit is a document from a bank that guarantees payment. It is an undertaking/ commitment by the bank, advising/informing the beneficiary that the documents under a letter of credit would be honoured, if the beneficiary (exporter) submits all the required documents as per the terms and conditions of the letter of credit.

A Letter of Credit is issued by a bank at the request of its customer (importer / buyer) in favour of the beneficiary (exporter / seller).

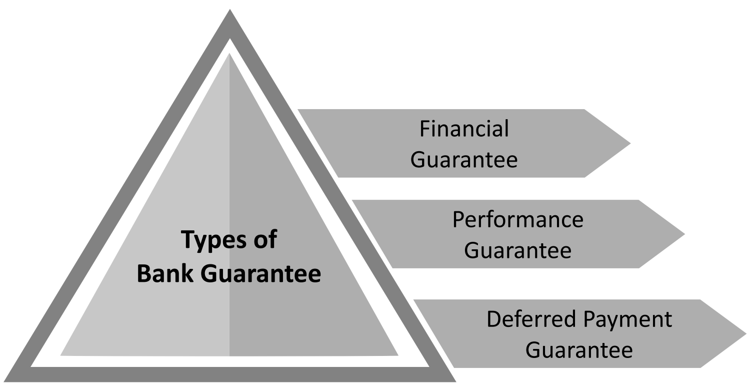


Bank Guarantee

A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfill his commitment to the beneficiary.

Bank guarantees are part of non-fund based credit facilities provided by the bank to the customers. Bank issue bank guarantee on behalf of his client as a commitment to third party assuring her/ him to honour the claim against the guarantee in the event of the non- performance by the bank's customer. A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfill his commitment to the beneficiary.

Banks issue different types of guarantees, on behalf of their customers, as illustrated below:



- **Financial Guarantee:** A financial guarantee is an agreement that guarantees a debt will be repaid to a lender by another party if the borrower defaults. The banker issues guarantee in favour of a government department against caution deposit or earnest money to be deposited by bank's client. At the request of his customer, in lieu of a caution deposit/ earnest money, the banker issues a guarantee in favour of the government department. This is an example of a Financial Guarantee. This type of guarantee helps the bank's customer to bid for the contract without depositing actual money. In case, the contractor does not take up the awarded contract, then the government department would invoke the guarantee and claim the money from the bank.

- **Performance Guarantee:** Performance Guarantees are issued by banks on behalf of their clients. In performance guarantee bank issue on behalf of his client to assure the third party to complete some work on time or as per the terms of contact between the parties. If the work is not completed as per the term of contract then the third party can request the bank to invoke the bank guarantee and make payment for default.

- **Deferred Payment Guarantee:** It is clear from the name of the Bank guarantee that under this guarantee, the banker guarantees payments of installments spread over a period of time.

Here, the banks undertake to make payment of instalments payable by the buyer of capital goods such as machinery, on long term credit given by the supplier. Normally advance payment of 10% to 15% of the price of the capital goods is made by the borrower (margin). The balance amount with interest is payable in installments spread over may be 1 to 5 years. The supplier accordingly draws bills due on different dates which are accepted by the borrower and further co-accepted by the banker or bank issues DPG. On every due date the buyer's bank makes payment of the bill to the supplier irrespective of there being balance in the buyer's (borrower's) account or not. Banks secure such guarantees by creating charge over the assets purchased.

A bank guarantee and a letter of credit are similar in many ways but they are two different things. Letters of credit ensure a transaction proceeds as planned, while bank guarantees reduce the loss if the transaction does not go as planned.

Difference between Letter of Guarantee and Bank Guarantee

A letter of credit, sometimes referred to as a documentary credit, acts as a promissory note from a bank. It represents an obligation taken on by a bank to make a payment once certain criteria are met. Once these terms are completed and confirmed, the bank will transfer the funds. The letter of credit ensures the payment will be made as long as the services are performed.

Illustration

An Indian wholesaler receives an order from a US company. The wholesaler has no way of knowing whether the buyer can fulfill his payment obligations, and requests a letter of credit be provided in their contract. The purchasing company applies for a letter of credit at a bank where it already has funds (LOC). After the goods have been shipped, the bank would pay the wholesaler its due as long as the terms of the sales contract are met, such as delivery before a certain time or confirmation from the buyer that the goods were received undamaged. The letter of credit substitutes the bank's credit for that of its client, ensuring correct and timely payment.

Letters of credit are especially important in international trade due to the distance involved and potentially differing laws in the countries of the businesses involved. In these transactions, it is not always possible for the parties to meet in person. The bank issuing the letter of credit holds payment on behalf of the buyer until it receives confirmation that the goods in the transaction have been shipped.

While letters of credit are used mostly in international trade agreements, bank guarantees are often used in real estate contracts and infrastructure projects.

Bank guarantees represent a more significant contractual obligation for banks than letters of credit do. A bank guarantee, like a letter of credit, guarantees a sum of money to a beneficiary; however, unlike a letter of credit, the sum is only paid if the opposing party does not fulfill the stipulated obligations under the contract. This can be used to essentially insure a buyer or seller from loss or damage due to nonperformance by the other party in a contract.

Bank guarantees insure both parties in a contractual agreement from credit risk. For instance, a construction company and its cement supplier may enter into a new contract to build a mall. Both parties may have to issue bank guarantees to prove their financial stance and capability. In a case where the supplier fails to deliver cement within a specified time, the construction company would notify the bank, which then pays the company the amount specified in the bank guarantee.

Both bank guarantees and letters of credit work to reduce financial risk. The seller takes on less risk when a letter of credit or bank guarantee is active, and would be more likely to agree to the transaction. These agreements are particularly important and useful in what would otherwise be risky transactions for the seller, such as certain real estate and international trade contracts. Banks, since they are agreeing to take on risk, thoroughly screen buyers interested in one of these transactions. After the bank has determined that the buyer is a reasonable risk, a monetary limit is placed on the agreement. The bank agrees to be obligated up to, but not exceeding, the limit. This protects the bank by providing a specific threshold of risk.

For more information about Letter of Credit and Bank Guarantee, students may refer Lesson 14 (Section II) of this study.

FOREIGN FUNDING

Globalisation has opened doors and opportunities that were never explored before. International Financing is also known as International Macroeconomics as it deals with finance on a global level. International finance helps organizations engage in cross-border transactions with foreign business partners, such as customers, investors, suppliers and lenders. Various international sources from where funds may be raised include the following:

(i) Commercial Banks;

(ii) International Agencies and Development Banks;

(iii) International Capital Markets.

With economies and the operations of the business organizations going global, Indian companies have an access to funds in the global capital market.

The Government of India has taken various policies initiatives to allow India companies to raised funds from International Market. These policy initiatives have led to the introduction of International Instruments like American Depository Receipts (ADR), Global Depository Receipts (GDR), Foreign Currency Convertible Bonds (FCCBs) and Foreign Currency Exchangeable Bonds (FCEBs) etc.

Increased globalization and investor appetite for investing in India, offer unique opportunity to companies looking to tap a new investor base, awareness or raise capital.

Capital can be raised from international capital market in foreign currency by accessing foreign capital market. Funds raised through foreign currency are called as euro equity or debt.

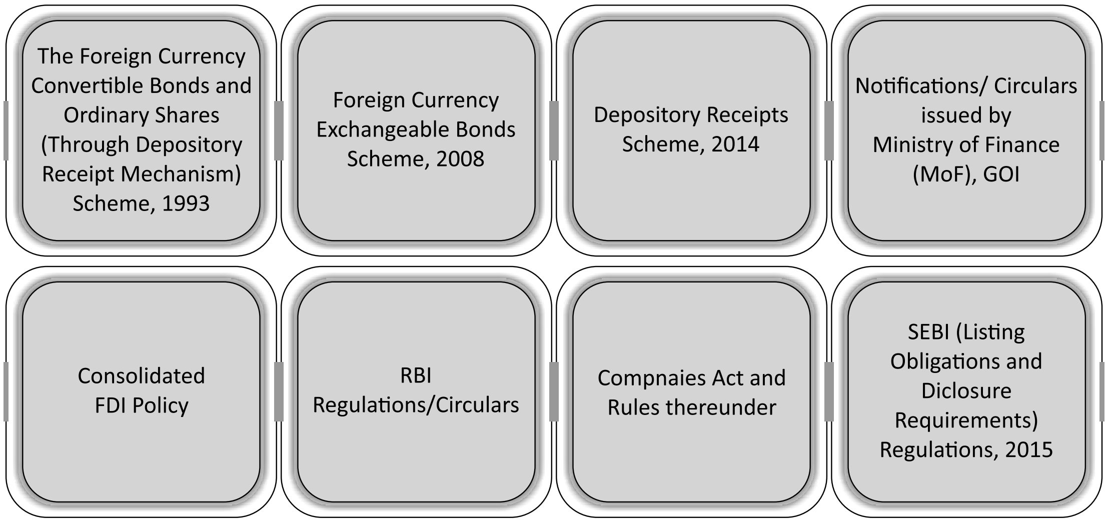
- **Euro Equity:** Euro equity represents shares denominated in dollar terms, issued by non-American and non-European companies to list their shares on American and European stock exchanges by complying the regulations of respective stock exchanges where the shares are intended to be listed. The euro equity issue can be made in different forms like American Depository Receipts and Global Depository Receipts.

Indian companies are allowed to raise capital in the international market through the issue of GDR/ADR/ FCCB/ FCEB and through External Commercial Borrowings.

- **Euro Debt:** Debts raised from international capital market by complying regulations of the respective country of which the capital market is accessed is called as euro debt. Euro debt can be issued in the form of ECB/FCCB/FCEB etc.

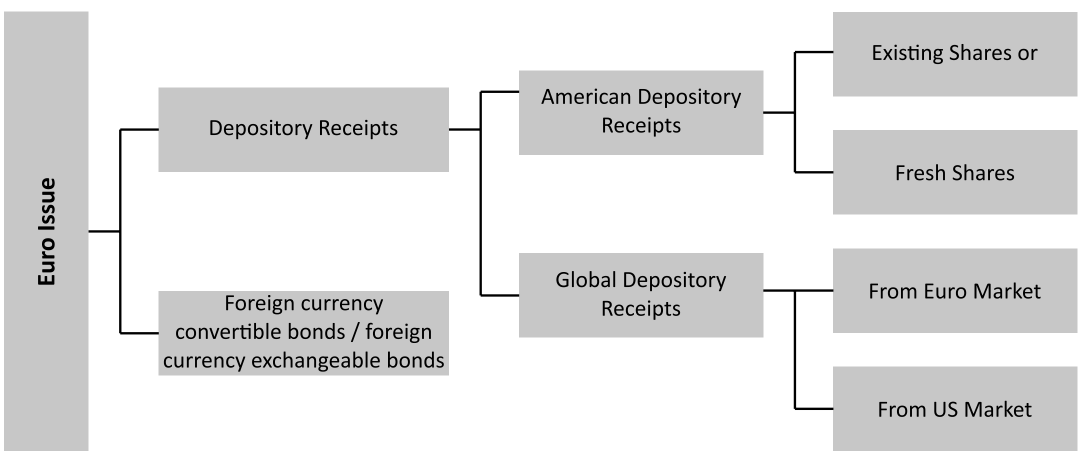
Regulatory Framework in India

Issue of ADR/GDR/FCCBs/FCEBs are regulated by the following regulations in India:



Euro issue

Euro issue means modes of raising funds by an Indian company outside India in foreign currency. There are different modes of Euro issue which is as follows:



Depository Receipts Scheme, 2014

The issuance of depository receipt is one of the mechanisms used by Indian companies to get an access to foreign investors. In simple terms, a depository receipt is a foreign currency denominated instrument which is issued by an overseas depository to non-residents against securities of the Indian company.

On October 21, 2014, the Ministry of Finance ("MoF") notified ("Notification"), the Depository Receipts Scheme, 2014 ("DR Scheme") by virtue of which issuance of DRs has been taken out of the 1993 Scheme and is now regulated by the DR Scheme.

Hitherto, instruments issued by Indian companies to tap global capital markets, viz. American depository receipts (ADRs) or global depository receipts (GDRs) or convertible debt instruments in the form of foreign currency convertible bonds (FCCBs) were governed by the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipts Mechanism) Scheme, 1993, which had been amended from time to time.

> The issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 stands repealed to the extent that it applies to Depository Receipts ('DRs'). It will, however, continue to apply to FCCBs. The DR Scheme came into effect from December 15, 2014.

The DR Scheme is based on the recommendations of the Sahoo Committee, which under the chairmanship of Mr. M.S. Sahoo undertook a comprehensive review of the 1993 Scheme and proposed significant deregulation and rationalisation of the manner in which Indian companies could tap global capital markets.

American Depository Receipts (ADR) & Global Depository Receipts (GDR)

Typically, companies in India issue securities in the form of depository receipts (DR) viz American Depository Receipts (ADR), Global Depository Receipts (GDR) or Foreign Currency Convertible Bonds (FCCB). While ADR and GDR are equity instruments, FCCB is a convertible debt instrument.

The DR Scheme 2014 is solely applicable to ADR and GDR. The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 continues to govern FCCB.

Regulation 2(c) of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 defines ADR as under:

"American Depository Receipt (ADR)"means a security issued by a bank or a depository in United States of America (USA) against underlying rupee shares of a company incorporated in India."

Regulation 2(i) of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004, defines GDR as under:

"Global Depository Receipt (GDR)" means a security issued by a bank or a depository outside India against underlying rupee shares of a company incorporated in India.

Difference between American Depository Receipts (ADR) and Global Depository Receipts (GDR)

- ADR are US $ denominated and traded only in US.
- GDRs are traded in various places such as New York Stock Exchange, London Stock Exchange, etc.

Provisions under the Companies Act, 2013

The Companies Act, 2013 has laid down provisions for issue of GDRs under Section 41 and prescribed the Companies (Issue of Global Depository Receipts) Rules, 2014.

According to Section 2(44) of Companies Act, 2013, "Global Depository Receipt" means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts.

Section 41 provides that a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed.

Foreign Currency Convertible Bonds (FCCBs)

Foreign Currency Convertible Bonds (FCCBs) are optionally convertible bonds issued in a currency other than Indian Rupees. A convertible bond is a mix between a debt and equity instruments. It acts like a bond by making regular coupon and principal payments, but these bonds also give the bondholders the option to convert the bond into shares at the expiry the term of the Bond.

The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company. Interest and redemption price (if conversion option is not exercised) is payable in dollars. FCCBs shall be denominated in any freely convertible Foreign Currency. However, it must be kept in mind that FCCB issue proceeds need to conform to ECB end use requirements.

Apart from the policy of ECB, issue of FCCB is also required to adhere to FEMA Regulations and in accordance with the scheme viz., “Issue of Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

Foreign investors also prefer FCCBs because of the dollar denominated servicing, the conversion option and, the arbitrage opportunities presented by conversion of the FCCBs into equity at a discount on prevailing Indian market price.

In addition, 25% of the FCCB proceeds can be used for general corporate restructuring.

Difference between Foreign Current Convertible Bonds (FCCBs) and Global Depository Receipts (GDR)

- FCCB is a type of Eurobond which can be exchanged for equity shares at some later date after issue of the Bond.
- GDR is a negotiable instrument in the form of depository receipts or certificate created by the overseas depository bank outside India and issued to non-resident investor against the issue of ordinary shares of foreign currency convertible bonds of the issuing company.

The major drawbacks of FCCBs are that the issuing company cannot plan its capital structure as it is not assured of conversion of FCCBs. Moreover, the projections for cash outflow at the time of maturity cannot be made.

Benefits to the Issuer Company

- Being Hybrid instrument, the coupon rate on FCCB is particularly lower than pure debt instrument there by reducing the debt financing cost.
- FCCBs are book value accretive on conversion. It saves risks of immediate equity dilution as in the case of public shares. Unlike debt, FCCB does not require any rating nor any covenant like securities, cover etc.
- It can be raised within a month while pure debt takes a longer period to raise. Because the coupon is low and usually payable at the time of redeeming the instrument, the cost of withholding tax is also lower for FCCBs compared with other ECB instruments.

Benefits to the Investor

- It has advantage of both equity and debt.
- It gives the investor much of the upside of investment in equity, and the debt portion protects the downside.
- Assured return on bond in the form of fixed coupon rate payments.

- Ability to take advantage of price appreciation in the stock by means of warrants attached to the bonds, which are activated when price of a stock reaches a certain point.
- Significant Yield to maturity (YTM) is guaranteed at maturity.
- Lower tax liability as compared to pure debt instruments due to lower coupon rate.

FCCB and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993

FCCBs are governed by the 'Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depositary Receipt Mechanism) Scheme, 1993' as amended from time to time and Notification FEMA No.120/ RB-2004 dated July 7, 2004.

The issuance of FCCBs was brought under the ECB guidelines in August 2005. In addition to the requirements of:

(i) having the maturity of the FCCB not less than 5 years,

(ii) the call & put option, if any, shall not be exercisable prior to 5 years,

(iii) issuance of FCCBs only without any warrants attached,

(iv) the issue related expenses not exceeding 4% of issue size and in case of private placement, shall not exceed 2% of the issue size, etc.

as required in terms of Notification FEMA No. 120/RB-2004 dated July 7, 2004, FCCBs are also subject to all the regulations which are applicable to ECBs.

Foreign Currency Exchangeable Bonds (FCEBs)

Indian promoters can new raise money abroad by issuing foreign currency bonds against the value of their investments in shares of listed group company, termed as Foreign Currency Exchangeable Bonds (FCEB). The issue of these bonds helps the promoter to meet the financing requirements within the group. Issue of Foreign Currency Exchangeable Bonds (FCEB) are governed by Foreign Currency Exchangeable Bonds Scheme, 2008 issued by Ministry of Finance, Department of Economic Affairs.

What is FCEB?

According to the "Issue of Foreign Currency Exchangeable Bonds (FCEBs) Scheme, 2018, FCEB means a bond expressed in foreign currency, the principal and the interest in respect of which is payable in foreign currency, issued by an issuing company, subscribed to by a person resident outside India, exchangeable into equity shares of another company, being Offered company in any manner either wholly or partly or on the basis of any equity related warrants attached to debt instruments. The FCEB may be denominated in any freely convertible foreign company.

Parties of FCEB

The issuer company (issuer) → **The offered Company (OC) and** → **Investor**

Under this option, an issuer company may issue FCEBs in foreign currency, and these FCEBs are convertible into shares of another company (offered company) that forms part of the same promoter group as the issuer company.

Example- Company ABC Ltd. issues FCEBs, then the FCEBs will be convertible into shares of company XYZ Ltd. that are held by company ABC Ltd. and where companies ABC Ltd. and XYZ Ltd. form part of the same promoter group. Unlike FCCBs that convert into shares of issuer itself, FCEBs are exchangeable into shares of OC. Also, relatively, FCEB has an inherent advantage that it does not result in dilution of shareholding at the OC level.

External Commercial Borrowing (ECB)

ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a standalone basis.

Merging of Tracks I and II as "Foreign Currency denominated ECB" and merging of Track III and Rupee Denominated Bonds framework as "Rupee Denominated ECB".

ECB Framework

The framework for raising loans through ECB comprises the following two options:

Parameters	***FCY denominated ECB***	***INR denominated ECB***
Currency of borrowing	Any freely convertible Foreign Currency.	Indian Rupee (INR)
Forms of ECB	Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; FCCBs; FCEBs and Financial Lease.	Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; and Financial Lease. Also, plain vanilla Rupee denominated bonds issued overseas (RDBs), which can be either placed privately or listed on exchanges as per host country regulations.
Eligible borrowers	All entities eligible to receive FDI. Further, the following entities are also eligible to raise ECB: a) Port Trusts; b) Units in SEZ; c) SIDBI; and d) EXIM Bank.	a) All entities eligible to raise FCY ECB; and a) Registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registered societies/ trusts/cooperatives and Non- Government Organisations (permitted only to raise INR ECB).

Foreign Direct Investment (FDI)

Foreign Direct Investment is one of the important drivers of economic growth and a source of non-debt finance for the economic development of India. FDI complements and supplements domestic investment. Domestic companies are benefited through FDI by way of enhanced access to supplementary capital and state-of-art-technologies, as also exposure to global managerial practices resulting into employment generation and accelerated growth of the sectors. Foreign investment through routes of Foreign Direct Investment (FDI) inflow and Foreign Portfolio Investment (FPI) inflows (net).

To promote FDI, the Government has put in place an investor-friendly policy, wherein except for a small negative list, most sectors are open for 100% FDI under the Automatic route. Further, the policy on FDI is reviewed on an ongoing basis, to ensure that India remains attractive & investor friendly destination. Changes are made in the policy after having intensive consultations with stakeholders including apex industry chambers, Associations, representatives of industries/groups and other organizations taking into consideration their views/comments.

Government has also taken various steps to improve the overall business regulatory environment in the country and create a conducive business environment by streamlining the existing regulations and processes and eliminating unnecessary requirements and procedures.

Government has taken various steps in addition to ongoing schemes to boost domestic investments in India. These include the National Infrastructure Pipeline, Reduction in Corporate Tax, easing liquidity problems of NBFCs and Banks, trade policy measures to boost domestic manufacturing. Government of India has also promoted domestic manufacturing of goods through the public procurement order, Phased Manufacturing Programme (PMP), Schemes for Production Linked Incentives of various Ministries.

It may be noted that Foreign Direct Investment ('FDI') means investment through capital instruments by a person resident outside India in an unlisted Indian company; or in 10% or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company. In case an existing investment by a person resident outside India in equity instruments of a listed Indian company falls to a level below 10% of the post issue paid-up equity capital on a fully diluted basis, the investment shall continue to be treated as FDI. 'Fully diluted basis' means the total number of shares that would be outstanding if all possible sources of conversion are exercised.

Entry Routes for Investment

Investments can be made by non-residents in the equity shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible preference shares of an Indian company, through the Automatic Route or the Government Route. Permissible FDI can be made under "Automatic route" or "Government route".

Automatic Route: It means the entry route through which investment by a person resident outside India does not require the prior approval of the Reserve Bank of India or the Central Government.

Government Route: It means the entry route through which investment by person resident outside India requires prior Government approval and foreign investment received under this route shall be in accordance with the conditions stipulated by the Government in its approval.

Foreign Portfolio Investment

'Foreign Portfolio Investment' means any investment made by a person resident outside India through capital instruments where such investment is less than 10 percent of the post issue paid-up share capital on a fully diluted basis of a listed Indian company or less than 10 percent of the paid up value of each series of capital instruments of a listed Indian company.

Explanation: The 10 percent limit for foreign portfolio investors shall be applicable to each foreign portfolio investor or an investor group as referred in Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.

According to section 2(1)(j) of the SEBI (Foreign Portfolio Investors) Regulations, 2019, "Foreign Portfolio Investor" means a person who has been registered under Chapter II - Registration of Foreign Portfolio Investors of these regulations and shall be deemed to be an intermediary in terms of the provisions of the SEBI Act, 1992.

Categories of Foreign Portfolio Investor

FPI Category	*Investors*
Category I	● Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled or at least 75% directly or indirectly owned by such Government and Government related investor(s). ● Pension funds and university funds. ● Appropriately regulated entities such as insurance or reinsurance entities, banks, asset management companies, investment managers, investment advisors, portfolio managers, broker dealers and swap dealers. ● Entities from the Financial Action Task Force member countries, or from any country specified by the Central Government by an order or by way of an agreement or treaty with other sovereign Governments, which are – I. appropriately regulated funds; II. unregulated funds whose investment manager is appropriately regulated and registered as a Category I foreign portfolio investor. However, the investment manager undertakes the responsibility of all the acts of commission or omission of such unregulated fund; III. university related endowments of such universities that have been in existence for more than five years. ● An entity (A) whose investment manager is from the Financial Action Task Force member country and such an investment manager is registered as a Category I foreign portfolio investor; or (B) which is at least seventy-five per cent owned, directly or indirectly by another entity and such an eligible entity is from a Financial Action Task Force member country. However such an investment manager or eligible entity undertakes the responsibility of all the acts of commission or omission of the applicants seeking registration under this sub-clause.
Category II	"Category II foreign portfolio investor" shall include all the investors not eligible under Category I foreign portfolio investors such as – ● appropriately regulated funds not eligible as Category-I foreign portfolio investor ● endowments and foundations ● charitable organisations ● corporate bodies ● family offices ● Individuals ● appropriately regulated entities investing on behalf of their client, as per conditions specified by the Board from time to time ● Unregulated funds in the form of limited partnership and trusts.

For more details about Foreign Funding – Institutions, Instruments, Laws & Procedure, the students may refer Lesson 15 & 16 of this study.

SECURITIZATION

Introduction

Securitization is the transformation of financial assets into securities. Securitization is used by financial entities to raise funding other than what is available via the traditional methods of on-balance-sheet funding.

Securitization is a technique used to convert illiquid assets/claims in to tradable securities.

In other words, Securitization is the process of pooling and repackaging of homogenous illiquid financial assets into marketable securities that can be sold to investors. The process leads to the creation of financial instruments that represent ownership interest in, or are secured by a segregated income producing asset or pool of assets. The pool of assets collateralizes securities.

These assets are generally secured by personal or real property (e.g. automobiles, real estate, or equipment loans), but in some cases are unsecured (e.g. credit card debt, consumer loans). There are four steps in a securitization:

(i) Special Purpose Distinct Entity (SPDE) is created to hold title to assets underlying securities;

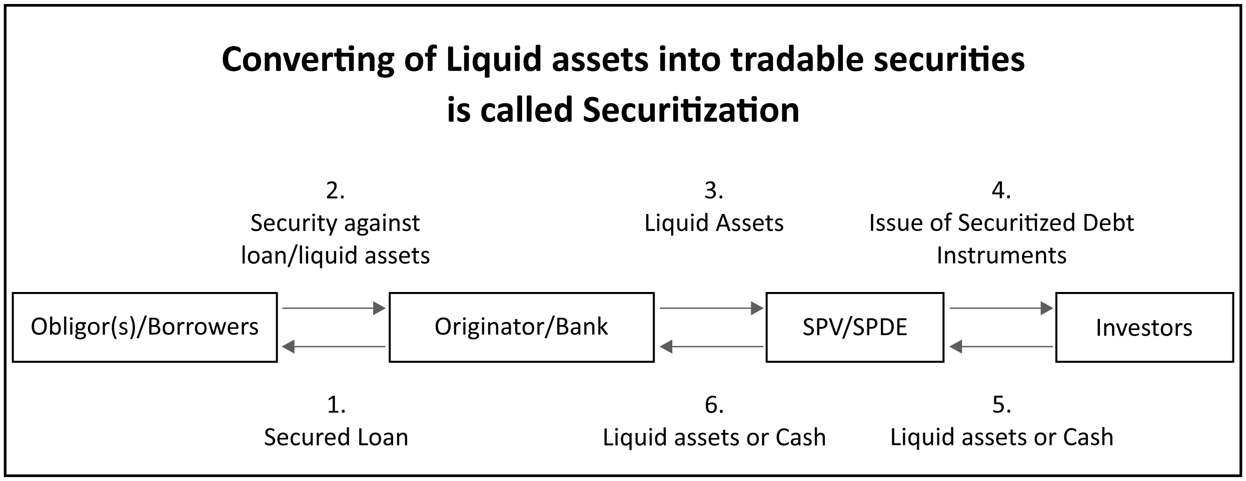
Securitisation as a structured finance mechanism has several commercial advantages, including balance sheet and risk management, increased liquidity, cost-efficient financing, marketability of the resulting securities and an opportunity for portfolio diversification, which has remained an attractive option for banks, NBFCs and financial institutions in India.

(ii) the originator or holder of assets sells the assets (existing or future) to the SPDE;

(iii) the SPDE with the help of an investment banker, issues securities which are distributed to investors; and

(iv) the SPDE pays the originator for the assets with the proceeds from the sale of securities.

Securitization Process



Steps in securitisation

(i) Acquisition of Financial Assets by Securitisation Company or reconstruction Company (i.e. SPVs) from the originator. Here financial assets are loans backed by properties. The originator is banks or FIs who has lent money to the original borrower.

(ii) the SPV, with the help of an investment banker, issues security receipts which are distributed to investors; and

(iii) the SPV pays the originator for the financial assets purchased with the proceeds from the sale of securities.

Parties involved in Securitisation

Primary Parties

- The Originator (Banks/FIs who has lent loan against properties)
- SPVs (Securitisation Company or reconstruction Company)
- Investors (To whom securities are issued, which is a participative interest against the pool of receivables which is bought by the SPVs from the originator). Few examples of assets that can be securitized :
  1. Residential mortgage loans
  2. Commercial mortgage loans
  3. Bank loans to businesses
  4. Commercial debt
  5. Student loans (Generally in US)
  6. Credit-card debt
  7. Automobile loans etc.

Besides above parties the following are involved in the Process of securitizations.

- The obligator (i.e. original borrower of the loan)
- Rating agency
- Administrator etc.

The industry was born in 1970 in the United States with the securitization of U.S. government-guaranteed residential home mortgages by the Government National Mortgage Association.

Securitized Debt Instruments

First securitization deal in India between Citi Bank and GIC Mutual Fund in 1991 for Rs. 160 million

Securitized debt instruments are regulated by the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, SEBI (Issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008 for listing on stock exchanges and the RBI Guidelines on Securitisation of Assets issued in 2012. (Revisions to the Guidelines on Securitisation Transactions - *https://rbidocs.rbi.org.in/rdocs/notification/PDFs/FIGUSE070512.pdyj*

Initially, SEBI (Issue and Listing of Securitized Debt Instruments) Regulations, 2008 ('SDI Regulations) was applicable to:

(a) public offers of securitised debt instruments;

(b) to listing of securitised debt instruments issued to public or any person(s), on a recognised stock exchange.

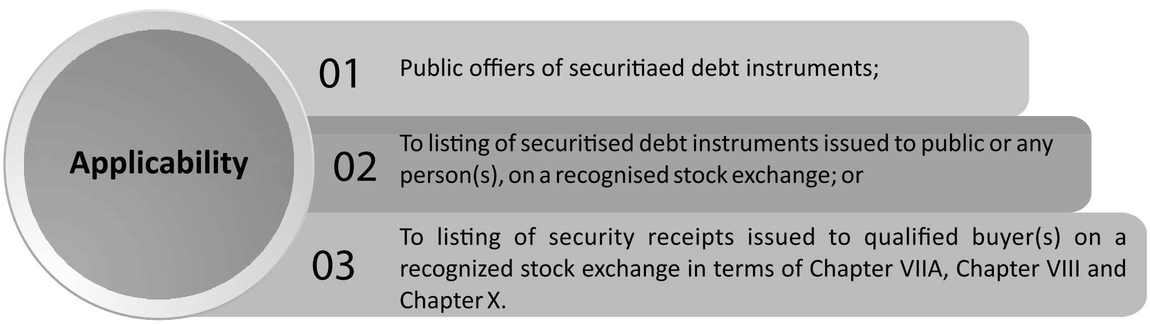
'Securitized debt instruments' has been defined to mean any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be.

The SRFAESI Act, 2002 has empowered the Banks and Financial Institutions with vast power to enforce the securities charged to them. The Banks can now issue notices to the defaulters to pay up the dues and if they fail to do so within 60 days of the date of the notice, the banks can take over the possession of assets like factory, land and building, plant and machinery etc. charged to them including the right to transfer by way of lease, assignment or sale and realize the secured assets. In case the borrower refuses peaceful handing over of the secured assets, the bank can also file an application before the relevant Magistrate for taking possession of assets. The banks can also take over the management of business of the borrower. The bank in addition can appoint any person to manage the secured assets the possession of which has been taken over by the bank. Banks can package and sell loans via "Securitisation" and the same can be traded in the market like bonds and shares.

Announcement made by Hon'ble Finance Minister in budget speech 2021-22

To improve credit discipline while continuing to protect the interest of small borrowers, for NBFCs with minimum asset size of Rs. 100 crores, the minimum loan size eligible for debt recovery under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 has been reduced to Rs. 20 lakhs from the level of Rs. 50 lakhs.

SEBI notified SEBI (Issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008 on May 26, 2008 taking into account the market needs, cost of the transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction and the interest of investors in such instruments.



Eligibility

A person cannot make a public offer of securitized debt instruments or seek listing for such securitized debt instruments unless –

(a) it is constituted as a special purpose distinct entity;

(b) all its trustees are registered with the SEBI under the SEBI (Issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008; and

(c) it complies with all the applicable provisions of these regulations and the SEBI Act.

The requirement of obtaining registration is not applicable for the following persons, who may act as trustees of special purpose distinct entities:

(a) any person registered as a debenture trustee with SEBI;

(b) any person registered as a securitization company or a reconstruction company with the RBI under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(c) the National Housing Bank established by the National Housing Bank Act, 1987;

(d) the National Bank for Agriculture and Rural Development established by the National Bank for Agriculture and Rural Development Act, 1981;

(e) any scheduled commercial bank other than a regional rural bank;

(f) any public financial Institution as defined under clause (72) of section 2 of the Companies Act, 2013; and

(g) any other person as may be specified by SEBI.

However, these persons and special purpose distinct entities of which they are trustees are required to comply with all the other provisions of the SEBI (Public Offer and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008.

An applicant seeking registration to act as a trustee shall:–

The networth requirement for registration to act as a trustee is at least Rs. 2 crore.

(a) have a networth of not less than two crore rupees.

(b) have in its employment, a minimum of two persons who, between them, have atleast five years.

PUBLIC OFFER OF SECURITIZED DEBT INSTRUMENTS

Offer to the Public

No offer shall be treated as made to the public, if the offer can properly be regarded, in all the circumstances–

(a) as not being likely to result, directly or indirectly, in the securitised debt instruments becoming available for subscription or purchase by persons other than those receiving the offer;

(b) otherwise as being the domestic concern of the persons making and receiving the offer.

However, above mentioned conditions apply only in respect of securitized debt instruments which belong to the same tranche and which are *pari passu* in all respects.

Any offer of securitized debt instruments made to fifty or more persons in a financial year shall be deemed to have been made to the public.

LISTING OF SECURITIZED DEBT INSTRUMENTS

Mandatory Listing

A SPDE desirous of making an offer of securitized debt instruments to the public shall make an application for listing to one or more recognized stock exchanges.

Application for listing

A SPDE to get the securitized debt instruments issued by it listed on a recognised stock exchange or otherwise desirous of getting the securitized debt instruments issued by it so listed shall make an application to the stock exchange in the form specified by it along with the requisite documents and particulars.

Listing Agreement

Every SPDE desirous of listing securitized debt instruments on a recognised stock exchange, shall execute an agreement with such stock exchange.

Every SPDE which has previously entered into agreements with a recognised stock exchange to list securitized debt instruments shall execute a fresh listing agreement with such stock exchange in line with SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Minimum public offering for listing

In respect of public offer of securitized debt instruments, the SPDE or trustee thereof shall satisfy the recognised stock exchange to which a listing application is made that each scheme of securitized debt instruments was offered to the public for subscription through advertisements in newspapers for a period of not less than two days and that applications received in pursuance of the offer were allotted in accordance with these regulations and the disclosures made in the offer document.

In case of a private placement of securitized debt instruments, the SPDE shall ensure that it has obtained credit rating from a registered credit rating agency in respect of its securitized debt instruments.

In case of a private placement of securitized debt instruments, the special purpose distinct entity shall file listing particulars with the recognised stock exchange, along with the application, containing such information as may be necessary for any investor in the secondary market to make an informed investment decision in respect of its securitized debt instruments and the SPDE shall promptly disseminate such information, as prescribed, in such manner as the recognised stock exchange(s) may determine from time to time. All credit ratings obtained including unaccepted ratings, if any, shall be disclosed in the listing particulars filed with the recognized stock exchange.

Continuous listing conditions

The SPDE or trustee thereof shall submit such information, including financial information relating to the schemes, to the stock exchanges and investors and comply with such other continuing obligations as may be stipulated in the listing agreement.

Trading of securitized debt instruments

The securitized debt instruments issued to the public or on a private placement basis, which are listed in recognised stock exchanges, shall be traded and such trades shall be cleared and settled in recognised stock exchanges subject to conditions specified by SEBI.

ISSUANCE AND LISTING OF SECURITY RECEIPTS

Eligibility

An issuer proposing to issue and list security receipts or only list its already issued security receipts shall comply with the provisions of chapter VIIA of SEBI (Issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008.

Security receipts proposed to be listed shall:

i. be issued in compliance with the applicable rules and guidelines, as framed by the Reserve Bank of India, from time to time;

ii. be issued on a private placement basis;

iii. comply with the provisions pertaining to issue of security receipts.

Sale of security receipts by the existing holder

- Any existing holder of security receipts, who proposes to sell, whole or part of, its holding of security receipts to the qualified buyers on private placement basis, where such security receipts are proposed to be listed, may do so, in accordance with the provisions of Chapter VIIA of these regulations.

  However, such sale by any holder of security receipts shall be permitted only if the holding is not less than fifty percent of the outstanding security receipts.

- A sale of security receipts by any existing holder of such security receipts under these regulations, shall be subject to the issuer compulsorily listing the security receipts before complying with the provisions of this chapter.

Conditions for Listing of Security Receipts

An issuer may list its security receipts on a recognized stock exchange subject to the following conditions:

(a) the security receipts have been issued on a private placement basis;

(b) the issuer has issued such security receipts in compliance with the applicable laws;

(c) the offer or invitation to subscribe to security receipts shall be made to such number of persons not exceeding two hundred or such other number, in a financial year, as may be prescribed from time to time;

(d) the security receipts proposed to be listed are in dematerialized form;

(e) the disclosures as provided in Regulation 38E of SEBI (Issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008 have been made in the offer document;

(f) the minimum allotment made to the qualified buyers is Rs. 10 lakhs;

(g) such security receipts have been valued prior to listing;

However, such valuation shall not be more than three months old from the date of listing and shall be done by an independent valuer;

(h) the security receipts have been rated by a credit rating agency registered with SEBI. However, such rating shall not be more than three months old from the date of listing.

The issuer shall comply with the conditions of listing of such security receipts as specified in SEBI Listing Regulations, 2015.

Offer Document

- An issuer seeking listing of security receipts on a recognized stock exchange shall make such disclosures in the offer document as specified by the Reserve Bank of India from time to time, and as specified in Schedule VA of SEBI (Issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008.

  However, the offer document shall not contain any false or misleading statement and shall disclose all material facts.

- The offer document shall be made available for download on the web sites of stock exchanges where such securities are listed.

- In exercise of the powers conferred by sub-rule (7) of rule 19 of the Securities Contracts (Regulation) Rules, 1957, SEBI shall waive the strict enforcement of sub-rules (1) to (3) of the said rule in relation to listing of security receipts issued in terms of these regulations, subject to compliance with these regulations.

Trading of security receipts

- The security receipts issued on a private placement basis, which are listed on recognised stock exchanges, shall be traded and such trades shall be cleared and settled in recognised stock exchanges subject to conditions specified by SEBI.
- The trading lot of the security receipts shall not be less than Rs 10 lakh.
- The trades of security receipts which have been made over the counter, shall be reported on a recognized stock exchange having a nation-wide trading terminal or such other platform as may be specified by SEBI.
- SEBI may specify conditions for reporting of trades on the recognized stock exchange or other platform.

LOAN AGAINST SECURITIES

Banks and financial institutions come up with innovative ways to fulfill the monetary requirements of every individual as per their credit worthiness and paying capacity. One step in this direction has been Loan against Securities, popularly referred to as LAS. Under "Loan against Securities", loan is advanced to a customer against pledge of securities or simply put loan against insurance policy, mutual funds, NSC and other securities. The list of approved securities against which LAS can be advanced varies from bank to bank, but primarily the following are considered to be approved securities against which LAS could be given.

1. Non-Convertible Debentures
2. Mutual Fund Units
3. NABARD Bonds
4. Dematerialised Shares
5. National Saving Certificates/Kissan Vikas Patra (Accepted only in Demat form)
6. Insurance Policies.

By pledging the securities held by the borrower, a loan against Securities is provided by a bank or a financial institution as an overdraft facility. The value of the overdraft limit that is advanced is determined on the basis of the securities that are pledged. The rate of interest is calculated only on the amount withdrawn and only for the period of utilization.

The advantageous part of pledging your securities is one that the borrower is able to get steady cash easily at the time of need and secondly the borrower need not be devoid of the benefits as a shareholder. This means that the borrower enjoys the rights of receiving dividends and bonuses along with gaining from the price movements in the shares. This facility is ideal to meet short- term financial needs and the interest rates are lesser than that in a personal loan.

Illustration

Zen Limited is in need of funds for its upcoming project and wishes to consider the facility of LAS. The company approaches the bank and pledges shares worth Rs. 10,00,000 held by it in Ten Limited, with the help of its Depository.

Depository creates a pledge on said shares in the favor of the bank and the bank disburses the payment to Zen Ltd.

The pledge was created for 1 year. At the end of this tenure Zen Ltd. will repay the loan to the bank along with the interest, at the rate as decided and intimated by the bank at the time of disbursement, and the bank will release the shares to Zen Ltd.

Features of Loan against Securities

1. **Secured Loan** - Loan against securities is a secured loan as the bonds, shares, debentures or mutual funds owned by the borrower are kept as collateral security when this loan is advanced.
2. **Tenure** - The tenure of loan against securities is generally one year.
3. **Rate of Interest** - Generally, interest rates at which loan against securities is advanced varies from 12%-15% per annum.
4. **Processing Fees** - Banks and financial institutions usually charge approximately 2 % as processing fees.
5. **Loan Amount** - The loan amount for which the borrower may be eligible depends upon the type of security that is being offered. For example, in case equity shares are offered then the amount that is eligible would be 50% of the value of such shares.
6. **Prepayment Charges** - There are generally no prepayment charges.

LOAN AGAINST PROPERTIES

Similar to loans against securities, this is a loan, banks grant against property owned by the prospective borrower. Banks take the property as security and based on the valuation of the property, they extend a loan, net of the margin fixed by them.

The types of Property against which LAP can be availed can range from owned residential properties g, self-occupied property, owned and rented property, owned land, owned commercial property, owned but rented out commercial property. The proceeds from these are used by borrowers for personal, business and consumption purposes. After due appraisal Banks sanction generally anywhere between 50% to 65% of the value of borrower's property. Banks offer repayment period of 10 to 15 years at competitive interest rates. For sanctioning loans against properties banks insist on creating a mortgage in their favour.

LESSON ROUND-UP

- Section 43 of the Companies Act, 2013 recognizes two kinds of share capital i.e.equity share capital and Preference share capital.
- A debenture being an attractive source of funding, is a long-term debt instrument issued by corporates and Government to secure fresh funds or capital.
- A bond is a debt instrument in which an investor loans money to an entity (typically corporate or government) which borrows the funds for a defined period of time at a variable or fixed interest rate.
- Indian entrepreneurs need private equity and debt products to meet the capital needs of their growth, restructuring, turn around or start-up plans. The main providers of this form of capital are private equity and venture capital funds which are channelled through Alternative Investment Funds (AIFs).
- According to Section 2(1)(z), "venture capital fund" means an Alternative Investment Fund which invests primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property right based activities or a new business model and shall include an angel fund as defined under Chapter III-A.

- 'Angel Investor' means any person who proposes to invest in an angel fund.
- A letter of credit is a document from a bank that guarantees payment and Bank Guarantee is a legal contract which can be imposed by law.
- Capital can be raised from international capital market in foreign currency by accessing foreign capital market. Funds raised through foreign currency are called as euro equity or debt.
- Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ ADR/FCCB/FCEB.
- ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc.
- FCCBs/DRs may be issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and Depository Receipts Scheme, 2014 respectively, as per the guidelines issued by the Government of India thereunder from time to time.
- "FDI" or "Foreign Direct Investment" means investment through capital instruments by a person resident outside India in an unlisted Indian company; or in ten per cent or more of the post issue paid- up equity capital on a fully diluted basis of a listed Indian company.
- 'Foreign Portfolio Investment' means any investment made by a person resident outside India through capital instruments where such investment is less than 10 percent of the post issue paid-up share capital on a fully diluted basis of a listed Indian company or less than 10 percent of the paid up value of each series of capital instruments of a listed Indian company.
- Securitization is the transformation of financial assets into securities. Securitization is used by financial entities to raise funding other than what is available via the traditional methods of on-balance-sheet funding.

GLOSSARY

Bond: A negotiable certificate evidencing indebtedness a debt security or IOU, issued by a company, municipality or government agency. A bond investor lends money to the issuer and, in exchange, the issuer promises to repay the loan amount on a specified maturity date. The issuer usually pays the bondholder periodic interest payments over the life of the loan.

Eurobond: Eurobonds are issued in a specific currency outside the currency's domicile. They are not subject to withholding tax and fall outside the jurisdiction of any one country. The Eurobond market is based in London. Not to be confused with euro-denominated bonds.

Foreign Currency Convertible Bonds: It means bonds issued in accordance with this scheme and subscribed by a non- resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments.

Equity Linked Instruments: Equity Linked Instruments includes instruments convertible into equity shares or share warrants, preference shares, debentures compulsorily or optionally convertible into equity.

Infrastructure Fund: Infrastructure fund means an Alternative Investment Fund which invests primarily in unlisted securities or partnership interest or listed debt or securitized debt instruments of investee companies or special purpose vehicles engaged in or formed for the purpose of operating, developing or holding infrastructure projects.

Investable Funds: Investable Funds means corpus of the scheme of Alternative Investment Fund net of expenditure for administration and management of the fund estimated for the tenure of the fund.

Social Impact Fund: Social Impact Fund means an Alternative Investment Fund which invests primarily in securities, units or partnership interest of social ventures or securities of social enterprises and which satisfies the social performance norms laid down by the fund.

Unit: Unit means beneficial interest of the investors in the Alternative Investment Fund or a scheme of the Alternative Investment Fund and may be fully or partly paid up.

Non-resident Indian and Overseas Citizen of India: Non-resident Indian and Overseas Citizen of India shall have the same meaning as assigned to such terms under rule 2 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 made under the Foreign Exchange Management Act, 1999.

Securitisation: Securitisation means acquisition of debt or receivables by any special purpose distinct entity from any originator or originators for the purpose of issuance of securitised debt instruments to investors based on such debt or receivables and such issuance.

Asset Pool: Asset Pool in relation to a scheme of a special purpose distinct entity, means the total debt or receivables, assigned to such entity and in which investors of such scheme have beneficial interest.

Credit Enhancement: Credit Enhancement means any arrangement intended to decrease the likelihood of default on the securitised debt instruments, including subordination, insurance, letter of credit, over-collateralisation, undertakings and guarantees.

Liquidity Provider: Liquidity Provider means a person who agrees to provide funds to the special purpose distinct entity for settlement of payments due to investors in accordance with the schedule of payments contained in the terms of issue of the securitised debt instruments issued to them, in the event of any short term cash flow shortfalls of the special purpose distinct entity.

Obligor: Obligor means a person who is liable, whether under a contract or otherwise.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. How is the Masala Bond more advantageous to the conventional source of funding from overseas sources?
2. Distinguish between REITs and InvITs.
3. What is an Alternative Investment Fund? Explain the different categories of an Alternative Investment Fund.
4. What do you understand by private equity? Discuss about different categories of private equity.
5. What do you mean by ‘Green Debt Securities’? Explain.
6. What are the Non-based credit facilities provided by the bank?

7. ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities. Comment.
8. What do you mean by Foreign Currency Exchangeable Bonds (FCEBs)? Distinguish between Foreign Currency Convertible Bonds (FCCBs) and FCEB.
9. Define Foreign Direct Investment.
10. Write short notes on: (i) Automatic Route (ii) Government Route.
11. What do you mean by securitization? Explain the securitization structure.

LIST OF FURTHER READINGS

- FAQs on External Commercial Borrowings available at https://m.rbi.org.in/Scripts/FAQView.aspx?Id=120
- Master Direction - External Commercial Borrowings, Trade Credits and Structured Obligations https://m.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510
- FAQs on Funding Option available at https://www.investindia.gov.in/faq-pdf/27/en
- Bare Act - Foreign Exchange Management Act, 1999 (FEMA), Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 and other rules and regulations made thereunder
- SEBI Manual
- Premier on Companies Act, 2013
- Regulations/Rules/Guidelines/Circulars issued by SEBI, RBI, MCA etc. from time to time
- SEBI Annual Reports
- SEBI Monthly Bulletin
- Foreign Exchange Management Manual – Snow White
- SEBI (Foreign Portfolio Investors) Regulations, 2019
- SEBI (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008.

Raising of Funds from Equity and Procedural Aspects – Public Funding

Lesson 8

KEY CONCEPTS

■ Primary & Secondary Markets ■ Initial Public Offer ■ Further Public Offer ■ Private Placement ■ Preferential Issue ■ Rights Issue ■ Fast Track Issue ■ Warrants ■ Intermediaries ■ Lead Manager ■ Underwriting ■ Green Shoe Option ■ Social Enterprise

Learning Objectives

To understand:

- Evolution of SEBI (ICDR) Regulations, 2018
- Various types of issues in capital market
- Modes of raising funds and compliance requirements
- Key Provisions for Draft offer letter, prospectus etc.
- Eligibility requirements for issuing various instruments
- Lock in period and its requirements
- Fast-track issue
- Green Shoe Option
- Social Stock Exchange

Lesson Outline

- Introduction
- Background
- Types of Issues
- Initial Public Offering / Further Public Offering
- Eligibility Requirements to be complied with for an IPO under SEBI (ICDR) Regulations, 2018
- General Conditions
- Additional conditions for an offer for sale
- Issue of Warrants
- Eligibility Criteria for Further Public Offer
- Promoters' Contribution
- Lock in Requirements
- Filing of Offer Document
- Pricing
- Minimum Offer to Public and Reservations
- Allocation in Net Offer
- Fast Track FPO
- Exit Opportunity to Dissenting Shareholders
- Initial Public Offer by Small and Medium Enterprises
- Innovators Growth Platform
- Documentation for IPO/FPO
- Rights Issues
- General Obligations of the Issuer and the Intermediary in case of Public Issue and Rights Issue
- Documentation for Right Issue
- Preferential Issues
- Pricing
- Documentation for Preferential Issue
- Qualified Institutional Buyer
- Conditions for Qualified Institutions Placements (QIP)
- Documentations for QIP
- Social Stock Exchange
- Green Shoe Option
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The SEBI Act, 1992
- The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
- The Securities Contracts (Regulations) Rules, 1957

INTRODUCTION

Securities market, including the market for public offerings, is dynamic and needs to keep pace with the evolving economic and technological environment. In order to keep pace with the change, there has been a commensurate change in the regulatory framework governing the primary market. SEBI in its endeavour to provide issuers and investors with an efficient mechanism for raising funds, has been continuously striving to streamline the process and methodologies associated with public issue fund raising process.

With more promoters looking out to raise money by divesting equities, regulations standard is becoming increasingly stringent. SEBI monitors all the dealings of companies who are planning to raise money on the stock exchanges and is quite careful about attempts which try to create artificial demands about upcoming issues. SEBI has come up with ICDR Regulations, 2018 to promote the development of a healthy capital market and to protect investors' interest while they deal with securities.

Management of a public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrar to the issue, solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/Statutory agencies such as Registrar of Companies, Reserve Bank of India, Stock Exchanges, SEBI etc. The whole process of issue of shares can be divided into two parts (i) pre-issue activities and (ii) post issue activities. All activities beginning with the planning of capital issue till the opening of the subscription list are pre-issue activities while all activities subsequent to the opening of the subscription list may be called post issue activities. Since only the demat shares are being admitted for dealings on the stock exchanges, hence the securities can be issued only in Dematerialised Form.

BACKGROUND

With the repeal of Capital Issues (Control) Act, 1947 all the guidelines, notifications, circulars etc. issued by the office of the Controller of Capital Issues became defunct. SEBI was given the mandate to regulate issuance of securities, which was earlier done by vide its order dated 11.6.1992 called the Guidelines for Disclosure and Investor Protection, 1992. Later, SEBI issued a compendium containing consolidated Guidelines, circulars, instructions relating to issue of capital effective from January 27, 2000. The compendium titled SEBI (Disclosure and Investor Protection) Guidelines, 2000 replaced the original Guidelines issued in June 1992 and clarifications thereof. On August 26, 2009 SEBI rescinded the SEBI (DIP) Guidelines, 2000 and notified SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

SEBI in order to align its provisions under ICDR Regulations with Companies Act, 2013 and allied regulations, had come with its consultation paper on May 04, 2018 detailing the suggestive changes under various fund raising options by listed issuers.

Between 2009-till date, numerous amendments have been made to the ICDR Regulations. Different types of offerings to raise funds in the primary market have been introduced. Further, there have been changes in market practices and regulatory environment over a period of time. A need was thus felt to review and realign the ICDR Regulations with these developments and to ensure that they reflect the best practices adopted globally. In view of the same, SEBI constituted the Issue of Capital & Disclosure Requirements Committee ("ICDR

Committee") under the Chairmanship of Shri Prithvi Haldea in June, 2017, to review the ICDR Regulations with the following objectives:

a) To simplify the language and complexities in the regulations;

b) To incorporate changes/ new requirements which have occurred due to change in market practices and regulatory environment;

c) To make the regulations more readable and easier to understand.

The ICDR Committee suggested certain policy changes. These suggestions were also taken to the Primary Market Advisory Committee (PMAC) of SEBI which comprises of eminent representatives from the Ministry of Finance, Industry, Market Participants, academicians, the Institute of Chartered Accountants of India and the Institute of Company Secretaries of India. The recommendations of the PMAC were incorporated in the draft of the proposed ICDR Regulations. In addition to the public consultation, the draft regulations along with the key policy changes were also forwarded to the Ministry of Finance (MoF), Ministry of Corporate Affairs (MCA) and the Reserve Bank of India (RBI) for their comments. The provisions of Companies Act, 1956 (wherever applicable), Companies Act, 2013, SEBI (Substantial Acquisition & Substantial Takeover) Regulations, 2011, SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 have been suitably incorporated.

SEBI in its Board Meeting held on 21st June, 2018 approved the proposal for replacing SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2009 with new SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2018.

In continuation to the same, SEBI vide its notification dated 11th September, 2018 issued SEBI (ICDR) Regulations, 2018 ('ICDR, 2018') which is effective from 60th day of its publication in Official Gazette.

Chapter No. under ICDR Regulations, 2018	***Particulars***
I.	Preliminary (Definitions)
II.	Initial Public Offer (IPO) on Main Board
III.	Rights Issue
IV.	Further Public Offer
V.	Preferential Issue
VI.	Qualified Institutions Placement
VII.	IPO of Indian Depositary Receipts (IDRs)
VIII.	Rights Issue of IDR
IX.	IPO by Small and Medium Enterprises (SME)
X.	Innovators Growth Platform (IGP)
X-A.	Social Stock Exchange
XI.	Bonus Issue
XII.	Miscellaneous

Classification of Securities Market

PRIMARY MARKET

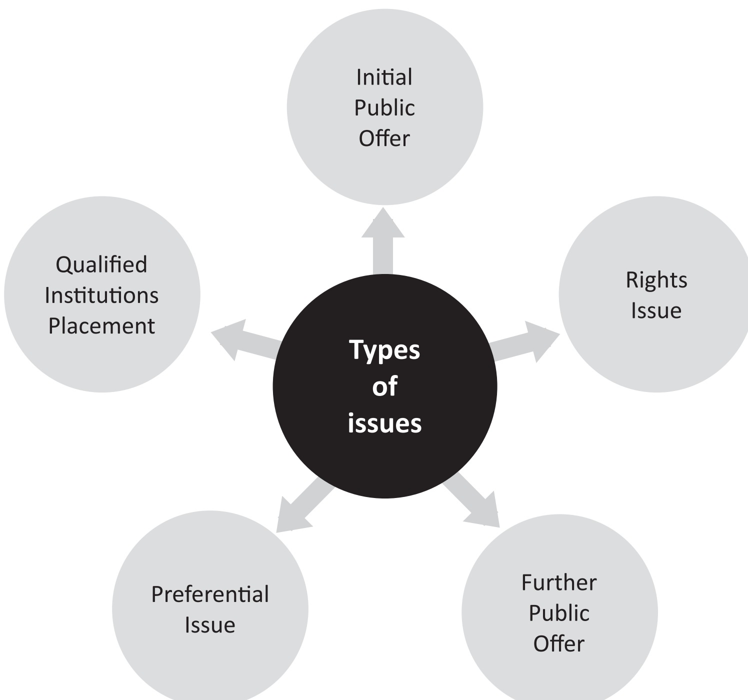
- IPOs / FPOs and Rights Issues (Main Board/SME)
- Reverse Book Building (RBBS) — Buyback, Tender Offer, Delisting
- Offer For Sale (OFS)
- Mutual Funds (Open Ended)
- Securitized Debt Instruments
- REITs / InvITs
- Debt Securities / NCRPS / Municipal Bonds
- Innovators Growth Platform (IGP)

SECONDARY MARKET

- Trading of Equity share
- Equity Derivatives
- Currency Derivatives
- Interest Rate Derivatives
- Commodity Derivatives
- Debt — Corporate Bond and Government Securities
- Mutual Funds (Close Ended)

TYPES OF ISSUES

Primary Market deals with those securities which are issued to the public for the first time. Primary Market provides an opportunity to issuers of securities, Government as well as corporates, to raise financial resources to meet their requirements of investment and/or discharge their obligations.



Initial Public Offer (IPO) means an offer of specified securities by an unlisted issuer to the public for subscription and which includes fresh issuance of shares by the company or includes an Offer for Sale (OFS) of specified securities to the public by any existing holder of such securities in an unlisted issuer. In order to qualify as an Initial public offer, the offer of securities must be by an unlisted issuer company and such an issue shall be made to the public and not to the existing shareholders of the unlisted issuer company or to selected group of investors.

Further Public Offer (FPO) means an offer of specified securities by a listed issuer company to the public for subscription. In other words, another issue to the public other than its existing shareholders by the listed persons is referred to as a Further Public offer.

Rights Issue of Securities is an issue of specified securities by a company only to its existing shareholders as on a record date in a predetermined ratio.

Preferential Issue refers to an issue, where a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter V of SEBI (ICDR) Regulations, 2018 it is called a preferential issue. The issuer is required to comply with various provisions which inter alia include pricing, disclosures in the notice, lock in etc., in addition to the requirements specified in the Companies Act.

Qualified Institutions Placement (QIP) is another form of Preferential issue which refers to an issue by a listed entity to only Qualified Institutional Buyers (QIBs) in accordance of Chapter VI of SEBI (ICDR) Regulations, 2018 which has relaxed compliance requirements as compared to preferential issue.

INITIAL PUBLIC OFFERING (IPO) / FURTHER PUBLIC OFFERING (FPO)

A public issue of specified securities by an issuer can be either an Initial Public Offering (IPO) or a Further Public Offering (FPO). An IPO is done by an unlisted issuer while a FPO is done by a listed issuer. As per the ICDR Regulations, the issuer shall comply with the following conditions before making an IPO of specified securities (Specified Securities means equity shares and convertible securities). The conditions need to be satisfied both at the time of filing the draft offer document (commonly referred to as the Draft Red Herring Prospectus or DRHP) and at the time of final offer document (commonly referred to as the Prospectus) with the Registrar of Companies.

ELIGIBILITY REQUIREMENTS TO BE COMPLIED WITH FOR AN IPO UNDER SEBI (ICDR) REGULATIONS, 2018

Entities not eligible to make an Initial Public Offer [Regulation 5]

An issuer shall not be eligible to make an initial public offer:

a. If the issuer, any of its promoters, promoter group, directors, selling shareholders are debarred from accessing the capital market by SEBI.

b. If any of the promoters or directors of the issuer is a promoter or a director of any other company which is debarred from accessing the capital market by SEBI.

c. If the issuer or any of its promoters or directors is a willful defaulter or a fraudulent borrower.

d. If any of the promoters or directors of the issuer is a fugitive offender.

e. If there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares of the issuer except outstanding options granted to the employees under an employee stock option scheme and fully paid-up outstanding convertible securities which are required to be converted on or before the date of filling of the Red Herring Prospectus or the Prospectus.

Exceptions to conditions (a) and (b) : The restrictions under (a) and (b) above shall not apply to the persons or entities mentioned therein, who were debarred in the past by SEBI and the period of debarment is already over as on the date of filing of the draft offer document with SEBI.

An issuer shall not be eligible to make an IPO, if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares of the issuer.

Non-applicability

- Outstanding options granted to employees, whether currently an employee or not, pursuant to an employee stock option scheme in compliance with the Companies Act, 2013, the relevant guidance note or accounting standards, if any, issued by the Institute of Chartered Accountants of India or pursuant to the Companies Act, 2013, in this regard.
- Fully paid-up outstanding convertible securities which are required to be converted on or before the date of filing of the red herring prospectus (in case of book-built issues) to the prospectus (in case of fixed price issues), as the case may be.

Eligibility requirements for an Initial Public Offer [Regulation 6(1)]

An issuer shall be eligible to make an IPO only if:

a. the issuer has net tangible assets of atleast Rs. 3 crores on a restated and consolidated basis, in each of the preceding three full years of (12 months each) of which not more than 50% is held in monetary assets;

   However, if more than 50% of the net tangible assets are held in monetary assets, the issuer has utilized or made firm commitments to utilize such excess monetary assets in its business or project. This limit of 50% shall not apply in case of IPO is made entirely through an offer for sale.

b. the issuer has an average operating profit of at least Rs. 15 crores, calculated on a restated and consolidated basis, during the three preceding years with operating profit in each of the three preceding years;

c. the issuer has a networth of atleast Rs.1 crore in each of the preceding three full years, calculated on a restated and consolidated basis;

d. in case the issuer has changed its name within the last one year, atleast 50% of the revenue calculated on a restated and consolidated basis, for the preceding one full year has been earned by it from the activity indicated by the new name.

In case the Eligibility condition is not met

However, in case an issuer does not satisfy the eligibility conditions stipulated above and included in Regulation 6(1) of ICDR Regulations 2018, it may still make an Initial Public Offer but only through the book building process and further undertake to allot at least 75% of the net offer to the public to Qualified Institutional Buyers (QIBs) and to refund full subscription money if it fails to do so. [Regulation 6(2)].

In case of IP0s under Regulation 6(2), if QIBs does not subscribe to allocated 75% of the net offer to public the issue will fail and the issuer company will have to refund full subscription money even though on overall basis the issue may have been over subscribed. Therefore, in these cases, 75% subscription from QIBs is must irrespective of subscription by retail investors and non-retail investors.

Eligibility Criteria for Main Board Listing - SEBI (ICDR) Regulations, 2018

As per SEBI (ICDR) Regulations, 2018 - Regulation 6(1) & 6(2)

Option I
Net tangible assets, profitability and net worth track record

Net Tangible Assets of at least Rs. 3 crores
(for past 3 years)

Not more than 50% in monetary assets

Average operating profit of Rs. 15 crores in preceding three years (of twelve months each), with operating profit in each of these preceding three years

+

Net worth of at least Rs. 1 crore in each of the preceding 3 full years

Option II
If any one of the conditions, i.e., net tangible assets, profitability and track reward is not there

Issue through book building route with at least 75% allotted to QIBs

+

If QIB part is not subscribed, the issue will fail even if it is oversubscribed on overall basis

If Option I is met
Qualified Institutional Buyer (QIB): Max. 50%
Retail: At least 35%
Non-Institutional Investors (NII): At least 15%

If Option I is not met
Qualified Institutional Buyer (QIB): Max. 75%
Retall: At least 10%
Non-Institutional Investors (NII): At least 15%

The above eligibility conditions are explained by the following example:

Eligibility Condition No. 1

In case the issuer is proposing to file its draft offer document with SEBI in August 2023, then the net tangible assets for the last 3 full years of 12 months each shall be at least Rs. 3 crores and not more than 50% of the same shall be held in monetary assets. In the following table, it is seen that the net tangible assets are more than Rs. 3 crores in the year ended March 31, 2021, March 31, 2022 and March 31, 2023. Further monetary assets constitute less than 50% of the net tangible assets in each of the three previous financial years:

(Rs. in lacs)
Year Ended March 31

Particulars	*2019*	*2020*	*2021*	*2022*	*2023*
Net Tangible Assets	1448.56	2275.53	2532.60	3510.33	4657.50
Monetary Assets	292.76	61.97	108.25	302.33	288.17
Monetary Assets as a percentage of Net Tangible Assets	20.21	2.72	4.27	8.61	6.19

"Net Tangible Assets" mean the sum of all net assets of the issuer, excluding intangible assets as defined in Accounting Standard 26 (AS 26) or Indian Accounting Standard (Ind AS) 38, as applicable, issued by the Institute of Chartered Accountants of India.

Eligibility Condition No. 2

In case the issuer proposes to file its draft offer document with SEBI in August 2023, then the average operating profit for three preceding years shall be atleast Rs. 15 crores. Further, the company shall have operating profit in each of the three years. The average of the profits for the 3 preceding years is Rs.15.75 crores which is more than the prescribed average of Rs.15 crores.

(Rs. in lacs)
Year Ended March 31

Particulars	***2021***	***2022***	***2023***
Operating Profit	1630.31	1232.65	1864.63

Eligibility Condition No. 3

In case the issuer proposes to file its draft offer document with SEBI in August 2023 then the networth shall be atleast Rs. 1 crore in each of the last 3 financial years. In the following table, it is seen that the company has a networth of Rs. 1 crore in each of the last three financial years prior to the date of the filing of the draft offer document with SEBI.

(Rs. in lacs)
Year Ended March 31

Particulars	***2019***	***2020***	***2021***	***2022***	***2023***
Equity Share Capital	1448.56	2000.00	2000.00	2000.00	2022.00
Share Application Money	0.00	0.00	0.00	0.00	165.00
Reserves & Surplus	0.00	304.52	590.02	1430.47	2742.71
Total	**1448.56**	**2304.52**	**2590.02**	**3595.47**	**4764.71**
Less: Misc Expenses not written off	0.00	0.00	0.00	0.00	0.00
Less: Deferred Tax Assets	0.00	0.00	13.45	0.00	61.08
Net worth	1448.56	2304.52	2576.57	3595.47	4703.63

Since all the above eligibility conditions are satisfied in the example and there is no change in the name of the company, this company is eligible to make an Initial Public Offering.

General Conditions [Regulation 7]

An issuer making an initial public offer shall ensure that:

a) it has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the Designated stock exchange;

b) it has entered into an agreement with a depository for dematerialisation of the specified securities already issued and proposed to be issued;

c) all its specified securities held by the promoters are in dematerialised form prior to filing of the offer document;

d) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

e) all its outstanding convertible securities have been converted into equity shares;

f) it has made firm arrangements of finance through verifiable means towards 75%. of the stated means of finance for a specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.

The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document shall not exceed 25% of the amount being raised by the issuer.

The amount for:

(i) general corporate purposes, and

(ii) such objects where the issuer company has not identified acquisition or investment target, as mentioned in objects of the issue in the draft offer document and the offer document,

shall not exceed 35% of the amount being raised by the issuer.

However, the amount raised for such objects where the issuer company has not identified acquisition or investment target, as mentioned in objects of the issue in the draft offer document and the offer document, shall not exceed 25% of the amount being raised by the issuer. Further provided that such limits shall not apply if the proposed acquisition or strategic investment object has been identified and suitable specific disclosures about such acquisitions or investments are made in the draft offer document and the offer document at the time of filing of offer documents.

Explanation:

(i) "Project" means the object for which monies are proposed to be raised to cover the objects of the issue;

(ii) Partnership Firms or LLP

In case of an issuer which had been a partnership firm or a limited liability partnership, the track record of distributable profits of the partnership firm or the LLP shall be considered only if the financial statements of the partnership business for the period during which the issuer was a partnership firm, conform to and are revised in the format prescribed for companies under the Companies Act, 2013 and also comply with the following:

a) adequate disclosures are made in the financial statements as required to be made in the format prescribed under the Companies Act, 2013;

b) the financial statements are duly certified by a Chartered Accountant stating that:

(i) the accounts and the disclosures made are in accordance with the provisions of Schedule III of the Companies Act, 2013;

(ii) the accounting standards of the Institute of Chartered Accountants of India have been followed;

(iii) the financial statements present a true and fair view of the firm's accounts.

(iii) Spinning off of a division

In case of an issuer formed out of a division of an existing company, the track record of distributable profits of the division spun-off shall be considered only if the requirements regarding financial statements as provided for partnership firms and LLPs are complied with.

Other important aspects related to IPO

- Minimum promoter contribution -20%
- Lock-in requirements- promoters and non- promoters
- Minimum Subscription -90%
- Expenses related to General Corporate Purposes cannot be more than 25% of the IPO size
- Choose one of the Exchange as designated Exchange for IPO

Additional Conditions for an Offer for Sale [Regulation 8]

Applicability

Shares must be fully paid-up.

Shall be held by the sellers for a period of at least one year prior to the filing of the draft offer document.

The holding period of such convertible securities, including depository receipts, as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period.

Further, such holding period of one year shall be required to be complied with at the time of filing of the draft offer document.

In case the equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale.

If the equity shares arising out of the conversion or exchange of the fully paid-up compulsorily convertible securities are being offered for sale, the conversion or exchange should be completed prior to filing of the offer document (i.e. red herring prospectus in the case of a book built issue and prospectus in the case of a fixed price issue), provided full disclosures of the terms of conversion or exchange are made in the draft offer document.

The requirement of holding equity shares for a period of one year shall not apply:

Non-Applicability

The offer for sale of a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in the infrastructure sector.

Equity shares offered for sale were acquired pursuant to any scheme approved by a High Court or approved by a tribunal or the Central Government under the sections 230 to 234 of Companies Act, 2013, as applicable, in lieu of business and invested capital which had been in existence for a period of more than one year prior to approval of such scheme.

If the equity shares offered for sale were issued under a bonus issue on securities held for a period of at least one year prior to the filing of the draft offer document with the SEBI and further subject to the following:

Such specified securities being issued out of free reserves and share premium existing in the books of account as at the end of the financial year preceding the financial year in which the draft offer document is filed with SEBI.

AND

Such equity shares not being issued by utilisation of revaluation reserves or unrealized profits of the issuer.

Additional condition for offer for sale through QIB route i.e. Option II of IPO as discussed earlier.

These conditions only apply for IPO through Option II i.e. QIB route.

Regulation 8A prescribed that for issues where draft offer document is filed under sub-regulation (2) of regulation 6 of these regulations:

- shares offered for sale to the public by shareholders holding, individually or with persons acting in concert, more than 20% of pre-issue shareholding of the issuer based on fully diluted basis, shall not exceed more than 50% of their pre-issue shareholding on fully diluted basis;
- shares offered for sale to the public by shareholders holding, individually or with persons acting in concert, less than 20% of pre-issue shareholding of the issuer based on fully diluted basis, shall not exceed more than 10% of pre-issue shareholding of the issuer on fully diluted basis;
- for shareholders holding, individually or with persons acting in concert, more than 20% of pre-issue shareholding of the issuer based on fully diluted basis, provisions of lock-in shall be applicable.

Issue of Warrants [Regulation 13]

An issuer shall be eligible to issue warrants in an initial public offer subject to the following:

a) the tenure of such warrants shall not exceed eighteen months from the date of their allotment in the initial public offer.

b) a specified security may have one or more warrants attached to it.

c) the price or formula for determination of exercise price of the warrants shall be determined upfront and disclosed in the offer document and at least 25 % of the consideration amount based on the exercise price shall also be received upfront.

However, in case the exercise price of warrants is based on a formula, 25 % consideration amount based on the cap price of the price band determined for the linked equity shares or convertible securities shall be received upfront.

d) in case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within three months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

ELIGIBILITY CRITERIA FOR FURTHER PUBLIC OFFER (FPO)

Entities not eligible to make a FPO [Regulation 102]

An issuer shall not be eligible to make a FPO of specified securities:

(a) If the issuer, any of its promoters, promoter group or directors, selling shareholders are debarred from accessing the capital market by SEBI.

(b) If any of the promoters or directors of the issuer is a promoter or a director of any other company which is debarred from accessing the capital market by SEBI.

(c) If the issuer or any of its promoters or directors is a willful defaulter or a fraudulent borrower.

(d) if any of the promoters or directors of the issuer is a fugitive economic offender.

Exceptions to conditions (a) and (b): The restrictions under (a) and (b) above shall not apply to the persons or entities mentioned therein, who were debarred in the past by SEBI and the period of debarment is already over as on the date of filing of the draft offer document with SEBI.

Eligibility requirements for FPO [Regulation 103]

An issuer may make a FPO if it has changed its name within the last one year and atleast 50% of the revenue in the preceding one full year has been earned from the activity suggested by the new name.

If an issuer does not satisfy the above mentioned conditions, it may make a FPO only, if, the issue is made through the book-building process and the issuer undertakes to allot at least 75% of the net offer, to qualified institutional buyers (QIBs) and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

General Conditions for FPO [Regulation 104]

An issuer making an FPO shall ensure that:

a. An application is made for listing of the specified securities to one or more of the recognized stock exchanges and choose one of the exchanges as the designated stock exchange.

b. An agreement is entered into with a depository for dematerialization of specified securities already issued or proposed to be issued.

c. All its existing partly paid up equity shares have either been fully paid up or have been forfeited. In other words, if a company has partly paid up equity shares, they shall not be permitted to make a public issue.

d. The issuer should make firm arrangements of finance through verifiable means towards 75% of the stated means of finance excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.

e. Amount for General Corporate Purposes as mentioned in objects of the issue in the draft offer document and the offer document shall not exceed 25% of the amount being raised by the issuer.

The amount for:

(i) general corporate purposes, and

(ii) such objects where the issuer company has not identified acquisition or investment target, as mentioned in objects of the issue in the draft offer document and the offer document,

shall not exceed 35% of the amount being raised by the issuer. However, the amount raised for such objects where the issuer company has not identified acquisition or investment target, as mentioned in objects of the issue in the draft offer document and the offer document, shall not exceed 25% of the amount being raised by the issuer.

However, such limits shall not apply if the proposed acquisition or strategic investment object has been identified and suitable specific disclosures about such acquisitions or investments are made in the draft offer document and the offer document at the time of filing of offer documents.

Explanation. – For the purposes of this regulation "finance for the specific project" shall mean finance for capital expenditures only.

For the purposes of this regulation, "project" means the object for which monies are proposed to be raised to cover the objects of the issue.

Issue of Warrants [Regulation 111]

An issuer shall be eligible to issue warrants in a further public offer subject to the following conditions:

- the tenure of such warrants shall not exceed eighteen months from the date of their allotment in the public issue;
- a specified security may have one or more warrants attached to it;
- the price or formula for determination of exercise price of the warrants shall be determined upfront and at least 25% of the consideration amount based on the exercise price shall also be received upfront. However, in case the exercise price of warrants is based on a formula, 25% consideration amount based on the cap price of the price band determined for the linked equity shares or convertible securities shall be received upfront;
- in case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within three months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

PROMOTERS' CONTRIBUTION [REGULATIONS 14 & 112]

In Case of IPO

The promoters of the issuer shall hold at least 20% of the post-issue capital.

However, in case the post-issue shareholding of the promoters is less than 20%., alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with IRDA or any non-individual public shareholder holding at least 5% of the post-issue capital or any entity (individual or non-individual) forming part of promoter group other than the promoter(s) may contribute to meet the shortfall in minimum contribution as specified for the promoters, subject to a maximum of 10% of the post-issue capital without being identified as promoter(s).

Non applicability

The requirement of minimum promoters' contribution shall not apply in case an issuer does not have any identifiable promoter.

Minimum Promoters' Contribution

The minimum promoters' contribution shall be as follows:

a) the promoters shall contribute 20%., as the case may be, either by way of equity shares, including SR equity shares held, if any, or by way of subscription to convertible securities.

   However, if the price of the equity shares allotted pursuant to conversion is not pre-determined and not disclosed in the offer document, the promoters shall contribute only by way of subscription to the convertible securities being issued in the public issue and shall undertake in writing to subscribe to the equity shares pursuant to conversion of such securities.

b) in case of any issue of convertible securities which are convertible or exchangeable on different dates and if the promoters' contribution is by way of equity shares (conversion price being pre-determined), such contribution shall not be at a price lower than the weighted average price of the equity share capital arising out of conversion of such securities.

c) in case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters shall bring in a contribution of at least 20% of the project cost in the form of equity shares, subject to contributing at least 20% of the issue size from their own funds in the form of equity shares.

However, if the project is to be implemented in stages, the promoters' contribution shall be with respect to total equity participation till the respective stage vis-à-vis the debt raised or proposed to be raised through the public issue.

Promoters' Contribution to be brought in before Public Issue Opens [Regulation 14 (3) & (4)]

The promoters shall bring full amount of the promoters' contribution including premium at least one day prior to the date of opening of the issue. In case the promoters have to subscribe to equity shares or convertible securities towards minimum promoters' contribution, the amount of promoters' shall be kept in an escrow account with a scheduled commercial bank, which shall be released to the issuer along with the release of the issue proceeds.

However, where the promoters' contribution has already been brought in and utilised, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document. Further, where the minimum promoters' contribution is more than one hundred crore rupees and the initial public offer is for partly paid shares, the promoters shall bring in at least one hundred crore rupees before the date of opening of the issue and the remaining amount may be brought on a pro-rata basis before the calls are made to the public. [Regulation 14 (4)]

Promoters' contribution shall be computed on the basis of the post-issue expanded capital:

(a) assuming full proposed conversion of convertible securities into equity shares;

(b) assuming exercise of all vested options, where any employee stock options are outstanding at the time of initial public offer.

Securities Ineligible Minimum Promoters' Contribution [Regulation 15]

For the computation of minimum promoters' contribution, the following specified securities shall not be eligible:

(a) Specified securities acquired during the preceding three years, if these are:-

- acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or
- resulting from a bonus issue by utilisation of revaluation reserves /unrealised profits of the issuer/from bonus issue against equity shares which are ineligible for minimum promoters' contribution.

(b) specified securities acquired by promoters and AIFs/ FVCIs / scheduled commercial banks/ PFIs/ Insurance companies or any non-individual public shareholder holding at least 5% of the post-issue capital or any entity (individual or non-individual) forming part of promoter group other than the promoter(s)during the preceding one year at a price lower than the price at which specified securities are being offered to public in the initial public offer.

(c) specified securities allotted to promoters and AIFs or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with IRDA or any non-individual public shareholder holding at least 5% of the post-issue capital or any entity (individual or non-individual) forming part of promoter group other than the promoter(s)during the preceding one year at a price less than the issue price, against funds brought in by them during that period, in case of an issuer formed by conversion of one or more partnership firms/LLPs, where the partners of the erstwhile partnership firms/LLPs are the promoters of the issuer and there is no change in the management.

(d) specified securities pledged with any creditor.

**In clause (c), specified securities, allotted to promoters against capital existing in such firms for a period of more than one year on a continuous basis, shall be eligible.*

However, Clause (b) shall not apply:

- if the promoters and AIFs or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with IRDA, or any non-individual public shareholder holding at least 5% of the post-issue capital or any entity (individual or non-individual) forming part of promoter group other than the promoter(s) as applicable pay to the issuer, the difference between the price at which specified securities are offered in the initial public offer and the price at which the specified securities had been acquired;
- if such specified securities are acquired in terms of the scheme under sections 230-240 of the Companies Act, 2013, as approved by a High Court or a tribunal or the Central Government, as applicable, by promoters in lieu of business and invested capital that had been in existence for a period of more than one year prior to such approval;
- to an initial public offer by a government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector.
- to equity shares arising from the conversion or exchange of fully paid-up compulsorily convertible securities, including depository receipts, that have been held by the promoters and alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with IRDAI or any non-individual public shareholder holding at least five per cent. of the post-issue capital or any entity (individual or non-individual) forming part of promoter group other than the promoter(s), as applicable, for a period of at least one year prior to the filing of the draft offer document and such fully paid-up compulsorily convertible securities are converted or exchanged into equity shares prior to the filing of the offer document (i.e., red herring prospectus in case of a book built issue and prospectus in case of a fixed price issue), provided that full disclosures of the terms of conversion or exchange are made in such draft offer document.

Specified securities referred above shall be eligible for the computation of promoters' contribution, if such securities are acquired pursuant to a scheme which has been approved by a High Court or approved by Tribunal or the Central Government under sections 230-240 of the Companies Act, 2013.

In Case of FPO

Exemption from Requirement of Promoters' Contribution [Regulation 112]

The requirements of minimum promoters' contribution shall not apply in case of:

(a) An issuer which does not have any identifiable promoter;

(b) where the equity shares of the issuer are frequently traded on a stock exchange for a period of at least three years immediately preceding the reference date, and;

  i) the issuer has redressed at least 95% of the complaints received from the investors till the end of the quarter immediately preceding the month of the reference date, and;

  ii) the issuer has been in compliance with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for a minimum period of three years immediately preceding the reference date. However, if the issuer has not complied with the provisions of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, relating to composition of board of directors, for any quarter during the last three years immediately preceding the date of filing of draft offer document/offer document, but is compliant with such provisions at the time of filing of draft offer document/offer document, and adequate disclosures are made in the offer document about such non-compliances during the three years immediately preceding the date of filing the draft offer document/offer document, it shall be deemed as compliance with the condition.

Provided further that where the promoters propose to subscribe to the specified securities offered to the extent greater than higher of the two options available in clause (a) of subregulation (1) of regulation 113, the subscription in excess of such percentage shall be made at a price determined in terms of the provisions of regulation 164 or the issue price, whichever is higher.

> Reference date for the purpose of computing the annualized trading turnover referred to in the said explanation shall be the date of filling the draft offer document with the SEBI and in case of fast track issue, the date of filling of offer document with ROC and before opening of the issues.

Minimum Promoters' Contribution [Regulation 113]

The promoters shall contribute in the public issue as follows:

a) either to the extent of 20%. of the proposed issue size or to the extent of 20%. of the post-issue capital;

b) in case of a composite issue (i.e. further public offer cum rights issue), either to the extent of 20%. of the proposed issue size or to the extent of 20% of the post-issue capital excluding the rights issue component.

In case of a public issue or composite issue of convertible securities, the minimum promoters' contribution shall be as follows:

a) the promoters shall contribute 20%., as the case may be, either by way of equity shares or by way of subscription to the convertible securities.

   However, if the price of the equity shares allotted pursuant to conversion is not pre-determined and not disclosed in the offer document, the promoters shall contribute only by way of subscription to the convertible securities being issued in the public issue and shall undertake in writing to subscribe to the equity shares pursuant to conversion of such securities.

b) in case of any issue of convertible securities which are convertible or exchangeable on different dates and if the promoters' contribution is by way of equity shares (conversion price being pre- determined), such contribution shall not be at a price lower than the weighted average price of the equity share capital arising out of conversion of such securities.

In case of a further public offer or composite issue where the promoters contribute more than the stipulated minimum promoters' contribution, the allotment with respect to excess contribution shall be made at a price determined in terms of the provisions relating to pricing of frequently trading shares or the issue price, whichever is higher.

In case the promoters have to subscribe to equity shares or convertible securities towards promoters' contribution, the promoters shall satisfy the requirements of at least one day prior to the date of opening of the issue and the amount of promoters' contribution shall be kept in an escrow account with a scheduled commercial bank and shall be released to the issuer along with the release of the issue proceeds.

Further, where the minimum promoters' contribution is more than one hundred crore rupees and the further public offer is for partly paid shares, the promoters shall bring in at least one hundred crore rupees before the date of opening of the issue and the remaining amount may be brought on a pro-rata basis before the calls are made to the public.

"Weighted average price":

(a) "weight" means the number of equity shares arising out of conversion of such specified securities into equity shares at various stages;

(b) "price" means the price of equity shares on conversion arrived at after taking into account predetermined conversion price at various stages.

Securities ineligible for minimum promoters' contribution [Regulation 114]

For the computation of minimum promoters' contribution, the following specified securities shall not be eligible:

(a) specified securities acquired during the preceding three years, if these are:

i) acquired for consideration other than cash and revaluation of assets or capitalization of intangible assets is involved in such transaction; or

ii) resulting from a bonus issue by utilisation of revaluation reserves or unrealised profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters' contribution.

(b) specified securities pledged with any creditor other than those for borrowings by the issuer or its subsidiaries.

Specified securities referred shall be eligible for the computation of promoters' contribution, if such securities are acquired pursuant to a scheme which has been approved by the High Court or approved by a tribunal or the Central Government under section 230 to 234 of the Companies Act, 2013.

LOCK IN REQUIREMENTS

For Securities Held, by Promoters [Regulations 16 & 115]

In a public issue, the specified securities held by promoters shall be locked-in for the period stipulated hereunder:

Three years lock-in	The promoters' contribution including contribution made by AIFs or FVCIS or scheduled commercial banks or PFIs or insurance companies registered with IRDA, or any non-individual public shareholder holding at least 5% of the post-issue capital or any entity (individual or non-individual) forming part of promoter group other than the promoter(s) shall be locked-in for a period of 18 months from the date of allotment in the Initial Public Offer.
Excess of Minimum Contribution	Promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of six months from the date of allotment in the initial public offer.
SR Equity Shares	SR equity shares shall be under lock-in until conversion into equity shares having voting rights same as that of ordinary shares or shall be locked-in for a period specified above, whichever is later. In case of FPO, the SR equity shares shall be under lock-in until their conversion to equity shares having voting rights same as that of ordinary shares, provided they are in compliance with the other provisions of these regulations.

Securities Held by Persons other than Promoters [Regulation 17]

The entire pre-issue share capital, held by persons other than the promoters, shall be locked-in for a period of six months from the date of allotment in the initial public offer.

The provisions of this regulation shall not apply, in case of:

(i) Equity shares allotted to employees under employee stock option prior to initial public offer, if the issuer has made full disclosures with respect to such option;

(ii) Equity shares held by an employee stock option trust or transferred to the employees by an employee stock option trust pursuant to exercise of options by the employees, in accordance with the employee stock option plan or employee stock purchase scheme.

However, equity shares allotted to the employees shall be subject to the provisions of lock-in as specified under the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021;

(iii) Equity shares held by a venture capital fund or AIF of category I & II or a FVCI and such equity shares shall be locked-in for a period of at least six months from the date of purchase by the venture capital or AIF of category I & II or FVCI.

> For Point No. (iii), in case such equity shares have resulted pursuant to conversion of fully paid-up compulsorily convertible securities, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of six months period and convertible securities shall be deemed to be fully paid- up, if the entire consideration payable thereon has been paid and no further consideration is payable at the time of their conversion.

There is no such requirements as mentioned above in case of a FPO.

Securities Lend to Stablising Agent under Green Shoe Option [Regulations 18 & 116]

If the shares held by promoter(s) are lent to the Stabilizing Agent (SA) as prescribed, they should be exempted from the lock-in requirements specified above, for the period starting from the date of such lending and ending on the date on which they are returned to the same lender(s). However, the securities should be locked-in for the remaining period from the date on which they are returned to the lender.

Lock-in of party-pad securities [Regulations 19 & 117]

If the specified securities which are subject to lock-in are partly paid-up and the amount called-up on such specified securities is less than the amount called-up on the specified securities issued to the public, the lock-in shall end only on the expiry of 18 months after such specified securities have become pari passu with the specified securities issued to the public.

Inscription or recording of non-transferability [Regulations 20 & 118]

The certificates of specified securities which are subject to lock-in shall contain the inscription "non-transferable" and specify the lock-in period and in case such specified securities are dematerialised, the issuer shall ensure that the lock-in is recorded by the depository.

Pledge of Locked in Shares [Regulations 21 & 119]

Specified securities, except SR equity shares, held by the promoters and locked in may be pledged as collateral security for a loan granted by a scheduled commercial bank or a public financial institution or a systemically important non-banking finance company or a housing finance company, subject to the following:

a) if the specified securities are locked-as per clause 16(a) Lock-in of specified securities held by the promoters, the loan has been granted to the issuer company or its subsidiary for the purpose of financing one or more of the objects of the issue and pledge of specified securities is one of the terms of sanction of the loan.

b) if the specified securities are locked-in as per Regulation 16(b) of Lock-in of specified securities held by the promoters and the pledge of specified securities is one of the terms of sanction of the loan.

However, in case of an IPO the provision as mentioned in point (ii) regarding lock-in, such lock-in shall continue pursuant to the invocation of the pledge and such transferee shall not be eligible to transfer the specified securities till the lock-in period stipulated in these regulations, has expired.

Transferability of locked-in specified securities [Regulations 22 & 120]

Subject to the provisions of SEBI (Substantial Acquisition of shares and Takeovers) Regulations, 2011, the specified securities, except SR equity shares, held by the promoters and locked-in may be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer.

However, lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.

APPOINTMENT OF LEAD MANAGERS, OTHER INTERMEDIARIES AND COMPLIANCE OFFICER [REGULATIONS 23 & 121]

- The issuer shall appoint one or more merchant bankers, which are registered with SEBI, as lead manager(s) to the issue.
- Where the issue is managed by more than one lead manager, the rights, obligations and responsibilities, relating *inter alia* to disclosures, allotment, refund and underwriting obligations, if any, of each lead manager shall be predetermined and be disclosed in the draft offer document and the offer document.
- At least one lead manager to the issue shall not be an associate as defined under the SEBI (Merchant Bankers) Regulations, 1992 of the issuer.
- If any of the lead manager is an associate of the issuer, it shall disclose itself as an associate of the issuer and its role shall be limited to marketing of the issue.
- The issuer shall, in consultation with the lead manager(s), appoint other intermediaries which are registered with SEBI after the lead manager(s) have independently assessed the capability of other intermediaries to carry out their obligations.
- The issuer shall enter into an agreement with the lead manager(s) and enter into agreements with other intermediaries as required under the respective regulations applicable to the intermediary concerned.

- Such agreements may include such other clauses as the issuer and the intermediaries may deem fit without diminishing or limiting in any way the liabilities and obligations of the lead manager(s), other intermediaries and the issuer under the Act, the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made thereunder or any statutory modification or statutory enactment thereof.
- In case of ASBA process, the issuer shall take cognizance of the deemed agreement of the issuer with the self-certified syndicate banks.
- The issuer shall, in case of an issue made through the book building process, appoint syndicate member(s) and in the case of any other issue, appoint bankers to issue, at centres.
- The issuer shall appoint a registrar to the issue, registered with SEBI which has connectivity with all the depositories.
- If the issuer itself is a registrar, it shall not appoint itself as registrar to the issue.
- The lead manager shall not act as a registrar to the issue in which it is also handling the post-issue responsibilities.
- The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances. It may be noted here that as per Regulation 6 of SEBI (LODR) Regulations, 2015 only a qualified Company Secretary can act as compliance officer of the listed entity.

DISCLOSURES IN AND FILING OF OFFER DOCUMENTS [REGULATION 24 & 122]

Disclosures in the draft offer document and offer document

- The draft offer document and the offer document shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision.
- The red-herring prospectus, shelf prospectus and prospectus shall contain:
  - (i) disclosures specified in the Companies Act, 2013; and
  - (ii) disclosures specified in Part A of Schedule VI of ICDR Regulations 2018. In case of FPO the disclosures are subject to the provisions of Parts C and D thereof.
- The lead manager(s) shall exercise **due diligence** and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosures made in the draft offer document and the offer document.
- The lead manager(s) shall call upon the issuer, its promoters and its directors or in case of an offer for sale, the selling shareholders, to fulfil their obligations as disclosed by them in the draft offer document and the offer document and as required in terms of ICDR Regulations 2018.
- The lead manager(s) shall ensure that the information contained in the offer document and the particulars as per audited financial statements in the offer document are not more than six months old from the issue opening date.

FILING OF OFFER DOCUMENT [REGULATIONS 25 & 123]

Prior to making an IPO/FPO, the issuer shall file three copies of the draft offer document with SEBI, in accordance with **Schedule IV**, along with fees as specified, through the lead manager(s).

The issuer shall also file the draft offer document with the stock exchange(s) where the specified securities are proposed to be listed, and submit to the stock exchange(s), the Permanent Account Number, bank account number and passport number of its promoters where they are individuals, and Permanent Account Number, bank account number, company registration number or equivalent and the address of the Registrar of Companies (ROC) with which the promoter is registered, where the ROC promoter is a body corporate.

The lead manager(s) shall submit the following to SEBI along with the draft offer document:

- a certificate, confirming that an agreement has been entered into between the issuer and the lead manager(s);
- a due diligence certificate;
- in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee.

➢ SEBI may specify changes or issue observations, on the draft offer document filed with it within a period of 30 days from the later of the following dates:

a) the date of receipt of the draft offer document filed with SEBI; or

b) the date of receipt of satisfactory reply from the lead merchant bankers, where SEBI has sought any clarification or additional information from them; or

c) the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency; or

d) the date of receipt of a copy of in-principle approval letter issued by the recognised stock exchanges.

➢ If SEBI specifies any changes or issues observations on the draft offer document filed with it, the issuer and the lead merchant banker shall carry out such changers and comply with the observations issued by SEBI before filing the offer documents with the Registrar of Companies or an appropriate authority, as applicable.

➢ If there are any changes in the draft offer document in relation to the matters specified in these regulations, an updated offer document or a fresh draft offer document, as the case may be, shall be filed with SEBI.

➢ Copy of the offer documents shall also be filed with SEBI and the stock exchanges through the lead manager(s) promptly after filing the offer document with the Registrar of Companies.

➢ The draft offer document and the offer document shall also be furnish to SEBI in a soft copy.

Draft offer document and offer document to be available to the public [Regulations 26 & 124]

➢ The draft offer document filed with SEBI shall be made public for comments, if any, for a period of at least twenty one days from the date of filing, by hosting it on the websites of the issuer, SEBI, stock exchanges where specific securities are proposed to be listed and lead manager(s) associated with the issue.

➢ The issuer shall, within two days of filing the draft offer document with SEBI, make a public announcement in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing the fact of filing of the draft offer document with SEBI and inviting the public to provide their comments to SEBI, the issuer or the lead manager(s) in respect of the disclosures made in the draft offer document.

➢ The lead manager(s) shall, after expiry of the period stipulated above, file with SEBI, details of the comments received by them or the issuer from the public, on the draft off document, during that period and the consequential changes, if any, that are required to be made in the draft off document.

- The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Registrar of Companies, SEBI and the stock exchanges, as applicable.
- The lead manager(s) and the stock exchanges shall provide copies of the offer document to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

PRICING

Face Value of Equity Shares [Regulations 27 & 125]

The disclosure about the face value of equity shares shall be made in the draft offer document, offer document, offer document, advertisements and application forms, along with price band or the issue price in identical font size.

An issuer in an IPO and FPO may determine the price of specified securities in consultation with the lead merchant banker or through the book building process.

Determining of Price through Book-Building Process in an IPO

The book-building process is a price discovery mechanism that's used by companies issuing their shares to the public for the first time. A company sets a price band with a lower and upper ceiling.

The investors desirous of subscribing to the public issue are encouraged to bid within this range. Once the issue closes, the company along with the Book Running Lead Managers (BRLMs) set the final cut-off price, using a weighted average method. The final cut-off price is the price at which the shares are issued to the investors.

A hypothetical example of how the book-building process works in an IPO is placed below:

Assume that a company wishes to issue 1,00,000 shares to the public via an IPO. It sets the price band for the issue as Rs. 250 to Rs. 300 per share. Interested investors can apply for the shares at any price within this Rs. 250 to Rs. 3000 range. Here's a hypothetical representation of the investors' bids.

No. of Shares Applied	Bid Price
10,000	Rs. 250
50,000	Rs. 275
60,000	Rs. 300

After the bid window closes, the final price, also known as cut-off price, is determined based on the proportion of application received at each price.

Investors who bid on or above the final cut-off price will be allotted the company's shares. And investors who bid lower than the final cut-off price will not be allotted any shares. Any amount blocked on their account on account of the IPO will be released.

An investor can choose the cut-off price and pay the application amount based on upper cap, i.e 300. If the cut-off price is lower than the cap price, the investor gets the necessary refund or the money gets adjusted with any due payment.

In the above example, to issue all 100,000 shares, minimum price will be 275, because applications for 50,000 and 60,000 shares (a total of 110,000) were received for or above 275 and above. The company will refund money to those who applied for shares at a bid price below 275. Furthermore, against 100,000 shares, 110,000 shares were applied for at the cut-off price of 275, so, the company will issue shares in the 10:11 ratio. That means that an investor who applied for 11 shares, will get 10 shares.

Price and Price Band [Regulations 29 & 127]

- The issuer may mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before filing the prospectus with the Registrar of Companies.

  However, the prospectus filed with the ROC shall contain only one price or the coupon rate, as the case may be.

- The cap on the price band, and the coupon rate in case of convertible debt instruments, shall be less than or equal to 120% of the floor price. Provided that the cap of the price band shall be at least one hundred and five percent of the floor price.

- The floor price or the final price shall not be less than the face value of the specified securities.

- Where the issuer opt not to make disclosure of the floor price or price band in the red herring prospectus, the issuer shall be announce the floor price or price band at **least two working days before the opening of the bid (in case of an initial public offer) and at least one working day before the opening of the bid (in case of a further public offer),** in all the newspapers in which the pre issue advertisement was released.

- The announcement referred above shall also contain all the relevant financial ratios computed for both the upper and lower end of the price band and also a statement drawing attention of the investors to the section titled “basis of issue price” of the offer document.

- The announcement and the relevant financial ratios shall be disclosed on the websites of those stock exchanges where the securities are proposed to be listed and shall also be pre-filled in the application forms available on the websites of the stock exchanges.

Differential Pricing [Regulations 30 & 128]

An issuer may offer specified securities at different prices, subject to the following:

(a) retail individual investors or retail individual shareholders or employees entitled for reservation made under regulation 33 & 130 of the ICDR Regulations, may be offered specified securities at a price not lower than by more than 10% of the price at which net offer is made to other categories of applicants, other than anchor investors;

(b) in case of a book built issue, the price of the specified securities offered to an anchor investor shall not be lower than the price offered to other applicants;

(c) In case the issuer opts for the alternate method of book building as specified under ICDR Regulations, 2018, the issuer may offer specified securities to its employees at a price not lower by more than 10% of the floor price.

In case of FPO, an additional condition is that in case of a composite issue, the price of the specified securities offered in the public issue may be different from the price offered in rights issue and justification for such price difference shall be given in the offer document; and discount, if any shall be expressed in rupee terms in the offer document.

MINIMUM OFFER TO PUBLIC AND RESERVATIONS

Minimum Offer to Public [Regulation 31]

The minimum net offer to the public shall be subject to the provision of clause (b) of sub-rule (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957 (SCRR).

The provisions of Rule 19(2)(b) of SCRR related to minimum offer to public are as given hereunder:

The minimum offer and allotment to public in terms of an offer document shall be -

(i) At least 25%. of each class or kind of equity shares or debentures convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is less than or equal to one thousand six hundred crore rupees;

(ii) at least such percentage of each class or kind of equity shares or debentures convertible into equity shares issued by the company equivalent to the value of four hundred crore rupees, if the post issue capital of the company calculated at offer price is more than one thousand six hundred crore rupees but less than or equal to four thousand crore rupees;

(iii) at least 10% of each class or kind of equity shares or debentures convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is above four thousand crore rupees but less than or equal to one lakh crore rupees;

(iv) at least such percentage of each class or kind of equity shares or debentures convertible into equity shares issued by the company equivalent to the value of five thousand crore rupees and at least five per cent of each such class or kind of equity shares or debenture convertible into equity shares issued by the company, if the post issue capital of the company calculated at offer price is above one lakh crore rupees.

Provided that the company referred to in this sub-clause (iv) shall increase its public shareholding to at least 10% within a period of 2 years and at least 25% within a period of 5 years, from the date of listing of the securities, in the manner specified by the Securities and Exchange Board of India.

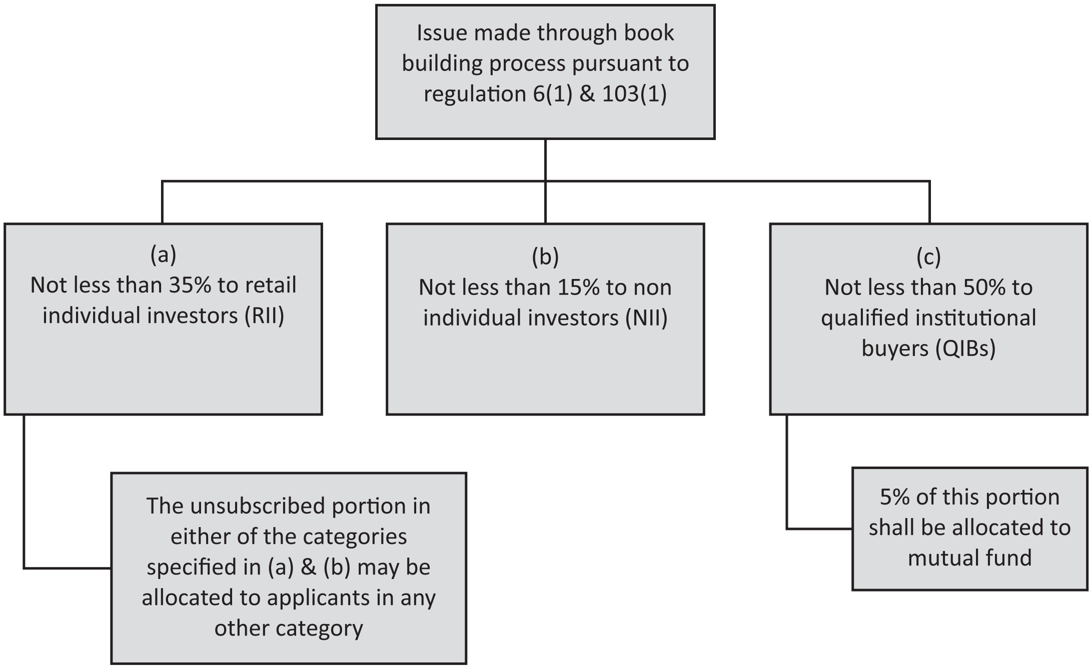
Provided further that the company, referred to in sub clause (ii) or sub-clause (iii), shall increase its public shareholding to at least 25%, **within a period of three years from the date of listing** of the securities, in the manner specified by the Securities and Exchange Board of India.

Provided further that this clause shall not apply to a company whose draft offer document is pending with the Securities and Exchange Board of India on or before the commencement of the Securities Contracts (Regulation) Third Amendment Rules, 2014, if it satisfies the conditions prescribed in clause (b) of sub-rule (2) of rule 19 of the Securities Contracts (Regulation) Rules, 1956 as existed prior to the date of such commencement.

ALLOCATION IN NET OFFER

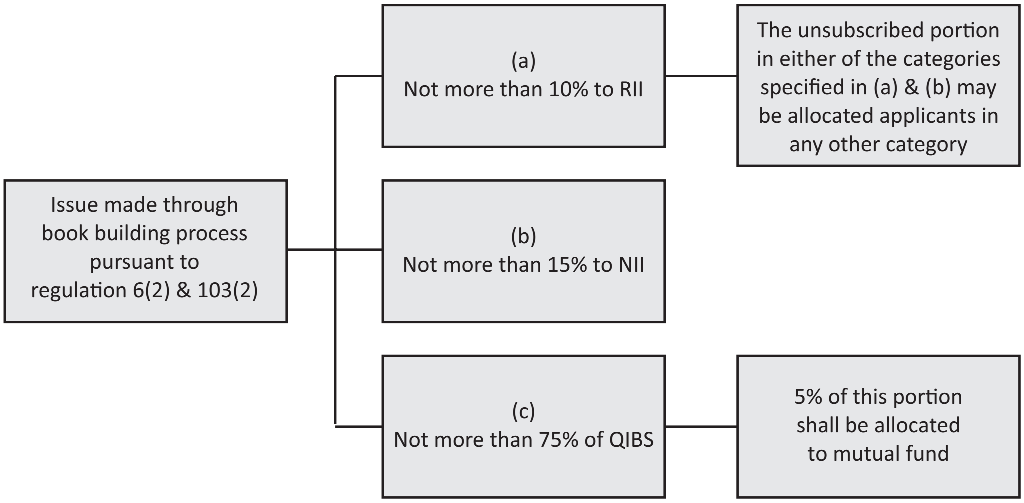
(1) Regulations 32(1) & 129(1)

In an issue made through the book building process pursuant to regulation 6 (1) & 103(1) the allocation in the net offer category shall be as follows:



(2) Regulations 32(2) & 129(2)

In an issue made through the book building process pursuant to regulation 6 (2) & 103(2) the allocation in the net offer category shall be as follows:



(3) Regulations 32(3) & 129(3)

In an issue made through the book building process, the issuer may allocate up to 60%. of the portion available for allocation to qualified institutional buyers to Anchor Investors in accordance with the conditions specified in this regard in Schedule XIII of SEBI ICDR Regulations 2018.

Regulation 2(1)(c) of ICDR, 2018 defines Anchor Investors as - “anchor investor” means a qualified institutional buyer who makes an application for a value of at least ten crore rupees in a public issue on the main board made through the book building process in accordance with these regulations or makes an application for a value of at least two crore rupees for an issue made in accordance with Chapter IX of these regulations.

In an issue made through book building process, the allocation in the non-institutional investors’ category shall be as follows:

(a) one third of the portion available to non-institutional investors shall be reserved for applicants with application size of more than two lakh rupees and up to ten lakh rupees;

(b) two third of the portion available to non-institutional investors shall be reserved for applicants with application size of more than ten lakh rupees.

Provided that the unsubscribed portion in either of the sub-categories specified in clauses (a) or (b), may be allocated to applicants in the other sub-category of non-institutional investors.

(4) Regulations 32(4) & 129(4)

In an issue made other than through the book building process, the allocation in the net offer category shall be made as follows:

Issue made through other than book building process

(a) Minimum 50% of Retail Individual Investors (RIIs); and

(b) Remaining to:

(i) Individual applicants other than RIIs; and

(ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for.

However, the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

It may be noted that, if the retail individual investor category is entitled to more than 50% of the issue size on a proportionate basis, the retail individual investors shall be allocated that higher percentage.

OTHER REQUIREMENTS WITH RESPECT TO IPO/FPO

Reservation on Competitive Basis [Regulations 33 & 130]

Reservation on competitive basis means reservation wherein specified securities are allotted in portion of the number of specified securities applied for in respect of a particular reserved category to the number of specified securities reserved for that category.

According to SEBI (ICDR) Regulations, 2018, there are certain persons eligible for reservation on competitive basis.

(1) The issuer may make reservation on a competitive basis out of the issue size excluding promoters’ contribution and net offer to public in favour of the following categories of persons:

- Employees
- shareholders (other than promoters and promoter group) of listed subsidiaries or listed promoter companies.

However, the issuer shall not make any reservation for the lead manager(s), registrar, syndicate member(s), their promoters, directors and employees and for the group or associate companies (as defined under the Companies Act, 2013) of the lead manager(s), registrar and syndicate member(s) and their promoters, directors and employees.

(2) In case of an FPO, other than in a composite issue, the issuer may make a reservation on a competitive basis out of the issue size excluding promoters' contribution to the existing retail individual shareholders of the issuer.

(3) The reservation on competitive basis shall be subject to following conditions:

- the aggregate of reservations for employees shall not exceed 5% of the post issue capital of the issuer and the value of allotment to any employee shall not exceed two lakhs rupees;

  However, in the event of under-subscription in the employee reservation portion, the unsubscribed portion may be allotted on proportionate basis, for a value in excess of two lakh rupees, subject to the total allotment to an employee not exceeding five lakh rupees.

- reservation for shareholders shall not exceed 10% of the issue size;
- no further application for subscription in the net offer can be made by persons (except an employee and retail individual shareholder of the listed issuer and retail individual shareholders of listed subsidiaries of listed promoter companies) in favour of whom reservation on a competitive basis is made;
- any unsubscribed portion in any reserved category may be added to any other reserved category and the unsubscribed portion, if any, after such inter-se adjustments among the reserved categories shall be added to the net offer category;
- in case of under-subscription in the net offer category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net public offer category.

(4) An applicant in any reserved category may make an application for any member of specified securities, but not exceeding the reserved portion for that category.

Abridged prospectus [Regulations 34 & 131]

The abridged prospectus shall contain the disclosures as specified in **Part E** of **Schedule VI** of SEBI ICDR Regulations 2018 and shall not contain any matter extraneous to the contents of the offer document. Every application form distributed by the issuer or any other person in relation to an issue shall be accompanied by a copy of the abridged prospectus.

ASBA [Regulations 35 & 132]

The issuer shall accept bids using only the ASBA facility in the manner specified by SEBI.

UPI stands for Unified Payments Interface. It is an instant payment system on the mobile platform. It offers inter- bank transfers between any two persons' bank accounts i.e. sending or receiving money in real-time among banks in India. The National Payments Corporation of India (NPCI) developed UPI and is regulated by the RBI.

ASBA stands for "Application supported by Blocked Amount" which means an application for subscribing to a public issue or rights issue, along with an authorization to self-certified syndicate bank to block the application money in a bank account. Under ASBA process instead of moving the application money from the bank account of applicant in an IPO to an escrow account, same is block in applicant's own bank account and if he receives shares in IPO same is released to the issuer company.

SEBI view its circular dated November 01, 2018 has introduced UPI in a phased manner as an alternate option for retail investors (Up to Rs. 2 lacs) as a substitute of ASBA to invest in an IPO starting from January 01, 2019. The objective was to eventually cut the time consumed in listing of the company post closure of IPO (T day) from 6 working days (i.e. Listing on T+6) to 3 working days (i.e. listing on T+3).

Thereafter, w.e.f. July 01, 2019, payment through UPI mechanism was made mandatory for retail investors in an IPO. After implementation of Phase III of said SEBI Circular the listing of company will happen within three working days from the date of closure of IPO (i.e. on T+3).

SEBI has vide its circular reference number SEBI/HO/CFD/DIL2/CIR/P/2020/13 dated January 22, 2020 has made it mandatory that Application for a rights issue shall be made only through ASBA facility.

Availability of Issue Material [Regulations 36 & 133]

The lead manager(s) shall ensure availability of the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, underwriters, bankers to the issue, and self-certified syndicate banks before the opening of the issue.

Prohibition on payment of incentives [Regulations 37 & 134]

Any person connected with the issue shall not offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the initial public offer, except for fees or commission for services rendered in relation to the issue.

IPO Grading – Applicable to IPO only [Regulation 39]

The issuer may obtain grading for its initial public offer from one or more credit rating agencies registered with SEBI.

Underwriting [Regulations 40 & 136]

If the issuer making an initial public offer/further public offer, other than through the book building process, desires to have the issue underwritten to cover under-subscription in the issue, it shall, prior to the filing of the prospectus, enter into an underwriting agreement with the merchant bankers or stock brokers registered with SEBI to act as underwriters, indicating therein the maximum number of specified securities they shall subscribe to, either by themselves or by procuring subscription, at a predetermined price which shall not be less than the issue price, and shall disclose the fact of such underwriting agreement in the prospectus.

The issuer making an initial public offer/further public offer, other than through the book building process, shall, prior to the filing of the prospectus, enter into an underwriting agreement with the merchant bankers or stock brokers registered with SEBI to act as underwriters, indicating therein the number of specified securities they shall subscribe to on account of rejection of applications, either by themselves or by procuring subscription, at a predetermined price which shall not be less than the issue price, and shall disclose the fact of such underwriting agreement in the prospectus.

If the issuer makes a public issue through the book building process:

(a) the issue shall be underwritten by lead manager and syndicate member. However, at least 75% of the net offer proposed to be compulsorily allotted to qualified institutional buyers for the purpose of compliance of the eligibility conditions specified in regulation 6(2) shall not be underwritten.

(b) the issuer shall, prior to the filing of the prospectus, enter into an underwriting agreement with the lead manager and syndicate member, indicating therein the number of specified securities they shall subscribe to on account of rejection of bids, either by themselves or by procuring subscription, at a price which shall not be less than the issue price, and shall disclose the fact of such underwriting agreement in the prospectus.

(c) if the issuer desires to have the issue underwritten to cover under-subscription in the issue, it shall, prior to the filing of the red herring prospectus, enter into an underwriting agreement with the lead manager and syndicate member to act as underwriters, indicating therein the maximum number of specified securities they shall subscribe to, either by themselves or by procuring subscription, at a price which shall not be less than the issue price, and shall disclose the fact of such underwriting agreement in the red herring prospectus.

(d) if the syndicate member fail to fulfil their underwriting obligations, the lead managers shall fulfil the underwriting obligations.

(e) the lead manager and syndicate member shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.

(f) in case of every underwritten issue, the lead manager shall undertake minimum underwriting obligations as specified in the SEBI (Merchant Bankers) Regulations, 1992.

(g) where the issue is required to be underwritten, the underwriting obligations should be at least to the extent of minimum subscription.

Monitoring Agency [Regulations 41 & 137]

If the issue size, excluding the size of offer for sale by selling shareholders, exceeds one hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a credit rating agency registered with SEBI.

The monitoring agency shall submit its report to the issuer in the format specified in the ICDR Regulations, 2016 on a quarterly basis, till 100% of the proceeds of the issue have been utilized.

The Board of directors and the management of the issuer shall provide their comments on the findings of the monitoring agency.

The issuer shall, within forty five days from the end of each quarter, publicly disseminate the report of the monitoring agency by uploading the same on its website as well as submitting the same to the stock exchange(s) on which its equity shares are listed.

Public Communication, Publicity Materials, Advertisements and Research Reports [Regulations 42 & 138]

All public communication, publicity materials, advertisements and research reports shall comply with the provisions of Schedule IX of SEBI ICDR Regulations, 2018.

Issue-related Advertisements [Regulations 43 & 139]

- Subject to the provisions of the Companies Act, 2013, the issuer shall, after filing the red herring prospectus (in case of a book built issue) or prospectus (in case of fixed price issue) with the Registrar of Companies, make a pre-issue advertisement in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.

- The pre-issue advertisement shall contain the disclosures specified in Part A of Schedule X of SEBI ICDR Regulations, 2018.

  However, the disclosures in relation to price band or floor price and financial ratios contained therein shall only be applicable where the issuer opts to announce the price band or floor price along with the pre-issue advertisement, if the issuer opts not to make disclosures of price band in the RHP.

- The issuer may release advertisements for issue opening and issue closing, which shall be in the formats specified in Parts B and C of Schedule X of SEBI ICDR Regulations, 2018.

- During the period the issue is open for subscription, no advertisement shall be released giving an impression that the issue has been fully subscribed or oversubscribed or indicating investors' response to the issue.

INFORMAL GUIDANCE

Query:

Whether a book running lead manager, syndicate member, or underwriter can share the standalone or aggregate bidding data available on the website of the stock exchange for IPO, Right Issue, and FPO of specified securities and units with the investors, as and when requested by such investors, during the bidding period?

Reply:

SEBI stated that the standalone and aggregate bidding data is displayed on the website of the stock exchanges in the accepted/standard format specified by SEBI and is publicly available information. This data being extraneous to the information disclosed in the draft offer document or offer document is explicitly permitted to be shared for the interests of investors by the Stock Exchanges. **Further, SEBI Regulations prohibit entities associated with the public issue of units from issuing advertisements which give any impression of status of subscription/oversubscription of the issue during the issue period.** While publicly available information may not create information asymmetry among investors, any effort to selectively present the standalone or aggregate bidding data on their own or on request by investors may create information asymmetry and may cause prejudice to the mind of some investors which is not warranted and not the intent of SEBI Regulations. Hence, a book running lead manager, syndicate member, or underwriter should not share the bidding data (standalone and aggregate) with the investors or on request of investors during the bidding period.

Reference: https://www.sebi.gov.in/enforcement/informal-guidance/oct-2020/informal-guidance-request-of-citi-group_48019.html

Opening of the Issue [Regulations 44 & 140]

A public issue (both IPO and FPO) may subject to compliance of Section 26(4) of the Companies Act, 2013 may be opened within 12 months from the date of issuance of the observations by SEBI.

In case of a fast track issue, the issue shall open within the period specifically stipulated under the Companies Act, 2013. In case the issuer has filed a shelf prospectus, the first issue may be opened within 3 months of the issuance of observations by SEBI.

An IPO and an FPO shall be opened **after** at least 3 working days from the date of filing the red herring prospectus in case of a book built issue or the prospectus in case of a fixed price issue with the Registrar of Companies.

Minimum Subscription [Regulations 45 & 141]

The minimum subscription to be received in an issue shall be not less than 90% of the offer through offer document except in case of an offer for sale of specified securities.

In case of an IPO, the minimum subscription to be received shall be subject to allotment of minimum number of specified securities, as prescribed in sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulation) Rules, 1957, which stipulates that atleast twenty five per cent of each class or kind of equity shares or debentures convertible into equity shares issued by the company was offered and allotted to public in terms of an offer document. In other words, the issue is said have received minimum subscription in an IPO if it receives 90% of the offer through offer document and 25% of the post issue capital from the public.

*[**Note:** in terms of Rule 19 (2)(b) of SCRR, subject to certain conditions, issuers are allowed to issue less than 25% of the post issue capital to public but in this case the issuer has to raise the minimum public shareholding to 25% within a period of three years from the date of listing.]*

In the event of non-receipt of minimum subscription, all application monies received shall be refunded to the applicants forthwith, but not later than 4 days from the closure of the issue.

Period of Subscription [Regulations 46 & 142]

- An IPO/FPO shall be kept open for at least 3 working days and not more than 10 working days.
- In case of a revision in the price band, the issuer shall extend the bidding (issue) period disclosed in the red herring prospectus, for a minimum period of three working days.
- In case of force majeure, banking strike or similar unforeseen circumstances, the issuer may, for reasons to be recorded in writing, extend the bidding (issue) period disclosed in the red herring prospectus (in case of a book built issue) or the issue period disclosed in the prospectus (in case of a fixed price issue), for a minimum period of one working day.

Application and Minimum Application Value [Regulations 47 & 143]

- A person shall not make an application in the net offer category for a number of specified securities that exceeds the total number of specified securities offered to the public.

  However, the maximum application by non-institutional investors shall not exceed total number of specified securities offered in the issue less total number of specified securities offered in the issue to QIBs.

Example

Altas Limited is proposing to issue a 3 crore specified securities offered @ Rs.600 per share. The total specified securities offered, also include offer made to:

- Qualified Institutional buyers - 2 crore specified securities
- Retail individual investors' category - 35 lakh specified securities Considering the above facts, comment on:
  a) How many specified securities can Mr. A apply in the net offer category
  b) What is the maximum number of specified securities which non-institutional investors can apply in the said issue.

As per Regulation 47 of SEBI ICDR, 'person shall not make an application in the net offer category for a number of specified securities that exceeds the total number of specified securities offered to public.' Accordingly, Mr. A cannot apply for more than 35 Lakh specified securities, the total number of securities offered to the public.

Further the maximum number of specified securities which a non-institutional investor can apply are:

Particulars	***No. of Specified Securities***
Securities offered in the issue (A)	3 crore
Less: Securities offered to QIB (B)	2 crore
Net available to non-institutional investors (A-B)	1 crore

Thus, the number of specified securities which non-institutional investors can apply shall not exceed 1 crore specified securities.

- The issuer shall stipulate in the offer document the minimum application size in terms of number of specified securities which shall fall within the range of minimum application value of ten thousand rupees to fifteen thousand rupees.
- The issuer shall invite applications in multiples of the minimum application value, as per Part B of Schedule XIV of SEBI ICDR Regulation 2018.
- The minimum sum payable on application per specified security shall be at least 25% of the issue price.

However, in case of an offer for sale, the full issue price for each specified security shall be payable at the time of application.

Manner of Calls [Regulations 48 & 144]

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment in the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited. In case the issuer has appointed a monitoring agency, the issuer shall not be required to call the outstanding subscription money within twelve months.

Allotment Procedure and Basis of Allotment [Regulations 49 & 145]

The issuer shall not make any allotment in excess of the specified securities offered through the offer document except in case of oversubscription for the purpose of rounding off to make allotment, in consultation with the designated stock exchange.

The issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than 1000.

In case of oversubscription, an allotment of not more than one percent of the net offer to the public for the purpose of making allotment in minimum lots.

The allotment of specified securities to applicants other than to the retail individual investors, non-institutional investors and anchor investors shall be on a proportionate basis within the respective investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed in the offer document.

However, the value of specified securities allotted to any person, except in case of employees, in pursuance of reservation made under these regulations, **shall not exceed two lakhs rupees for retail investors or up to five lakhs rupees for eligible employees.**

The allotment of specified securities to each **retail individual investor shall not be less than the minimum bid lot, subject to the availability of shares in retail individual investor category,** and the remaining available shares, if any, shall be allotted on a proportionate basis.

The allotment of specified securities to each non-institutional investor shall not be less than the minimum application size, subject to the availability of shares in non-institutional investors' category, and the remaining shares, if any, shall be allotted on a proportionate basis in accordance with the conditions specified in this regard in Schedule XIII of these regulations.

The authorised employees of the designated stock exchange, along with the lead manager(s) and registrars to the issue, shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the procedure as specified in Part A of Schedule XIV.

Allotment, Refund and Payment of Interest [Regulations 50 & 146]

- The issuer and lead manager(s) shall ensure that specified securities are allotted and/or application monies are refunded or unblocked within such period as may be specified by SEBI.
- The lead manager(s) shall ensure that the allotment, credit of dematerialised securities, refunding or unblocking of application monies, as may be applicable, are done electronically.
- Where specified securities are not allotted and/or application monies are not refunded or unblocked within the period stipulated above, the issuer shall undertake to pay interest at the rate of 15% per annum to the investors and within such time as disclosed in the offer document and the lead manager(s) shall ensure the same.
- SEBI vide Circular dated November 01, 2018 has made an endeavor to reduce listing time to 3 working days from the date of closure of issue and accordingly mandated that the retail individual investors use the **Unified Payments Interface (UPI).** However, till SEBI notifies the same, securities are listed in 6 working days.

Illustration explaining the procedure of allotment

Example A

(1) Total number of specified securities on offer@ Rs. 600 per share: 1 crore specified securities.

(2) Specified securities on offer for retail individual investors' category: 35 lakh specified securities.

(3) The issue is over-all subscribed by 2.5 times, whereas the retail individual investors' category is oversubscribed 4 times.

(4) The issuer has fixed the minimum application/bid size as 20 specified securities (falling within the range of ten thousand to fifteen thousand rupees) and in multiples thereof.

(5) A total of one lakh retail individual investors have applied in the issue, in varying number of bid lots i.e. between 1 - 16 bid lots, based on the maximum application size of up to two lakh rupees.

(6) Out of the one lakh investors, there are five retail individual investors A, B, C, D and E who have applied as follows: A has applied for 320 specified securities. B has applied for 220 specified securities. C has applied for 120 specified securities. D has applied for 60 specified securities and E has applied for 20 specified securities.

(7) As the allotment to a retail individual investor cannot be less than the minimum bid lot, subject to availability of shares, the remaining available shares, if any, shall be allotted on a proportionate basis.

The actual entitlement shall be as follows:

Sl. No.	***Name of Investor***	***Total Number of specified securities applied for***	***Total number of specified securities eligible to be allotted***
1.	A	320	20 specified securities (i.e. the minimum bid lot) + 38 specified securities [(35,00,000 - (1,00,000 * 20)} / (140,00,000 - (1,00,000 * 20)}] * 300 (i.e. 320-20)
2.	B	220	20 specified securities (i.e. the minimum bid lot) + 25 specified securities [{35,00,000 - (1,00,000 * 20) / (140,00,000 - (1,00,000 * 20)}] * 200 (i.e. 220-20)
3.	C	120	20 specified securities (i.e. the minimum bid lot) + 13 specified securities [{35,00,000 - (1,00,000 * 20)} / {(140,00,000 - (1,00,000 * 20)}] * 100 (i.e. 120-20)
4.	D	60	20 specified securities (i.e. the minimum bid lot) + 5 specified securities [{(35,00,000 - 1,00,000 * 20)} / {(140,00,000 - (1,00,000 * 20)}] * 40 (i.e. 60-20)
5.	E	20	20 specified securities (i.e. the minimum bid lot)

Example B

(1) Total number of specified securities on offer @ Rs. 600 per share: 1 crore specified securities.

(2) Specified securities on offer for retail individual investors' category: 35 lakh specified securities.

(3) The issue is overall subscribed by 7 times, whereas the retail individual investors' category is over-subscribed 9.37 times.

(4) The issuer has decided the minimum application/bid size as 20 specified securities (falling within the range of ten thousand to fifteen thousand rupees) and in multiples thereof.

(5) A total of two lakh retail individual investors have applied in the issue, in varying number of bid lots i.e. between 1-16 bid lots, based on the maximum application size of up to two lakh rupees.

(6) As per the allotment procedure, the allotment to retail individual investors shall not be less than the minimum bid lot, subject to availability of shares.

(7) Since the total number of shares on offer to the retail individual investors is 35,00,000 and the minimum bid lot is 20 shares, the maximum number of investors who can be allotted this minimum bid lot should be 1,75,000. In other words, 1,75,000 retail applicants shall get the minimum bid lot and the remaining 25,000 retail applicants will not get any allotment.

The details of the allotment shall be as follows:

No. of lots	*No. of shares at each lot*	*No. of retail investors applying at each lot*	*Total no. of shares applied at each lot*	*No. of investors who shall receive minimum bid-lot (to be selected by a lottery)*
A	B	C	D=(B*C)	E
1.	20	10,000	2,00,000	8,750=(1,75,000/2,00,000)*10,000
2.	40	10,000	4,00,000	8,750
3.	60	10,000	6,00,000	8,750
4.	80	10,000	8,00,000	8,750
5.	100	20,000	20,00,000	17,500
6.	120	20,000	24,00,000	17,500
7.	140	15,000	21,00,000	13,125
8.	160	20,000	32,00,000	17,500
9.	180	10,000	18,00,000	8,750
10.	200	15,000	30,00,000	13,125
11.	220	10,000	22,00,000	8,750
12.	240	10,000	24,00,000	8,750
13.	260	10,000	26,00,000	8,750
14.	280	5,000	14,00,000	4,375
15.	300	15,000	45,00,000	13,125
16.	320	10,000	32,00,000	8,750
Total		2,00,000	328,00,000	1,75,000

Post-issue Advertisements [Regulations 51 & 147]

The lead manager(s) shall ensure that an advertisement giving details relating to:

- subscription,
- basis of allotment,
- number, value and percentage of all applications including ASBA,
- number, value and percentage of successful allottees for all applications including ASBA,
- date of completion of despatch of refund orders, as applicable, or
- instructions to self-certified syndicate banks by the registrar,
- date of credit of specified securities and date of filing of listing application, etc.

is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

The above mentioned details shall also be placed on the websites of the stock exchange(s).

Post-issue responsibility of the lead manager(s) [Regulations 52 & 148]

- The responsibility of the lead manager(s) shall continue until completion of the issue process and for any issue related matter thereafter.
- The lead manager(s) shall regularly monitor redressal of investor grievances arising from any issue related activities.
- The lead manager(s) shall continue to be responsible for post-issue activities till the applicants have received the securities certificates, credit to their demat account or refund of application monies and the listing agreement is entered into by the issuer with the stock exchange and listing or trading permission is obtained.
- The lead manager(s) shall be responsible for and co-ordinate with the registrars to the issue and with various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from syndicate member(s) or collecting bank branches and/ or self-certified syndicate banks, processing of the applications including application form for ASBA and other matters till the basis of allotment is finalised, credit of the specified securities to the demat accounts of the allottees and unblocking of ASBA accounts/ dispatch of refund orders are completed and securities are listed, as applicable.
- Any act of omission or commission on the part of any of the intermediaries noticed by the lead manager(s) shall be duly reported by them to SEBI.
- In case there is a devolvement on the underwriters, the lead manager(s) shall ensure that the notice for devolvement containing the obligation of the underwriters is issued within ten days from the date of closure of the issue.
- In the case of undersubscribed issues that are underwritten, the lead manager(s) shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to SEBI.

Release of subscription money [Regulations 53 & 149]

- The lead manager(s) shall confirm to the bankers to the issue by way of copies of listing and trading approvals that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or release the money for refund in case of failure of the issue.
- In case the issuer fails to obtain listing or trading permission from the stock exchanges where the specified securities were to be listed, it shall refund through verifiable means the entire monies received within 4 days of receipt of intimation from stock exchanges rejecting the application for listing of specified securities, and if any such money is not repaid within 4 days after the issuer becomes liable to repay it, the issuer and every director of the company who is an officer in default shall, on and from the expiry of the fourth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent per annum.
- The lead manager(s) shall ensure that the monies received in respect of the issue are released to the issuer in compliance with the provisions of Section 40 (3) of the Companies Act, 2013, as applicable.

Reporting of transactions of the promoters and promoter group [Regulations 54 & 150]

The issuer shall ensure that all transactions in securities by the promoter and promoter group between the date of filing of the draft offer document or offer document, as the case may be, and the date of closure of the issue shall be reported to the stock exchange(s), within twenty four hours of such transactions.

Post-issue reports [Regulations 55 & 151]

The lead manager(s) shall submit a final post-issue report, along with a due diligence certificate as, within seven days of the date of finalization of basis of allotment or within seven days of refund of money in case of failure of issue.

Restriction on Further Capital Issues [Regulations 56 & 152]

The issuer shall not make any further issue of specified securities in any manner whether by way of a public issue, rights issue, bonus issue, preferential issue, qualified institutions placement or otherwise except pursuant to an employee stock option scheme:

- In case of a fast track issue, during the period between the date of filing the offer document (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies and the listing of the specified securities offered through the offer document or refund of application monies; or
- in case of other issues, during the period between the date of filing the draft offer document and the listing of the specified securities offered through the offer document or refund of application monies;

unless full disclosures regarding the total number of specified securities or amount proposed to be raised from such further issue are made in such draft offer document or offer document, as the case may be.

FAST TRACK FPO [REGULATION 155]

Eligibility

An Issuer Company whose shares are already listed, need not file the draft offer document with SEBI and obtain observations from SEBI, or make a security Deposit with the Stock Exchanges for its follow-on public offer (FPO) if it satisfies the following conditions:

(a)	Listing	The equity shares of the issuer have been listed on any stock exchange for a period of at least three years immediately preceding the reference date.
(b)	Demat Form	Entire shareholding of the promoter group of the issuer is held in dematerialised form on the reference date.
(c)	Market Capitalisaton	The average market capitalisation of public shareholding of the issuer is at least one thousand crore rupees in case of public issue and two hundred and fifty crore rupees in case of rights issue.
(d)	Trading Turnover	The annualised trading turnover of the equity shares of the issuer during six calendar months immediately preceding the month of the reference date has been at least 2% of the weighted average number of equity shares listed during such six months' period. However if the public shareholding is less than 15% of its issued equity capital, the annualised trading turnover of its equity shares has been at least 2% of the weighted average number of equity shares available as free float during such six months' period.

(e)	Delivery based Trading	Annualized delivery-based trading turnover of the equity shares during six calendar months immediately preceding the month of the reference date has been at least 10% of the annualised trading turnover of the equity shares during such six months' period.
(f)	Compliance with LODR	The issuer has been in compliance with the equity listing agreement or SEBI Listing Regulations, 2015, as applicable, for a period of at least three years immediately preceding the reference date. However, if the issuer has not complied with the provisions of the listing agreement or SEBI Listing Regulations, 2015, as applicable, relating to composition of board of directors, for any quarter during the last three years immediately preceding the reference date, but is compliant with such provisions at the time of filing of the red herring prospectus with the Registrar of Companies, and adequate disclosures are made in the red herring prospectusabout such non-compliances during the three years immediately preceding the reference date, it shall be deemed as compliance with the condition. Further, imposition of monetary fines by stock exchange on the issuer shall not be a ground for ineligibility for undertaking issuances under these regulations.
(g)	Investor Complaints	The issuer has redressed at least 95% of the complaints received from the investors till the end of the quarter immediately preceding the month of the reference date.
(h)	No show cause Notices	That no show-cause notices, excluding proceedings for imposition of penalty, have been issued by the Board and pending against the issuer or its promoters or whole time directors as on the reference date.
(i)	No alleged Violations	If the issuer or the promoter or the promoter group or the director of the issuer has settled any alleged violations of securities laws through the settlement mechanism of the Board in the past three years immediately preceding the reference date, then the disclosure of such compliance of the settlement order, shall be made in the offer document.
(j)	Disciplinary Measures	Equity shares of the issuer have not been suspended from trading as a disciplinary measure during last three years immediately preceding the reference date.
(k)	Conflict of Interest	There shall be no conflict of interest between the lead merchant banker(s) and the issuer or its group or associate company in accordance with applicable regulations.
(l)	Audit Qualification	For audit qualifications, if any, in respect of any of the financial years for which accounts are disclosed in the offer document, the issuer shall provide the restated financial statements adjusting for the impact of the audit qualifications. Further, for the qualifications wherein impact on the financials cannot be ascertained, the same shall be disclosed appropriately in the offer document.

"Average Market Capitalisation of Public Shareholding" means the sum of daily market capitalisation of public shareholding for a period of one year up to the end of the quarter preceding the month in which the proposed issue was approved by the shareholders or the board of the issuer, as the case may be, divided by the number of trading days.

Post-listing exit opportunity for dissenting shareholders [Regulations 59 & 157]

- In case of further public offers, including under the fast track route, the promoters or shareholders in control of an issuer shall provide an exit offer to dissenting shareholders as provided for in the Companies Act, 2013, in case of change in objects or variation in the terms of contract related to objects referred to in the offer document as per conditions and manner is provided in Schedule XX of SEBI ICDR Regulations, 2018;
- The exit offer shall not apply where there are neither identifiable promoters nor shareholders in control of the listed issuer.

EXIT OPPORTUNITY TO DISSENTING SHAREHOLDERS [SCHEDULED XX]

The provisions of this Chapter shall apply to an exit offer made by the promoters or shareholders in control of an issuer to the dissenting shareholders in terms of section 13(8) and section 27(2) of the Companies Act, 2013, in case of change in objects or variation in the terms of contract referred to in the offer document.

However, the provisions of this Chapter shall not apply where there are neither identifiable promoters nor shareholders in control of the listed issuer.

What is Dissenting Shareholder?

"Dissenting Shareholder" mean those shareholders who have voted against the resolution for change in objects or variation in terms of a contract, referred to in the offer document of the issuer.

Conditions for exit offer

The promoters or shareholders in control shall make the exit offer in accordance with the provisions as specified, to the dissenting shareholders, in cases only if a public issue has opened after April 1, 2014; if:

- the proposal for change in objects or variation in terms of a contract, referred to in the offer document is dissented by at least 10 % of the shareholders who voted in the general meeting; and
- the amount to be utilized for the objects for which the offer document was issued is less than 75 % of the amount raised (including the amount earmarked for general corporate purposes as disclosed in the offer document).

Eligibility of Shareholders for availing the exit offer

Only those dissenting shareholders of the issuer who are holding shares as on the relevant date shall be eligible to avail the exit offer.

Exit offer price

The 'exit price' payable to the dissenting shareholders shall be the highest of the following:

a) the volume-weighted average price paid or payable for acquisitions, whether by the promoters or shareholders having control or by any person acting in concert with them, during the fifty-two weeks immediately preceding the relevant date;

b) the highest price paid or payable for any acquisition, whether by the promoters or shareholders having control or by any person acting in concert with them, during the twenty-six weeks immediately preceding the relevant date;

c) the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the relevant date as traded on the recognised stock exchange where the maximum volume of trading in the shares of the issuer are recorded during such period, provided such shares are frequently traded;

d) where the shares are not frequently traded, the price determined by the promoters or shareholders having control and the merchant banker taking into account valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such issuers.

Manner of providing exit to Dissenting Shareholder

- The notice proposing the passing of special resolution for changing the objects of the issue and varying the terms of contract, referred to in the prospectus shall also contain information about the exit offer to the dissenting shareholders.
- In addition to the disclosures required under the provisions of section 102 of the Companies Act, 2013 read with rule 32 of the Companies (Incorporation) Rules, 2014 and rule 7 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 and any other applicable law, a statement to the effect that the promoters or the shareholders having control shall provide an exit opportunity to the dissenting shareholders shall also be included in the explanatory statement to the notice for passing special resolution.
- After passing of the special resolution, the issuer shall submit the voting results to the recognised stock exchange(s), in terms of the provisions of regulation 44(3) of SEBI (LODR) Regulations, 2015.
- The issuer shall also submit the list of dissenting shareholders, as certified by its compliance officer, to the recognised stock exchange(s).
- The promoters or shareholders in control, shall appoint a merchant banker registered with SEBI and finalize the exit offer price in accordance with these regulations.
- The issuer shall intimate the recognised stock exchange(s) about the exit offer to dissenting shareholders and the price at which such offer is being given.
- The recognised stock exchange(s) shall immediately on receipt of such intimation disseminate the same to public within one working day.
- To ensure security for performance of their obligations, the promoters or shareholders having control, as applicable, shall create an escrow account which may be interest bearing and deposit the aggregate consideration in the account at least two working days prior to opening of the tendering period.
- The tendering period shall start not later than seven working days from the passing of the special resolution and shall remain open for ten working days.
- The dissenting shareholders who have tendered their shares in acceptance of the exit offer shall have the option to withdraw such acceptance till the date of closure of the tendering period.
- The promoters or shareholders having control shall facilitate tendering of shares by the shareholders and settlement of the same through the recognised stock exchange mechanism as specified by SEBI for the purpose of takeover, buy-back and delisting.
- The promoters or shareholders having control shall, within a period of ten working days from the last date of the tendering period, make payment of consideration to the dissenting shareholders who have accepted the exit offer.
- Within a period of two working days from the payment of consideration, the issuer shall furnish to the recognised stock exchange(s), disclosures giving details of aggregate number of shares tendered, accepted, payment of consideration and the post-offer shareholding pattern of the issuer and a report by the merchant banker that the payment has been duly made to all the dissenting shareholders whose shares have been accepted in the exit offer.

Maximum permissible non-public shareholding

In the event, the shares accepted in the exit offer were such that the shareholding of the promoters or shareholders in control, taken together with persons acting in concert with them pursuant to completion of the exit offer results in their shareholding exceeding the maximum permissible non-public shareholding, the promoters or shareholders in control, as applicable, shall be required to bring down the non-public shareholding to the level specified and within the time permitted under Securities Contract (Regulation) Rules, 1957.

Rule 19 A of SCRR prescribes that every listed company other than public sector company shall maintain public shareholding of at least 25%.

Where the public shareholding in a listed company falls below 25%. at any time, such company shall bring the public shareholding to 25% within a maximum period of twelve months.

INITIAL PUBLIC OFFER BY SMALL AND MEDIUM ENTERPRISES (SME) [CHAPTER IX OF SEBI (ICDR) REGULATIONS, 2018]

If post issue paid-up capital <= Rs. 10 Crores - Listing only on SME Board

If post issue paid-up capital is > Rs. 10 crores but up to Rs. 25 crores - Option to list either on SME Board or on Main Board

SEBI does not issue any observation on the offer document

The lead manager(s) shall submit a due-diligence certificate to SEBI

IPO shall be 100% underwritten. The lead manager(s) shall underwrite at least 15%

Compulsory market making for a minimum period of 3 years from the date of listing

Minimum application size in IPO & Trading lot shall be one lakh rupees

May migrate to Main Board if SR is passed through postal ballot with majority of minority

INNOVATORS GROWTH PLATFORM [CHAPTER X OF SEBI (ICDR) REGULATIONS, 2018

Aimed to list start-ups which are intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platform

At least 25% of pre-issue capital is held by QIBs, Innovators Growth Platform Investors, Any other class of investors as specified by SEBI

Listing is allowed with or without IPO. SEBI will issue its observations in both the cases

The minimum offer size shall be ten crore rupees in case of IPO

Minimum application size shall be two lakh rupees and in multiples thereof

Number of allottees in the initial public offer shall at least be 50

Minimum trading lot shall be two lakh rupees and in multiples thereof.

An issuer shall be eligible for listing on the Innovators Growth Platform if none of the promoters or directors of the issuer company is a fugitive economic offender.

Additional conditions in terms of allotment, for listing with public issue:

- Any under-subscription in the non-institutional investor category shall be available for subscription under the institutional investors' category.
- The issuer may allocate up to sixty per cent of the issue size on a discretionary basis, prior to the issue opening, to eligible investors as identified under sub-regulation (1) of regulation 283, in accordance with the requirements with respect to anchor investors for public issue made on the SME exchange as may be specified

DOCUMENTATION FOR IPO/FPO

The stage wise documentation for IPO/FPO is as follows:

- In principal Approval Stage
- Basis of Allotment Stage
- Listing & Trading Approval Stage.

IPO/FPO Draft Prospectus/RHP clearance

Along with the application for seeking in-principle approval of the Exchange to use name of the Exchange in the offer document, the following documents/information shall to be filed by the Company with the Exchange:

1. 05 copies of the draft offer document.
2. Copy of resolution passed by the Board of Directors for issue of securities and by the shareholders at the AGM/ EGM authorising the issue of securities to the public.
3. Copy of the letter vide which the draft Offer Document was filed with SEBI. Acknowledgement through which the Draft Offer Document was filed with SEBI.
4. Latest date/period up to which the information has been incorporated in the draft offer document. Date of opening of public issue to be intimated as soon as it is finalized.
5. Undertaking form BRLM(s) / Lead Manager(s) confirming that the draft offer document contains:
   a. All material disclosures which are true and adequate to enable the applicants to take an informed investment decision;

b. All the disclosures that are specified under the Companies Act, 2013; and

c. All the disclosures that are specified under Part A of Schedule VI of the SEBI (ICDR) Regulations, 2018.

6. In case of Individuals, PAN, TAN, Bank Account Number, Passport Number of the Promoters and in case the promoter is a body corporate, PAN , bank account number, company registration number or equivalent and the address of the Registrar of Companies with which the promoter is registered.

7. Printed Balance Sheets, Profit & Loss Accounts and Cash Flow Statements for the preceding 5 years.

8. Following Certificates to be submitted by the Lead Manager(s):

   a) A due Diligence Certificate as per Form A of Schedule V of SEBI (ICDR) Regulations, 2018 submitted to SEBI.

   b) In case of Issue of Convertible Debt Instruments, a due diligence certificate from the debenture trustee as per Form B of Schedule V of SEBI (ICDR) Regulations, 2018.

9. A statement containing particulars of the dates of, and parties to all the material contracts, agreements (including agreement for technical advice and collaboration), concessions and similar other documents (except those entered into in the ordinary course of business carried on or intended to be carried on by the company) together with a brief description of the terms, subject matter and general nature of the documents. The copies of the aforesaid material contracts or documents which are received/ executed/ in-hand should be kept ready and be available for inspection. The Company should also state the place, time and date where these documents can be inspected.

10. Name of the exchange which is proposed to be designated by the Company as the lead exchange, for the purposes of approval of the basis of allotment, and for depositing the security deposit as required under the listing conditions of the exchanges.

11. Copy of Form 32/DIR 12 filed with the ROC for appointment of directors and company secretary.

12. Memorandum & Articles of Association of the Company.

13. Confirmation from the Issuer Company and BRLM(s)/ Lead Manager(s) confirming that:

   - The Company is eligible to make an issue under SEBI (ICDR) Regulations, 2018 and is in compliance with Regulation 5 and 7 of said regulations.

   - The Company is in compliance with all the eligibility criteria of the Exchange for listing on Main Board.

   - The Company is in compliance with the eligibility requirement for an IPO as laid down under Regulation 6(1) or Regulation 6(2) of SEBI (ICDR) Regulations 2018 as may be applicable. Further in case of issues filed under Regulation 6 (2) of SEBI (ICDR) Regulations 2018, and the applicant company will allot at least 75% of the net offer to Qualified Institutional Buyers and will refund the full subscription money if it fails to do so.

   - In case of offer for sale of shares in proposed IPO by the existing shareholders, the selling shareholders are in compliance with the Additional Conditions for an Offer for Sale laid down under Regulation 8 of SEBI (ICDR) Regulations, 2018.

   - There are no restrictive clauses in the Articles of Association of the Company.

   - The provisions of the Memorandum and Articles of Association are not inconsistent with the clauses of the Listing agreement or any other applicable law, Rules or Regulations.

- For the proposed IPO, the company has complied with all the statutory requirements including requirements of the Companies Act, 2013, SEBI Act, 1992, RBI Guidelines, SEBI (ICDR) Regulations, 2018 etc. and no statutory authority has restrained the company from issuing its securities to public through IPO.

14. The company has appointed <name > as compliance officer in term of Regulation 23(8) of SEBI (ICDR) Regulations, 2018 and his contact details are given hereunder: <Provide contact details>.

15. A certificate from the statutory auditor/practicing chartered accountant certifying compliance of conditions of Corporate Governance as stipulated SEBI (LODR) Regulations, 2015. The company should also give the composition of various committees as required under the said clause.

16. Complete details of any outstanding ESOP and other employee benefit schemes and a confirmation from Merchant Bankers & Statutory Auditor that said schemes are in compliance with the requirement of the SEBI (Share Based Employee Benefits) Regulations, 2014.

17. The Company shall undertake to inform the Exchange forthwith of any material development which takes place after the filing of the application with the Exchange but prior to the issue of the in-principle approval that may render the information provided to the Exchange (whether in the application or otherwise) incorrect or outdated or which otherwise has a bearing on the proposed issue of securities.

18. If Company had filed the IPO documents with BSE in past , kindly provide details of the same. Also, provide following details of its listed group companies:

    1. Name of the Company
    2. ISIN Number
    3. Name of the Exchange, where it is listed
    4. Scrip Code/Scrip Symbol
    5. If under suspension Reason for suspension.

19. Processing Fees

20. Undertaking from MD/ CS/ Compliance Officer of the company stating:

    a) We hereby confirm that the company or its promoters or whole time directors are not in violation of the provisions of the SEBI Delisting Regulations, 2021.

    b) We hereby confirm that the company, its promoters, its directors are not in violation of the restrictions imposed by SEBI under SEBI circular no. SEBI/HO/ MRD/DSA/CIR/P/2017/92 dated August 01, 2017.

    c) The dividend entitlement for the current year for all the existing shares including the shares issued in the public issue shall rank *pari-passu*.

Basis of Allotment

1. One soft Copy of final prospectus filed with ROC along with its acknowledgement copy.
2. Proceeding details / minutes of basis of allotment, verified and signed by R & T Agent, BRLM (Responsible for post issue) and the Issuer along with the reasons for exception to rejection cases.
3. Category wise, summary of list of “technical rejection” cases Specifying - Application No., Category, Name & Add., Pan #, DP ID, CL ID, Quantity, price Amount and reason for rejection.

4. Copy of the statutory advertisement released in respect of the public issue / offer for sale, opening and closing of the issue, price revision, if any etc. upto the stage of basis of allotment.
5. Auditor's certificate for the following:
   (a) Receipt of the minimum promoter's contribution, if applicable with date and amount.
   (b) If minimum promoter's has been brought in by alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India, as specified under Regulation 14(1) of SEBI (ICDR) Regulation, 2018, bifurcation of the same shall be provided with date of receipt of the same from each of the party with percentage to the post issue capital. Further, a confirmation that the same is in compliance with the requirement of SEBI (ICDR) Regulations, 2018.
6. Declaration from the Managing Director / Company Secretary that there is no injunction / prohibition order of a competent court of law on the issue or on a part of any particular category of the issue.
7. Confirmation that:
   – Only QIBs as mentioned under the definition in SEBI ICDR, regulation 2018 are proposed to be allotted equity shares under QIB category.
   – No QIB has Bid and proposed to be allotted equity shares under non-QIB or retail category.
8. The Basis of allotment has been prepared in compliance with SEBI (ICDR) Regulations, 2018 and for its issue the company has complied with said regulation and all other statutory requirement.
9. Verification of all the final certificates issued by the controlling branch and the same have been found in order.
10. The validation of the electronic bid details with the depository's records for DP ID, client ID and PAN.
11. If Approval from SEBI is sought for relaxation in PAN mismatch applications, then copy of SEBI approval letter as well as the true copy of request letter to SEBI, should be submitted.

Checklist for listing IPO

Documents to be submitted on T+2 days (i.e. within 2 working days from the closure of the issue)

1. All due diligence certificates with SEBI by Merchant banker(s).
2. Observation Letter issued by SEBI pursuant to filing of draft offer document.
3. List of authorized signatories along with their specimen signatures.
4. Confirmation from Lead Managers that devolvement notices have been sent to underwriters (applicable if the issue has devolved).
5. Certificate from the BRLM(s) that the issue has received minimum subscription as specified under Regulation 45 (1) of SEBI (ICDR) Regulations, 2018.
6. Confirmation from the company regarding the email ID for Investor Grievances as per Regulation 46 of SEBI (LODR), Regulations, 2015.
7. Copies of all advertisements published in connection with the issue upto T+1 stage.
8. Confirmation from the company stating that they have obtained authentication for SCORES from SEBI as per Regulation 13 of LODR Regulations, 2015.

Documents to be submitted before T+3 days (i.e., within 3 working days from the closure of the issue

The documents as per Basis of Allotment checklist.

The following documents to be submitted before T+4 days (i.e. within 4 working days from the closure of the issue):

1. One Copy of final prospectus filed with ROC alongwith ROC filing acknowledgement copy.
2. Certified true copy of the basis of allotment approved by the Designated Stock Exchange.
3. Copy of Internal Minutes executed in between Lead Manager, Issuer and Registrar.

Documents to be submitted before T+4 days (i.e., within 4 working days from the closure of the issue

1. Letter of listing application.
2. Listing Agreement as per SEBI (LODR) Regulations, 2015 duly executed on non-judicial stamp paper along with certified true copy of the resolution passed by the Board of Directors for authorizing officer to sign and execute the listing agreement.
3. Certified true copy of the resolution passed by the Board of Directors for allotment of securities (the resolution should specifically make a mention of total number of Securities allotted/allocated by the issuer).
4. Certificate from statutory Auditors/Practicing Chartered Accountant/ Practicing Company Secretary stating that:
   a) Allotment has been made as per the basis of allotment approved by the Designated Stock Exchange.
   b) The share certificates corresponding to equity Securities under lock in have been enfaced with non- transferability condition, as per format given below:

Number of Securities	*Distinctive numbers range*		*Lock-in Date*	
	From	*To*	*From*	*To*

   c) Allotment of shares from the employees' quota has been made to permanent/regular employees of the company and of the promoter companies, as on the date of the opening of the public issue and who are entitled to such allotment.
5. If Pre-IPO shares are held in physical form, then confirmation from RTA to the issue that the Pre- IPO shares held in physical form are locked-in in their system upto the dates mentioned as per the table shown below. Further, the RTA should confirm that as and when the physical share certificates, if received for dematerialization will be locked in upto the dates as mentioned below:

Number of Securities	*Distinctive numbers range*		*Lock-in Date*	
	From	*To*	*From*	*To*

6. Lock-in confirmation from depositories for pre-IPO equity shares held in dematerialized form.
7. In case Securities issued (including anchor investors) in dematerialized form are under lock-in, then a certificate from the depositories must be furnished stating that the Securities are under lock-in confirming the date upto which they are under lock-in (applicable only in cases where the equity Securities issued are under lock in).
8. Shareholding pattern of company (pre issue, issue and post issue) in format given as per Regulation 31 of SEBI (LODR), Regulations, 2015 with PAN. **Also provide Post issue shareholding pattern (without PAN).**
9. Copies of all statutory advertisements published till date.
10. Certification of Compliance with Regulation 17-27 of the SEBI (LODR) Regulations, 2015 relating to Corporate Governance and **if there is any change after In-Principle Approval kindly highlight the same.**
11. Details of Current Issue in the format showing category-wise Gross, Valid & Allotted applications & equity shares.
12. Initial Listing Fees, Annual Listing Fees.
13. Confirmation from the issuer for the following:
    - That the copies of all advertisements published as regards the present issue have been submitted to the Exchange.
    - That the issuer is compliant with the requirement of common agency as specified by SEBI.
    - That all securities required to be under lock-in are subjected to lock-in, as mentioned in Offer Document for the issue.
14. Certified true copy of the additional material contracts and documents (mentioned in the final offer document/ Prospectus) which have not been submitted earlier with the Exchange including SEBI observation letter. (Soft copy for all the material contracts and documents)
15. Confirmation from the Lead Manager and Issuer confirming that the issue in compliance with all requirements of Companies Act, 2013, SEBI (ICDR) Regulations, 2018 and any other applicable law(s), Rules and Regulations and no statutory authority has restrained the Company from issuing and listing of shares pursuant to present issue.
16. Soft copy of total securities issued by the Issuer (in MS-Excel & pdf file format only thru email).
17. List of all allottees, addresses, category wise & sub-category wise, (QIB/HNI/Retail/Reserved category) along with number of shares applied, allotted, amount paid, bank account details, PAN number, Demat account details etc.
18. Confirmation from the company stating that they have obtained authentication for SCORES from SEBI as per Regulation 13 of SEBI (LODR) Regulations, 2015.
19. Confirmation from RTA on the total quantum of non-syndicate member(NSM) commission payable as per SEBI circular CIR/CFD/14/2012 dated Oct. 4, 2012 in the captioned issue. The calculation format for determining the quantum of commission should be as per the aforesaid SEBI circular.

    The commission payment instruction - dat file format has to be forwarded from the RTA/Issuer/BRLM once the NSM commission calculation process is completed.
20. Confirmation from the issuer on the transfer of the NSM commission amount to the Bank Account of the Exchange.

21. Confirmation from the issuer on the transfer of the NSM commission amount to the Bank Account of the Exchange.
22. Date of Listing & Scrip Symbol (max 10 alphabets).
23. Undertaking from MD/ CS/ Compliance Officer of the company stating:
    a) *"We hereby confirm that the company or its promoters or whole time directors are not in violation oy the provisions of the SEBI Delisting Regulations, 2021."*
    b) *"We hereby confirm that the company, its promoters, its directors are not in violation of the restrictions imposed by SEBI under SEBI circular no. SEBI/HO/ MRD/DSA/CIR/P/2017/92 dated August 01, 2017."*
24. CIN, PAN, TAN & GSTIN of the Company.
25. DIN & PAN of Promoters and Directors.

Documents to be submitted before T+5 days (i.e., within 5 working days from the closure of the issue

1. Certified true copy of the letter from Registrars and lead manager regarding dispatch of share/ debenture/ warrant certificates, allotment advice, refund orders, underwriting commission, uploading of electronic credit of Securities, uploading of ECS/NEFT/RTGS credits and brokerage warrants.
2. Confirmation from the depositories regarding the credit of beneficiary accounts of the security holders.
3. Certificate from the Registrar reconciling the total securities allotted with the total securities credited, and securities that have failed to be credited.
4. Basis of allotment advertisement.

RIGHTS ISSUE

Unless otherwise provided, SEBI (ICDR) Regulations, 2018 shall apply to a rights issue by a listed issuer, where the aggregate value of the issue is fifty crore rupees or more.

"Right Issue" means an offer of specified securities by a listed issuer to the shareholders of the issuer on the record date fixed for the said purpose.

However, in case of rights issue of size less than Rs. 50 crore, the issuer shall prepare the letter of offer in accordance with requirements a specified in SEBI (ICDR) Regulations, 2018 and file the same with SEBI for information and dissemination on SEBI's website.

Eligibility Conditions [Regulation 61]

An issuer shall not be eligible to make a rights issue of specified securities:

Eligibility Conditions

(a) if the issuer, any of its promoters, promoter group or directors of the issuer are debarred from accessing the capital market by SEBI;

(b) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by SEBI;

(c) if any of its promoters or directors is a fugitive economic offender.

It may be noted that the restrictions imposed under (a) & (b) will not apply to the persons or entities mentioned therein who were debarred in the past by SEBI and the period of debarment is already over as on the date of filing of the draft letter of offer with SEBI.

Conditions [Regulation 62]

The issuer making a rights issue of specified securities shall ensure that:

(a) it has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange,

(b) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited and

(c) it has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for the specified project proposed to be funded from issue proceeds, excluding the amount to be raised through the proposed rights issue or through existing identifiable internal accruals.

Explanation - For the purpose of this regulation 'finance for the specific project' shall mean finance of capital expenditures only.

- The amount for general corporate purposes, as mentioned in the object of the issue in the draft letter of offer and the letter of offer, shall not exceed 25%of the amount raised by the issuer.
- Where the issuer or any of its promoters or directors is a wilful defaulter, the promoters or promoter group of the issuer shall not renounce their rights except to the extent of renunciation within the promoter group.

The amount for:

(i) general corporate purposes, and

(ii) such objects where the issuer company has not identified acquisition or investment target, as mentioned in objects of the issue in the draft offer document and the offer document,

shall not exceed 35% of the amount being raised by the issuer. Provided that the amount raised for such objects where the issuer company has not identified acquisition or investment target, as mentioned in objects of the issue in the draft offer document and the offer document, shall not exceed 25% of the amount being raised by the issuer. Provided further that such limits shall not apply if the proposed acquisition or strategic investment object has been identified and suitable specific disclosures about such acquisitions / investments are made in the draft offer document and the offer document at the time of filing of offer documents.

Where the issuer or any of its promoters or directors is a wilful defaulter or a fraudulent borrower, the promoters or promoter group of the issuer shall not renounce their rights except to the extent of renunciation within the promoter group.

Where the issuer has issued SR equity shares to its promoters or founders, then such a SR shareholder shall not renounce their rights and the SR shares received in a rights issue shall remain under lock-in until conversion into equity shares having voting rights same as that of ordinary equity shares along with existing SR equity shares.

Record Date [Regulation 68]

- A listed issuer making a rights issue shall announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue for such period as may be specified in SEBI (LODR) Regulations, 2015.
- The issuer shall not withdraw rights issue after announcement of the record date. If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period of twelve months from the record date already announced.

- The issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities, ESOPs or exercise of warrants issued prior to the announcement of the record date, on the stock exchange where its securities are listed.

OTHER REQUIREMENTS WITH RESPECT TO THE RIGHT ISSUE

Appointment of Lead Managers and Other Intermediaries [Regulation 69]

The issuer shall appoint one or more merchant bankers, which are registered with the Board, as lead manager(s) to the issue. The issuer shall appoint a registrar to the issue registered with the SEBI, which has connectivity with all the depositories. Provided that if the issuer itself is a registrar, it shall not appoint itself as a registrar to the issue. Provided further that a lead manager shall not act as a registrar to the issue in which it is also handling the post-issue responsibilities.

Disclosures in the draft letter of offer and letter of offer [Regulation 70]

The draft letter of offer and letter of offer shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision. The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft letter of offer and the letter of offer.

Filing of the draft letter of offer and letter of offer [Regulation 71]

Prior to making a rights issue, the issuer shall, except in case of a fast track issue, file a draft letter of offer, with SEBI, along with fees as specified, with SEBI and with the stock exchange(s), through the lead manager(s). If SEBI specifies any changes or issues observations on the draft letter of offer the issuer and lead manager(s) shall carry out such changes in the draft letter of offer and shall submit to SEBI an updated draft letter of offer complying with the observations issued by the Board and highlighting all changes made in the draft letter of offer before filing the letter of offer with the stock exchanges.

Draft letter of offer and letter of offer to be available to the public [Regulation 72]

The draft letter of offer filed with SEBI shall be made public for comments, if any, for a period of at least 21 days from the date of filing, by hosting it on the websites of the issuer, SEBI, stock exchanges where specified securities are proposed to be listed and the lead manager(s) associated with the issue.

The issuer shall, within 2 days of filing of the draft letter of offer with SEBI, make a public announcement in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing to the public the fact of filing of the draft letter of offer with SEBI and inviting the public to provide their comments to the Board, the issuer or to the lead manager(s) in respect of the disclosures made in the draft letter of offer.

Pricing [Regulation 73]

- The issuer shall decide the issue price, in consultation with the lead manager(s), before determining the record date, which shall be determined in accordance with the designated stock exchange.
- The issue price shall not be less than the face value of the specified securities.
- The issue shall disclose the issue price in the letter of offer filed with SEBI and the stock exchanges.

Reservation [Regulation74]

- The issuer shall make a rights issue of equity shares only if it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof.
- The equity shares so reserved for the holders of fully or partly compulsorily convertible debt instruments shall be issued to the holder of such convertible debt instruments at the time of conversion of such convertible debt instruments, on the same terms at which the equity shares offered in the rights issue were issued. For the purposes of offering such rights entitlements, the issuer company shall not be required to credit rights entitlements.
- Subject to other applicable provision of these regulations, the issuer may make reservation for its employees along with rights issue subject to the condition that the value of allotment to any employee shall not exceed two lakhs rupees.

However, in the event of under-subscription in the employee reservation portion, the unsubscribed portion may be allotted on a proportionate basis, for a value in excess of two lakhs rupees, subject to the total allotment to an employee not exceeding five lakhs rupees.

Abridged Letter of Offer [Regulation 75]

- ➢ The abridged letter of offer shall contain the disclosures as specified in Part F of Schedule VI by SEBI (ICDR), Regulations, 2018 and shall not contain any matter extraneous to the contents of the letter of offer.
- ➢ Every application form distributed by the issuer or any other person in relation to the issue shall be accompanied by a copy of the abridged letter of offer.

ASBA [Regulation 75]

An applicant to the rights issue shall do so only through the ASBA facility, which facility shall be provided by the issuer in the manner specified by SEBI:

Provided that payment through any other electronic banking mode shall be permitted in respect of an application made for any reserved portion outside the issue period.

Availability of letter of offer and other issue materials [Regulation 77]

- The lead manager(s) shall ensure availability of the letter of offer and other issue material including application forms with stock exchanges, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, and underwriters, bankers to the issue, investors' associations and self certified syndicate banks before the opening of the issue.
- The abridged letter of offer, along with application form, shall be despatched through registered post or speed post or by courier service or by electronic transmission to all the existing shareholders at least three days before the date of opening of the issue.
- The letter of offer shall also be provided by the issuer or lead manager(s) to any existing shareholder who makes a request in this regard.

Credit of Rights Entitlements and Allotment of Specified Securities [Regulation 77A]

(1) The rights entitlements shall be credited to the demat account of the shareholders before the date of opening of the issue.

(2) Allotment of specified securities shall be made in the dematerialised form only.

Conditions for making applications on plain paper [Regulation 78]

- Shareholders who have not received the application form may make an application in writing on a plain paper, along with the requisite application money.
- Shareholders making an application on plain paper shall not be entitled to renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently.
- If a shareholder makes an application both in an application form as well as on a plain paper, both applications are liable to be rejected.

Underwriting [Regulation 81]

If the issuer desires to have the issue underwritten, it shall appoint merchant bankers or stock brokers, registered with the Board, to act as underwriters. However, the issue can be underwritten only to the extent of entitlement of shareholders other than the promoters and promoter group.

In case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.

Issue-related advertisements [Regulation 84]

The issuer shall issue an advertisement in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation, at the place where registered office of the issuer is situated and also give an intimation to the stock exchanges for dissemination on their websites, at least 2 days before the date of opening of the issue, disclosing the following:

- the date of completion of despatch of abridged letter of offer and the application form;
- the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;
- a statement that if the shareholders entitled to receive the rights entitlements have neither received the original application forms nor are in a position to obtain the form; they may make an application through the form available on the website of Registrar, stock exchanges or lead managers or in writing on a plain paper to subscribe to the Rights Issue along with a format specifying therein the necessary particulars such as name, address, ratio of rights issue, issue price, number of equity shares held, ledger folio numbers, depository participant ID, client ID, number of equity shares entitled and applied for, additional shares if any, and the amount to be blocked with SCSB along with the application;
- a statement to the effect that if the shareholder makes an application on plain paper and also on application form both his applications shall be liable to be rejected at the option of the issuer.

During the period the issue is open for subscription, no advertisement shall be released giving an impression that the issue has been fully subscribed or oversubscribed, or indicating investors' response to the issue. An announcement regarding closure of issue shall be made only after the lead manager(s) is satisfied that at least 90%. of the offer through letter of offer has been subscribed and a certificate has been obtained to that effect from the registrar to the issue.

However, such an announcement shall not be made before the date on which the issue is to be closed except for issue closing advertisement made in the format prescribed in these regulations.

Subscription Period [Regulation 87]

A rights issue shall be open for subscription for a minimum period of 7 days and for a maximum period of 30 days and no withdrawal of application shall be permitted after the issue closing date.

Payment Option [Regulation 88]

The issuer shall give one of the following payment options to all the shareholders for each type of instrument:

- part payment on application with balance money to be paid in calls; or
- full payment on application.

However, where the issuer has given the part payment option to investors, the part payment on application shall not be less than 25% of the issue price and such issuer shall obtain the necessary regulatory approvals to facilitate the same.

Provided further that payment of balance money in calls, outside the issue period, may be through electronic banking modes.

Procedure for making a Rights Issue

The various steps involved for issue of rights share are enumerated below:

- Check whether the rights issue is within the authorised share capital of the company. If not, steps should be taken to increase the authorised share capital.
- Issue Notice of Board Meeting to all the directors of company at least 7 days before the date of Board Meeting.
- Notify the stock exchange concerned the date of Board Meeting at which the rights issue is proposed to be considered at least 2 days in advance of the meeting.
- Convene another Board Meeting which shall decide on the following matters:
  - Quantum of issue and the proportion of rights shares.
  - Alteration of share capital, if necessary, and offering shares to persons other than existing holders of shares in terms of Section 62 of the Companies Act, 2013.
  - Fixation of record date.
  - Appointment of merchant bankers and underwriters.
  - Approval of draft letter of offer or authorisation of managing director/ company secretary to finalise the letter of offer in consultation with the managers to the issue, the stock exchange and SEBI.
- Immediately after the Board Meeting notify the concerned Stock Exchanges about particulars of Board of Directors decision.
- File a draft letter of Offer with SEBI and obtain Observations (if any) and incorporate the same in the Letter offer.
- Rights issue shall be kept open for at least 7 days and not more than 30 days.

- File a copy of the letter of offer with the stock exchange where the shares of the company are listed and obtain the In-principle approval for listing of equity shares to be issued under the proposed Rights Issue.
- Dispatch letters of offer and the Composite Application Form to shareholders by registered post.
- Check that an advertisement giving date of completion of dispatch of letter of offer has been released in at least an English National Daily, one Hindi National Paper and a Regional Language Daily where registered office of the issuer company is situated and that the shareholder can apply on plain paper if he does not receive the application form.
- The advertisement should state that applications of shareholders who apply both on plain paper and also in a composite application form are liable to be rejected.
- Make arrangement with bankers for acceptance of share application forms.
- Finalise the allotment in consultation with Stock Exchange.
- Convene Board Meeting and make allotment of shares.
- Make an application to the Stock Exchange(s) where the company's shares are listed for permission of listing of new shares.

Introduction of dematerialized Rights Entitlements (REs)

SEBI has vide its Circular dated January 22, 2020 introduced dematerialized Rights Entitlements (REs). Salient points related to dematerialized Rights Entitlements and its trading on stock exchange platform are given hereunder:

1. In the letter of offer and the abridged letter of offer, the issuer shall disclose the process of credit of REs in the demat account and renunciation thereof.
2. REs shall be credited to the demat account of eligible shareholders in dematerialized form.
3. In REs process, the REs with a separate ISIN shall be credited to the demat account of the shareholders before the date of opening of the issue, against the shares held by them as on the record date.
4. Physical shareholders shall be required to provide their demat account details to Issuer /Registrar to the Issue for credit of REs not later than two working days prior to the issue closing date, such that credit of REs in their demat account takes place at least one day before the issue closing date.
5. REs shall be traded on secondary market platform of Stock exchanges, withT+2 rolling settlement, similar to the equity shares. Trading in REs on the secondary market platform of stock exchanges shall commence along with the opening of the issue and shall be closed at least four days prior to the closure of the rights issue.
6. Investors holding REs in dematerialized mode shall be able to renounce their entitlements by trading on stock exchange platform or off-market transfer. Such trades will be settled by transferring dematerialized REs through depository mechanism, in the same manner as done for all other types of securities.

GENERAL OBLIGATIONS OF THE ISSUER AND THE INTERMEDIARY IN CASE OF PUBLIC ISSUE AND RIGHTS ISSUE

– No person connected with the issue shall offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application for allotment of specified securities.

– All public communications, publicity materials, advertisements and research reports shall comply with the requirements as specified in ICDR Regulations, 2018.

– The lead manager and the Issuer Company shall ensure that the contents of the offer document as hosted on their web sites are the same as the printed versions filed with the Registrar of Companies and shall also ensure that the copies of the same are available to the public.

– The post-issue lead merchant banker shall actively associate himself with post-issue activities such as allotment, refund, despatch and giving instructions to syndicate members, Self Certified Syndicate Banks and other intermediaries and shall regularly monitor redressal of investor grievances arising therefrom.

– The Issuer company shall appoint a Compliance Officer, who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

DOCUMENTATION FOR RIGHTS ISSUE

Pre Issue Formalities

The following document should be submitted to obtain in-principle approval for the proposed Rights issue:

1. Covering letter making application for In-principle approval for the proposed Rights issue of the company.
2. Certified true copy of the resolution passed by the Board of Directors for issue of securities under proposed rights issue/ approving the proposed fast track rights issue.
3. Certified true copy of the resolution passed by the Shareholders, if any;
   a. for issue of securities under proposed rights issue/ fast track rights issue.
   b. increase in the authorised share capital (if required).
4. Permanent Account Number, bank account number and passport number of its promoters where they are individuals, and Permanent Account Number, bank account number, company registration number or equivalent and the address of the Registrar of Companies with which the promoter is registered, where the promoter is a body corporate.
5. Undertaking from the Company Secretary/Compliance Officer of the issuer as per the following format:

   "Neither the issuer nor any of its promoters or directors is a wilful defaulter as defined SEBI (ICDR) Regulations, 2018"; OR

   "<Name of the issuers / <name>, the promoter(s) of the issuer / <name> the director(s) of the issuer is a wilful defaulter as defined under SEBI (ICDR) Regulations, 2018 and disclosures in this regard has been made at <p1ace of disclosures.as per the format given in said regulation."
6. Certificate from all Lead Manager/Merchant Banker confirming the following:
   a) The issuer is eligible to make a rights issue of securities under SEBI (ICDR) Regulations, 2018;
   b) For the proposed rights issue the issuer has complied with all the statutory formalities including the requirements of Companies Act, 2013, SEBI (ICDR) Regulations, 2018 etc. and no statutory authority has restrained the company from coming up with the proposed rights issue.
7. Compliance with Regulation 99 (in case of fast track rights issue).
8. 10 Copies of Draft Letter of Offer along with a soft copy on CD.
9. Processing fees.

Formalities before Issue Opening - Right Issue

1. 10 Copies of Final Letter of Offer along with Composite Application Form ("CAF")
2. ASBA Fees
3. 1% Security Deposit
4. A request letter from Company/LM for activation of Right Renunciation Facility on the Stock Exchange (if required)

Post Issue Formalities - Right Issue

Checklist of documents for Basis of allotment

Company has to finalise the basis of allotment, and submit the documents as under, within 10 days from closure of the issue:

1. Bid data of Exchanges other than the designated stock exchange.
2. All rejections application along with Summary statement (1 set photocopy to be submitted).
3. Certified copies of all Bank final certificates (ASBA & NON ASBA).
4. Minutes of Basis of allotment duly signed by all the Lead Manager, Registrar and the Company.
5. Basis of allotment sheet for each category.
6. Round summary in case of over subscription, in hard as well as soft format.
7. Copy of post issue initial monitoring report filed with SEBI (3 days monitoring report).
8. Undertaking from Lead Manager, Company and the Registrar.
9. Pre Allotment shareholding and Post proposed Allotment Shareholding pattern as per Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
10. The calculation of ex right price by the Statutory Auditor/ Practicing Company Secretary/ Practicing Chartered Accountant, if not available in the offer document.

Checklist of documents for listing of securities issued pursuant to the Right Issue

The company should submit the letter of application along with the following documents / formalities:

1. Listing Application for all types of securities issued on rights basis should be submitted.
2. Certified copy of the resolution passed by the Board of Directors for allotment of securities on Right Basis.
3. Shareholding pattern for pre and post issue as per the format prescribed under Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for all types of securities issued on Rights basis.
4. A certified copy of Basis of Allotment as approved by Designated Stock Exchange should be filed.
5. Auditors/Practicing CA/CS certificate that allotment has been done as per basis of allotment approved by the designated stock exchange.
6. The total number of securities allotted in the physical category and in Demat (CDSL & NSDL Separately) with category wise distinctive numbers should be filed.

7. An undertaking from the Managing Director/Compliance Officer certifying that all the documents filed by the Company with the Exchange are same/similar/identical in all respect with the documents filed by the Company with Register of Companies/SEBI/RBI/FIPB in respect of the allotment/enlistment of the aforesaid rights share on the Exchange, and that the company has complied with all the legal and statutory formalities and no statutory authority has restrained the company from issuing and allotting the securities on rights basis.

8. Undertaking from the Company Secretary/Compliance Officer of the issuer as per the following format:

   - "The company or its promoters or whole time directors are not in violation of the provisions of the SEBI Delisting Regulations, 2021".
   - "We hereby confirm that the company, its promoters, its directors are not in violation of the restrictions imposed by SEBI under SEBI circular no. SEBI/HO/ MRD/DSA/CIR/P/2017/92 dated August 01, 2017."
   - For the proposed rights issue, the issuer has complied with all the statutory formalities including the requirements of Companies Act, 2013, SEBI (ICDR) Regulations, 2018 etc. and no statutory authority has restrained the company from coming up with the proposed rights issue.

9. Undertaking from the Compliance Officer of the issuer as per the following format:

   "Neither the issuer nor any of its promoters or directors is a wilful defaulter as defined under SEBI (ICDR) Regulations, 2018"; OR

   "<Name of the issuer> / <name>, the promoter(s) of the issuer / <name> the director(s) of the issuer is a wilful defaulter as defined under SEBI (ICDR) Regulations, 20 l8and disclosures in this regard has been made at <place of disclosure>.as per the format given in said regulation."

10. Annual Listing fees.

Formalities for obtaining Trading approval

1. A certified true copy of the Certificate/Letter from Registrars to Issue confirming the date of completion of posting of Refund Orders and Share certificate/Debenture Certificates in Physical form (if any).
2. Confirmation from the depositories for crediting of securities to the beneficiary owner's account.
3. Copies of Newspaper advertisement of Basis of Allotment.

PREFERENTIAL ISSUE [CHAPTER V OF SEBI (ICDR) REGULATIONS, 2018]

Applicability [Regulation 158]

"Preferential issue" means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis in accordance with Chapter V of SEBI (ICDR) Regulations, 2018 and does not include an offer of specified securities made through employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or depository receipts issued in a country outside India or foreign securities.

Non-applicability

- The provisions of Chapter V shall not apply where the preferential issue of equity shares is made pursuant to:

(a) conversion of a loan or an option attached to convertible debt instruments in terms of sections 62 (3) & (4) of the Companies Act, 2013, whichever is applicable;

(b) a scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956 or approved by a tribunal or the Central Government under sections 230 to 234 of the Companies Act, 2013, as applicable;

However, the pricing provisions of preferential issue shall apply to the issuance of shares under schemes mentioned in clause (b) in case of allotment of shares only to a select group of shareholders or shareholders of unlisted companies pursuant to such schemes.

(c) a qualified institutions placement in accordance with Chapter VI of these regulations.

- The provisions of this Chapter, except the lock-in provisions, shall not apply where the preferential issue of specified securities is made in terms of the rehabilitation scheme approved by the BIFR under the SICA, 1985 or the resolution plan approved under Section 31 of the IBC, 2016, whichever is applicable.
- The provisions of this Chapter relating to pricing and lock-in shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993.
- The provisions relating to disclosure to shareholders and pricing shall not apply to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where SEBI has granted relaxation to the issuer in terms of regulation 11 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of the shareholders.
- The provisions relating to issuers ineligible to make a preferential issue and lock-in of pre-preferential allotment holding, shall not apply to a preferential issue of specified securities where the proposed allottee is a mutual fund registered with SEBI or insurance company registered with IRDA or a scheduled commercial bank or a public financial institution.
- The provisions of this Chapter shall not apply where the preferential issue of specified securities is made to the lenders pursuant to conversion of their debt, as part of a debt restructuring implemented in accordance with the guidelines specified by the Reserve Bank of India, subject to the following conditions:

(a) guidelines for determining the conversion price have been specified by the Reserve Bank of India in accordance with which the conversion price shall be determined and which shall be in compliance with the applicable provisions of the Companies Act, 2013;

(b) conversion price shall be certified by two independent valuers;

(c) specified securities so allotted shall be locked-in for a period of one year from the date of their allotment;

However, for the purpose of transferring the control, the lenders may transfer the specified securities allotted to them before completion of the lock-in period subject to continuation of the lock-in on such securities for the remaining period, with the transferee.

(d) the lock-in of equity shares allotted pursuant to conversion of convertible securities issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in;

(e) the applicable provisions of the Companies Act, 2013 are complied with, including the requirement of a special resolution.

Explanation - For the purpose of this sub-regulation, "lenders" shall mean all scheduled commercial banks (excluding Regional Rural Banks) and All India Financial Institutions.

Conditions for Preferential Issue [Regulation 160]

A listed issuer may make a preferential issue of specified securities, if:

- all equity shares allotted by way of preferential issue shall be made fully paid up at the time of the allotment;
- a special resolution has been passed by its shareholders;
- all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form before an application seeking in-principle approval is made by the issuer to the stock exchange(s) where its equity shares are listed;
- the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed, SEBI Listing Regulations, 2015 as amended, and any circular or notifications issued by SEBI thereunder;
- the issuer has obtained the Permanent Account Number of the proposed allottees except those allottees which may be exempt from specifying their Permanent Account Number for transacting in the securities market by the SEBI before an application seeking in-principle approval is made by the issuer to the stock exchange(s) where its equity shares are listed;
- the issuer has made an application seeking in-principle approval to the stock exchange(s), where its equity shares are listed, on the same day when the notice has been sent in respect of the general meeting seeking shareholders' approval by way of special resolution.

Issuers Ineligible to make Preferential Issue [Regulation 159]

Preferential issue of specified securities shall not be made to any person who has sold or transferred any equity shares of the issuer during the 90 trading days preceding the relevant date.

Further in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, SEBI may grant relaxation from the requirements of this sub-regulation in terms of sub- regulation (2) of regulation 11 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 to such a preferential allotment.

> It may be noted that where any person belonging to promoter(s) or the promoter group has sold/ transferred their equity shares in the issuer during the 90 trading days preceding the relevant date, the entire promoter(s) and promoter group should be ineligible for allotment of specified securities on preferential basis.

The, above restriction shall not apply to any sale of equity shares by any person belonging to promoter(s) of the promoter group which qualifies for inter-se transfer amongst qualifying persons under clause (a) of sub-regulation (1) of regulation 10 of the SEBI (Substantial Acquisition of Shares and Takeover Regulations), 2011 or in case of transfer of shares held by the promoters or promoter group on account of invocation of pledge by a scheduled commercial bank or public financial institution or a systemically important non- banking finance company or mutual fund or insurance company registered with the IRDA.

Where any person belonging to promoter(s) or the promoter group has previously subscribed to warrants of an issuer **but failed to exercise the warrants,** the promoter(s) and promoter group shall be ineligible for issue of specified securities of such issuer on preferential basis for a period of one year from:

(a) the date of expiry of the tenure of the warrants due to non-exercise of the option to convert; or

(b) the date of cancellation of the warrants, as the case may be.

An issuer shall not be eligible to make a preferential issue if any of its promoters or directors is a fugitive economic offender.

An issuer shall not be eligible to make a preferential issue if it has any outstanding dues to SEBI, the stock exchanges or the depositories. However, this shall not be applicable in a case where such outstanding dues are the subject matter of a pending appeal or proceeding(s), which has been admitted by the relevant Court, Tribunal or Authority, as the case may be.

Relevant Date [Regulation 161]

'Relevant date' means :

(a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue.

However, in case of a preferential issue of specified securities pursuant to any resolution of stressed assets under a framework specified by the RBI or a resolution plan approved by the NCLT under the IBC, 2016, the date of approval of the corporate debt restructuring package or resolution plan shall be the relevant date.

(b) in case of preferential issue of convertible securities, either the relevant date referred clause (a) or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares. [It may be noted that the choice of relevant date shall be informed to the shareholders upfront while seeking approval for the proposed preferential issue].

Explanation: Where the relevant date falls on a Weekend/Holiday, the day preceding the Weekend/Holiday will be reckoned to be the relevant date.

For example, if the meeting of the shareholders is on November 13, 2018, the Relevant date shall be October 13, 2018. However, since October 13, 2018 is a Saturday, the relevant date shall be Friday October 12, 2018.

Tenure of convertible securities [Regulation 162]

The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment. Upon exercise of the option by the allottee to convert the convertible securities within the tenure, the issuer shall ensure that the allotment of equity shares pursuant to exercise of the convertible securities is completed within 15 days from the date of such exercise by the allottee.

Disclosures to Shareholders [Regulation 163]

(1) The issuer shall, in addition to the disclosures required under the Companies Act, 2013 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing special resolution:

(a) the objects of the preferential issue;

(b) Maximum number of specified securities to be issued;

(c) intent of the promoters, directors or key managerial personnel or senior management of the issuer to subscribe to the offer;

> "Senior Management" shall mean the officers and personnel of the issuer who are members of its core management team, excluding the Board of Directors, and shall also comprise all the members of the management one level below the Chief Executive Officer or Managing Director or Whole Time Director or Manager (including Chief Executive Officer and Manager, in case they are not part of the Board of Directors) and shall specifically include the functional heads, by whatever name called and the **Company Secretary** and the Chief Financial Officer.

(d) the shareholding pattern of the issuer before and after the preferential issue;

(e) the time within which the preferential issue shall be completed;

(f) the identity of the natural persons who are the ultimate beneficial owners of the shares proposed to be allotted and/or who ultimately control the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue.

However, if there is any listed company, mutual fund, bank or insurance company in the chain of ownership of the proposed allottee, no further disclosure will be necessary.

> It may be noted that, for the purpose of identification of the ultimate beneficial owners of the allottees, where the allottees are institution/entities, the identification of such ultimate beneficial owners, shall be in accordance with the guidelines prescribed by SEBI, if any.

(g) the percentage of post preferential issue capital that may be held by the allottee(s) and change in control, if any, in the issuer consequent to the preferential issue;

(h) an undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;

(i) an undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked-in till the time such amount is paid by the allottees.

(j) disclosures, similar to disclosures specified in Schedule VI of the ICDR Regulations, 2018 if the issuer or any of its promoters or directors is a wilful defaulter or a fraudulent borrower;

(k) the current and proposed status of the allottee(s) post the preferential issues namely, promoter or non-promoter.

(2) The issuer shall place a copy of the certificate of a practicing company secretary before the general meeting of the shareholders, considering the proposed preferential issue, certifying that the issue is being made in accordance with the requirements of these regulations.

The issuer shall also host the certificate on its website and provide a link for the same in the notice for the general meeting of the shareholders considering the proposed preferential issue.

(3) Specified securities may be issued on a preferential basis for consideration other than cash. Provided that consideration other than cash shall comprise only swap of shares pursuant to a valuation report by an independent registered valuer, which shall be submitted to the stock exchange(s) where the equity shares of the issuer are listed.

(4) The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated.

Allotment pursuant to special resolution [Regulation 170]

- Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution.
- In case of exemption from the applicability of the SEBI (SAST) Regulations, 2011 or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of the order on such application or the date of approval or permission, as the case may be.
- In case of relaxation granted by SEBI in terms of the SEBI (SAST) Regulations, 2011, the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by the SEBI in its order granting the relaxation.
- Where a preferential allotment is made that attracts an obligation to make an open offer for shares of the issuer under the SEBI (SAST) Regulations, 2011, and there is no offer made under regulation 20 (1) of the SEBI (SAST) Regulation, 2011, the period of fifteen days shall be considered from the expiry of the period specified regulation 20 (1) or date of receipt of all statutory approvals required for the completion of an open offer under the SEBI (SAST) Regulation, 2011.

  In this case, the period of fifteen days shall be counted from the expiry of the offer period as defined in the SEBI (SAST) Regulations, 2011.

  However, this above-mentioned provision shall not apply to an offer made under regulation 20 (1) of the SEBI (SAST) Regulation, 2011, pursuant to a preferential allotment.
- The requirement of allotment within fifteen days shall not apply to allotment of specified securities on preferential basis pursuant to any resolution of stressed assets under a framework specified by the RBI or a resolution plan approved by the NCLT under the IBC 2016.
- If the **allotment of the specified securities is not completed within fifteen days** from the date of special resolution, **a fresh special resolution shall be passed** and the relevant date for determining the price of specified securities shall be taken with reference to the date of the latter special resolution.
- Allotment of the specified securities shall be made **only in dematerialised form.**
- The requirement of allotment in dematerialised form shall also be applicable for the equity shares to be allotted pursuant to exercise of option attached to warrant or conversion of convertible securities.

PRICING

Pricing of equity shares – Frequently traded shares [Regulation 164]

1. Listed for more than 90 trading days

If the equity shares of the issuer have been listed on a recognised stock exchange ***for a period of 90 trading days or more as on the relevant date,*** the equity shares shall be allotted at a price not less than higher of the following:

(a) The 90 trading days' volume weighted average price (VWAP) of the related equity shares quoted on the recognised stock exchange preceding the relevant date; or

(b) The 10 trading days' volume weighted average prices of the related equity shares quoted on a recognised stock exchange preceding the relevant date.

However, if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than that determined under these regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.

2. Listed for less than 90 trading days

If the equity shares of the issuer have been listed on a recognised stock exchange for a ***period of less than 90 trading days*** as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:

(a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of compromise, arrangement and amalgamation under sections 230 to 234 the Companies Act, 2013, as applicable, pursuant to which the equity shares of the issuer were listed, as the case may be; or

(b) the average of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or

(c) the average of the 10 trading days' volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

However, if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than that determined under these regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.

Where the price of the equity shares is determined in terms of point no. 2, such price shall be recomputed by the issuer on completion of 90 trading days from the date of listing on a recognised stock exchange with reference to the 90 trading days volume weighted average prices of the related equity shares quoted on the recognised stock exchange during these 90 trading days and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

However, if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than that determined under these regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.

- A preferential issue of specified securities to QIBs, not exceeding five in number, shall be made at a price not less than the 10 trading days' volume weighted average prices of the related equity shares quoted on a recognised stock exchange preceding the relevant date.

  However, if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than that determined under these regulations, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.

- Allotment shall not be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to the promoters of the issuer. Provided that a qualified institutional buyer who does not hold any shares in the issuer and who has acquired rights in the capacity of a lender shall not be deemed to be a person related to the promoters.

Explanation. – For the purpose of this clause, a qualified institutional buyer who has any of the following rights shall be deemed to be a person related to the promoters of the issuer:-

(a) rights under a shareholders' agreement or voting agreement entered into with promoters or promoter group;

(b) veto rights; or

(c) right to appoint any nominee director on the board of the issuer.

Pricing of infrequently traded shares [Regulation 165]

Where the shares are not frequently traded, the price determined by the issuer shall take into account valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies. However, the issuer shall submit a certificate stating that the issuer is in compliance of this regulation, obtained from an independent merchant banker or an independent registered to the stock exchange where the equity shares of the issuer are listed.

"Frequently traded shares" means the shares of the issuer, in which the traded turnover on any recognised stock exchange during the 240 trading days preceding the relevant date, is at least 10% of the total number of shares of such class of shares of the issuer.

Where the share capital of a particular class of shares of the issuer is not identical throughout such period, the weighted average number of total shares of such class of the issuer shall represent the total number of shares.

Adjustments in pricing – Frequently or Infrequently traded shares

(1) The price determined for preferential issue shall be subject to appropriate adjustments, if the issuer:

(a) makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares;

(b) makes an issue of equity shares after completion of a demerger wherein the securities of the resultant demerged entity are listed on a stock exchange;

(c) makes a rights issue of equity shares;

(d) consolidates its outstanding equity shares into a smaller number of shares;

(e) divides its outstanding equity shares including by way of stock split;

(f) re-classifies any of its equity shares into other securities of the issuer;

(g) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

(2) The effect on the price of the equity shares of the issuer due to material price movement and confirmation of reported event or information may be excluded as per the framework specified under regulation 30 (11) of the SEBI (LODR) Regulations, 2015 for determination of the price for a preferential issue in accordance with regulations 164, 164A, 164B or 165 of these regulations.

Special Provisions Related to Pricing in Preferential Issue of Shares of Companies having stressed Assets

On June 22, 2020 SEBI has amended the SEBI (ICDR) Regulations, 2018 and relaxed the pricing methodology for preferential issues by listed companies having stressed assets and exempt allottees of preferential issues from open offer obligations in such cases. SEBI has inserted new Regulation 164A and 164B in SEBI (ICDR) Regulations, 2018 making provisions for companies having stressed assets and are summarized hereunder.

Pricing in preferential issue of shares of companies having stressed assets [Regulation 164A]

1) In case of frequently traded shares, the price of the equity shares to be allotted pursuant to the preferential issue shall not be less than the 10 trading days' volume weighted average price of the related equity shares quoted on a recognised stock exchange preceding the relevant date.

2) No allotment of equity shares shall be made unless the issuer company meets any two of the following criteria:

   a) the issuer has disclosed all the defaults relating to the payment of interest/ repayment of principal amount on loans from banks / financial institutions/ Systemically Important Non- Deposit taking Non-banking financial companies/ Deposit taking Non-banking financial companies and /or listed or unlisted debt securities in terms of SEBI Circular dated November 21, 2019 and such payment default is continuing for a period of at least 90 calendar days after the occurrence of such default;

   b) there is an Inter-creditor agreement in terms of Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019 dated June 07, 2019;

   c) The credit rating of the financial instruments (listed or unlisted), credit instruments / borrowings (listed or unlisted) of the listed company has been downgraded to "D".

3) The issuer company making the preferential issue shall ensure compliance with the following conditions:

   a) The preference issue shall be made to a person not part of the promoter or promoter group as on the date of the board meeting to consider the preferential issue. The preference issue shall not be made to the following entities:

      i) undischarged insolvent in terms of the Insolvency and Bankruptcy Code, 2016;

      ii) 'wilful defaulter or a fraudulent borrower' as per the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949;

      iii) person disqualified to act as a director under the Companies Act, 2013;

      iv) a person debarred from trading in securities or accessing the securities market by the Board;

      Explanation: The restriction under (iv) shall not apply to the persons or entities mentioned therein who were debarred in the past by the Board and the period of debarment is already over as on the date of the board meeting considering the preferential issue.

      v) a person declared as a fugitive economic offender;

      vi) a person who has been convicted for any offence punishable with imprisonment-

         A. For two years or more under any Act specified under the Twelfth Schedule of the Insolvency and Bankruptcy Code, 2016;

         B. For seven years or more under any law for the time being in force:

      Provided that such restriction shall not be applicable to a person after the expiry of a period two years from the date of his release from imprisonment.

      vii) A person who has executed a guarantee in favour of a lender of the issuer and such guarantee has been invoked by the lender and remains unpaid in full or part.

4) The resolution for the preferential issue and exemption from open offer shall provide the votes cast by the shareholders in the 'public' category in favour of the proposal shall be more than the number

of votes cast against it. The proposed allottee (s) in the preferential issue that already hold specified securities shall not be included in the category of 'public' for this purpose:

Provided that where the company does not have an identifiable promoter; the resolution shall be deemed to have been passed if the votes cast in favour are not less than three times the number of the votes, if any, cast against it.

5) The proceeds of such preferential issue shall not be used for any repayment of loans taken from promoters/ promoter group/ group companies. The proposed use of proceeds shall be disclosed in the explanatory statement sent for the purpose of the shareholder resolution.

6) a) The issuer shall make arrangements for monitoring the use of proceeds of the issue by a credit rating agency registered with the SEBI:

   (i) The monitoring agency shall submit its report to the issuer in the format specified in terms of Schedule XI (with fields as applicable) on a quarterly basis till 100% of the proceeds of the issue have been utilized.

   (ii) The board of directors and the management of the issuer shall provide their comments on the findings of the monitoring agency as specified in Schedule XI.

   (iii) The issuer shall, within forty five days from the end of each quarter, publicly disseminate the report of the monitoring agency by uploading the same on its website as well as submit the same to the stock exchange(s) on which the equity shares of the issuer are listed.

   b) The proceeds of the issue shall also be monitored by the Audit Committee till utilization of the proceeds.

7) The allotment made shall be locked-in for a period of three years from the last date of trading approval.

8) The statutory auditor and the audit committee shall certify that all conditions under sub- regulations (1), (2), (3), (4) and (5) of regulation 164A are met at the time of dispatch of notice for general meeting proposed for passing the special resolution and at the time of allotment.

Optional Pricing in preferential issue [Regulation 164B]

(1) In case of frequently traded shares, the price of the equity shares to be allotted pursuant to the preferential issue shall be determined by regulation 164 or regulation 164B, as opted for.

(2) The price of the equity shares to be allotted pursuant to the preferential issue shall not be less than the higher of the following:

   (a) the average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the twelve weeks preceding the relevant date; or

   (b) the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(3) Specified securities allotted on a preferential basis using the pricing method determined under sub-regulation (2) shall be locked-in for a period of three years.

(4) The pricing method determined at sub-regulation (2) shall be availed in case of allotment by preferential issue made between July 01, 2020 or from the date of notification of this regulation, whichever is later and December 31, 2020.

(5) All allotments arising out of the same shareholders approval shall follow the same pricing method.

Lock-in of specified securities [Regulation 167]

The specified securities allotted on preferential basis to **promoter or promoter group** and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, **shall be locked-in for a period of 18 months from date of trading approval** granted for the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be.

However, not more than 20% of the total capital of the issuer shall be locked-in for 18 months from the date of trading approval. Further, Equity shares allotted in excess of the 20% shall be locked-in for six months from the date of trading approval pursuant to exercise of options or otherwise, as the case may be.

In case of convertible securities or warrant which are not listed on stock exchanges, such securities shall be locked in for a period of one year from the date of allotment.

- The specified securities allotted on preferential basis to persons **other than promoter and promoter group** and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be **locked in for a period of six months from the date of trading approval.**

  However, in case of convertible securities or warrants which are not listed on stock exchanges, such securities shall be locked in for a period of one year from the date of allotment.

  The date of trading approval shall mean the latest date when trading approval has been granted by all the stock exchanges where the equity shares of the issuer are listed, for specified securities allotted as per the provisions of this lesson.

- Lock-in of the equity shares allotted pursuant to conversion of convertible securities other than warrants, issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in.

- The equity shares issued on a preferential basis pursuant to any resolution of stressed assets under a framework specified by the RBI or a resolution plan approved by the NCLT under the IBC 2016, shall be locked-in for a period of one year from the trading approval. However, the lock-in provision shall not be applicable to the specified securities to the extent to achieve 10% public shareholding.

- If the amount payable by the allottee, in case of re-calculation of price is not paid till the expiry of lock-in period, the equity shares shall continue to be locked-in till such amount is paid by the allottee.

- The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date up to a period of 90 trading days from the date of trading approval.

- However, in case of convertible securities or warrants which are not listed on stock exchanges, the entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date up to a period of 90 trading days from the date of allotment of such securities.

- Lock-in requirements for an allottee who has become a promoter due to change in control consequent to the preferential issue shall be the same as those applicable to the promoters and promoter group under this regulation.

Transferability [Regulation 168]

Subject to the provisions of SEBI (SAST) Regulations, 2011, specified securities held by promoters and locked-in in, may be transferred among the promoters or the promoter group or to a new promoter or persons in control of the issuer. However, the lock-in on such specified securities shall continue for the remaining period with the transferee.

The specified securities allotted on a preferential basis shall not be transferable by the allottees till the trading approval is granted for such securities by all the recognised stock exchanges where the equity shares of the issuer are listed.

INFORMAL GUIDANCE

Query:

Whether as per Regulation 168 of the SEBI (ICDR) Regulations, 2018, the specified securities of Shri Dinesh Mills Limited (hereinafter referred as "SDM") held by promoters / members of the promoter group of and locked-in as per Regulation 167(1) of SEBI (ICDR) Regulations, 2018 can be transferred to Acquirer Trusts through its trustees having control over the affairs of SDM?

Reply:

The specified securities i.e. shares of Shri Dinesh Mills Limited, held by promoters/ members of the promoter group and locked-in as per Regulation 167 (1) of SEBI (ICDR) Regulations, 2018, may be transferred to the Acquirer Trusts under Regulation 168 (1) of SEBI (ICDR) Regulations, 2018. However, the said transferability, is subject to the provisions of SEBI (SAST) Regulations, 2011. In the instant case, pursuant to the proposed transfer of shares to the Trusts, the Trusts {through its trustees) would have control over the affairs of SDM. Even otherwise, the Trusts shall fall within the definition of "promoter group" under SEBI (ICDR) Regulations, 2018, as the trustees and ultimate beneficiaries of the Trusts are promoters and members of the promoter group family of the SDM. Considering the above, the Trusts shall be considered as part of 'new promoter' or 'promoter group' or 'persons in control of the issuer' and consequently, there shall not be any contravention of provisions of SEBI (ICDR) Regulations, 2018, on transfer of locked -in securities to the Trusts. However, the balance lock-in period shall continue in the hands of the Trusts.

Reference: https://www.sebi.gov.in/enforcement/informal-guidance/feb-2020/in-the-matter-of-nimish-upendrabhai-patel-under-sebi-substantial-acquisition-of-shares-and-takeovers-regulations-2011-sebi-prohibition-of-insider-trading-regulations-2015-and-sebi-issue-of-ca-_45888.html

Payment of consideration [Regulations 169]

Full consideration of specified securities other than warrants shall be paid by the allottees at the time of allotment of such specified securities except in case of shares issued for consideration other than cash.

However, in case of preferential issue of specified securities pursuant to any resolution of stressed assets under a framework specified by RBI or a resolution plan approved by NCLT under the IBC, 2016, the consideration may be in terms of such scheme.

In the case of warrants, an amount equivalent to at least 25% of the consideration determined in terms of the

ICDR Regulations, 2018 shall be paid against each warrant on the date of allotment of warrants. The balance 70% of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.

However, in case the exercise price of the warrants is based on the formula, at least 25% of the consideration amount calculated as per the formula with conversion date being the relevant dates shall against each warrant on the date of allotment of warrants and the balance consideration shall be paid at the time of allotment of the equity shares pursuant to exercise of options against each such warrant by the warrant holder.

In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such warrant (i.e. the 25% paid at the time of the issuance of the warrants) shall be **forfeited** by the issuer.

However, in case the exercise price of the warrants is based on the formula, at least 25% of the consideration amount calculated as per the formula with conversion date being the relevant date shall be paid against each warrant on the date of allotment of warrants and the balance consideration shall be paid at time of allotment of the equity shares pursuant to exercise of options against each such warrant by the warrant holder.

The issuer shall ensure that the consideration of specified securities, if paid in cash, shall be received from respective allottee's bank account and in the case of joint holders, shall be received from the bank account of the person whose name appears first in the application.

The issuer shall submit a certificate of the statutory auditor to the stock exchange where the equity shares of the issuer are listed stating that the issuer is in compliance of the SEBI (ICDR) Regulations, 2018 and the relevant documents thereof are maintained by the issuer as on the date of certification.

Allotment [Regulation 170]

Allotment pursuant to the special resolution shall be completed within a period of 15 days from the date of passing of such resolution. Provided that where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of 15 days shall be counted from the date of the order on such application or the date of approval or permission, as the case may be.

If the allotment of the specified securities is not completed within 15 days from the date of special resolution, a fresh special resolution shall be passed and the relevant date for determining the price of specified securities under this Chapter shall be taken with reference to the date of the latter special resolution.

Allotment of the specified securities shall be made only in dematerialised form.

DOCUMENTATION FOR PREFERENTIAL ISSUE

Pre-Issue Formalities

1. Covering letter for "In-principle approval" for issue and allotment of Securities on a preferential basis under Regulation 28(1) of the SEBI (LODR), Regulations, 2015.
2. Certified copy of the resolution passed by the Board of Directors of the company for the proposed preferential issue.
3. Printed copy of notice of AGM/EGM.
4. Where allotment is:

I) for consideration other than cash:

a) Certified copy of valuation report;

b) Certified copy of Shareholders Agreements;

c) Certified copy of approval letters from FIPB and RBI if applicable.

II) pursuant to a resolution plan approved by NCLT under Insolvency and Bankruptcy Code, 2016 (IBC)/ CDR Scheme/ Order of High Court/ BIFR

a) Certified copy of resolution plan approved by NCLT under IBC (Extract of the relevant resolution) / relevant scheme/ order.

III) pursuant to conversion of loan of financial institutions:

a) Certified copy of the Loan Agreement executed by the company.

5. Brief particulars of the proposed preferential issue.

6. In case if the prior holding of the allottee is under pledge with banks/ financial institution(s), company needs to provide an undertaking/ confirmations from the banks/ financial institutions, company and allottee(s).

7. Confirmation by the Managing Director/ Company Secretary.

8. Certificate from Statutory Auditors/ Practicing Chartered Accountant/ Practicing Company Secretary.

9. Pricing certificate by Statutory Auditor/ Practicing Chartered Accountant/ Practicing Company Secretary. In case the securities of the company are infrequently traded pricing certificate as prescribed under the SEBI (ICDR) Regulation, 2018.

10. Non-refundable processing fees.

Brief particular of the proposed preferential issue are:

I) Company details:

Name of the Company	
Scrip Code	
ISIN No.	
Face Value of the equity shares of the company	
Authorized Capital of the Company (Rs.)	
Nominal value of the equity share capital (Rs.)	
Paid up equity share capital of the Company (Rs.)	
Maximum no. of shares that may be issued (inclusive of convertible instruments) pursuant to the proposed preferential issue	
Paid up equity share capital of the Company post proposed issue on fully diluted basis (Rs.)	

II) Issue details:

Date of Board Meeting wherein the proposed preferential issue was approved	
Date of General Meeting approving the issue u/s 62	
Date of approval by CDR/ Order passed by the Hon'ble High Court/NCLT, if applicable	
Relevant date	
Offer Price (Rs.)	
Minimum price as computed under SEBI (ICDR) Regulations, 2018 Regulations	
Consideration (cash/ other than cash/conversion of loan)	
Whether any other regulatory approval is required for the issue. If yes, details thereof	

Details of security proposed to be issued			
	Promoters	***Non-promoters***	***Total***
Equity (Nos.)			
Warrants (Nos.)			
Others (PCD/FCD, preference shares, etc) (Nos.)			
In case of convertible instrument, period when the same can be exercised/ converted			

III) Allottee details:

Name of the Proposed Allottee	***Category (Promoter / non-Promoter)***	***Permanent Account Number (PAN)***	***If allottee is not a natural person, identity of the natural person who are the ultimate beneficial owner of the shares proposed to be issued, if applicable***	***No. of securities to be allotted***	***Allottee is: *QIB/ Eton QIB***	***Post issue % of capital that allottee will hold***

(*) QIB as defined under SEBI (ICDR) Regulations, 2018

IV) Details of pre-preferential shareholding of the allottees:

Name of the Allottee	***Pre-preferential shareholding (No. of shares)***	***Whether pre-preferential shareholding in physical/ demat***	***Lock in Details***		***Pledge Details***	
			Date From	***Date To***	***No. of shares***	***Name of instit-ution***
TOTAL						

In cases where the pre-preferential shareholding of the allottee(s) is in physical form, allotment to such a1lottee(s) shall be made only if such pre-preferential shareholding is dematerialised before the allotment.

V) Shareholding pattern of the company pre and post proposed preferential issue:

Category	***Pre preferential issue***		***Post preferential issue***	
	No of Shares	***%***	***No of Shares***	***%***
Promoters and Promoter Group (A)		(A) / (A)+(B)		(A) / (A)+(B)
Public (B)		(B) / (A)+(B)		(B) / (A)+(B)
Total (A) + (B)				
Custodian (C)				
Grand Total (A) + (B) + (C)				

Post Issue Formalities

Documents required for granting listing approvals, for the equity shares issued on a preferential basis:

1. Covering letter for listing approval of equity shares issued and allotted on preferential basis.
2. Letter of Application (i.e. by Listed companies applying for listing of further issue) duly completed.
3. Brief particular of the new securities issued .
4. Certified copy of the resolution passed by board of directors for allotment of equity shares along with depository confirmation for the credit of securities in dematerialized form.
5. Certified copy of the resolution passed by board of directors for allotment of convertible instrument, applicable only where the allotment of equity shares is pursuant to conversion of convertible instrument.
6. Certified copy of the resolution passed by the shareholders of the Company approving the allotment on preferential basis and the resolution passed for increasing the authorized capital wherever applicable.

7. Shareholding Pattern as per the format prescribed under Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 giving details pre and post allotment.
8. Certified copy of the compliance certificate from the Statutory Auditor placed before the shareholders in the general meeting.
9. Certificate from Statutory Auditor of the company for receipt of funds.
10. Certificate from the Statutory Auditors/ Practicing Chartered Accountant/ Practicing Company Secretary for compliance.
11. Certificate from the Managing Director/Company Secretary of the company.
12. Confirmation for authentication on SEBI for SCORES.
13. Certified copy of the order passed by Hon'ble NCLT/ Hon'ble High Court/ BIFR/ Copy of NCLT approved resolution plan/scheme approved by CDR, if applicable.
14. Details of Processing fee/ Additional listing fee, if applicable, to be paid on the enhanced capital.

QUALIFIED INSTITUTIONS PLACEMENT [CHAPTER VI OF SEBI (ICDR) REGULATIONS, 2018]

'Qualified Institutions Placement' means allotment of eligible securities by a listed issuer to qualified institutional buyers (QIB's) on private placement basis and includes an offer for sale of specified securities by the promoters and/or promoters group on a private placement basis in terms of SEBI (ICDR) Regulations, 2018.

Qualified Institutional Buyer (QIB)

"Qualified Institutional Buyer" means:

- a mutual fund, venture capital fund, alternative investment fund and foreign venture capital investor registered with SEBI;
- a foreign portfolio investor other than individuals, corporate bodies and family offices;
- a public financial institution;
- a scheduled commercial bank;
- a multilateral and bilateral development financial institution;
- a state industrial development corporation;
- an insurance company registered with the Insurance Regulatory and Development Authority of India;
- a provident fund with minimum corpus of twenty five crore rupees;
- a pension fund with minimum corpus of twenty five crore rupees registered with the PFRDA established under Section 3(1) of the PFRDA Act, 2013;
- National Investment Fund set up by resolution no. F. No. 2/3/2005-DDII dated November 23, 2005 of the Government of India published in the Gazette of India;
- insurance funds set up and managed by army, navy or air force of the Union of India; and
- insurance funds set up and managed by the Department of Posts, India; and
- systemically important non-banking financial companies.

Eligible Securities for the purpose of QIP [Regulations 171]

Eligible Securities include equity shares, non-convertible debt instruments along with warrants and convertible securities other than warrants.

Conditions for QIP

Relevant Date

In case of allotment of equity shares	In case of allotment of eligible convertible securities
In case of allotment of equity shares, the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorised by the board of directors of the issuer decides to open the proposed issue.	In case of allotment of eligible convertible securities, either the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorised by the board of directors of the issuer decides to open the Issue of such convertible securities or the date on which the holders of such convertible securities become entitled to apply for the equity shares.

A listed issuer may make a qualified institutions placement of eligible securities if it satisfies the following conditions:

(i) Special Resolution

Approval

A special resolution approving the QIP has been passed by its shareholders, and the special resolution shall, among other relevant matters, specify that the through qualified institutions placement and the relevant date.

Completion

Allotment pursuant to the special resolution shall be completed within a period allotment is proposed to be made of 365 days from the date of passing of the special resolution.

Non-applicability

No shareholders resolution will be required in case the QIP is through an offer for sale by promoters or promoter group for compliance with minimum public shareholding requirements specified in the Securities Contracts. (Regulation) Rules 1957.

(ii) Equity shares of the same class - It shall mean equity shares which rank pari-passu in relation to rights as to dividend, voting or otherwise.

(a) Equity Share of the same class

Proposed to be allotted through QIP

Pursuant to conversion or exchange of eligible securities offered through QIP

Have been listed on a stock exchange for a period of at least one year prior to the date of issuance of notice to its shareholders for convening the meeting to pass the special resolution.

(b)

Issuer

Transferee company

Scheme of compromise, arrangement and amalgamation sanctioned by a High Court

OR

Approved by a tribunal or the Central Government under sections 230 to 234 of the Companies Act, 2013

Whichever is applicable makes QIP

The period for which the equity shares of the same class of the transferor company were listed on a stock exchange having nation-wide trading terminals shall also be considered for the purpose of computation of the period of one year.

This clause shall not be applicable to an issuer proposing to undertake qualified institutional placement for complying with the minimum public shareholding requirements specified in the Securities Contracts (Regulation) Rules,1957.

(c) An issuer shall be eligible to make a qualified institutions placement if any of its promoters or directors is not a fugitive economic offender.

All eligible securities issued through a qualified institutions placement shall be listed on the recognized stock exchange where the equity shares of the issuer are listed. However, the issuer shall seek approval under rule 19(7) of the Securities Contracts (Regulation) Rules, 1957, if applicable.

The issuer shall not make any subsequent qualified institutions placement until the expiry of two weeks from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

Conditions for offer for sale by promoters for compliance with minimum public shareholding requirements specified in the Securities Contracts (Regulation) Rules, 1957. [Regulation 173]

The promoters and members of the promoter group may make an offer for sale of fully paid up equity shares, through a qualified institutions placement, for the purpose of achieving minimum public shareholding in terms of the Securities Contracts (Regulation) Rules, 1957. Provided that the promoters or members of the promoter group shall not make such offer for sale if the promoter or member of the promoter group has purchased or sold any equity shares of the issuer during twelve weeks period prior to the date of the opening of the issue and they shall not purchase or sell any equity shares of the issuer during the twelve weeks period after the date of closure of the issue:

Provided further that such promoters or members of the promoter group may, within the twelve week periods provided above, sell equity shares of the issuer held by them through offer for sale through stock exchange mechanism specified by the Board or through an open market sale, in accordance with the conditions specified by the Board from time to time, subject to the condition that there shall be a gap of minimum two weeks between the two successive offer(s).

Monitoring agency [Regulation 173A]

If the issue size, excluding the size of offer for sale by selling shareholders, exceeds one hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a credit rating agency registered with the SEBI. This clause shall not apply to an issue of specified securities made by a bank or public financial institution or an insurance company.

The monitoring agency shall submit its report to the issuer on a quarterly basis, till hundred percent of the proceeds of the issue have been utilised. The board of directors and the management of the issuer shall provide their comments on the findings of the monitoring agency. The issuer shall, within 45 days from the end of each quarter, upload the report of the monitoring agency on its website and also submit the same to the stock exchange(s) on which its equity shares are listed.

Appointment of Lead Managers [Regulation 174]

An issuer shall appoint one or more merchant bankers, which are registered with SEBI, as lead manager(s) to the issue.

At least one lead manager to the issue shall not be an associate, as defined under SEBI (Merchant Bankers) Regulations, 1992) of the issuer and if any of the lead manager is an associate of the issuer, it shall disclose itself as an associate of the issuer and its role shall be limited to marketing of the issue.

The lead manager(s) shall, while seeking in-principle listing approval of the stock exchanges for the eligible securities, furnish to each stock exchange on which the same class of equity shares of the issuer are listed, a due diligence certificate stating that the eligible securities are being issued under QIP and that the issuer complies with requirements of Chapter VI of SEBI (ICDR) Regulations, 2018, and also furnish a copy of the preliminary placement document along with any other document required by the stock exchange.

Placement Document [Regulation 175]

The lead manager(s) shall exercise due diligence and shall satisfy themselves with all aspects of the Issue including the veracity and adequacy of disclosures in the offer document.

The QIP shall be made on the basis of a preliminary placement document and placement document which shall contain all material information, including those specified in the Companies Act, 2013, if any, and disclosures as specified in SEBI (ICDR) Regulations, 2018, shall be made, including as specified therein if the issuer or any of its promoters or directors is a wilful defaulter or a fraudulent borrower.

The preliminary placement document and the placement document shall be serially numbered and copies the same shall be circulated only to select investors.

The preliminary placement document and the placement document shall be placed on the websites of the relevant stock exchange(s) and of the issuer with a disclaimer to the effect that it is in connection with a QIP and that no offer is being made to the public or to any other category of investors.

Pricing [Regulation 176]

Pricing of QIP		
At a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class quoted on the stock exchange during the two weeks preceding the relevant date.	Issuer may offer a discount of not more than five per cent. on the price so calculated, subject to approval of shareholders.	Except that no shareholders' approval will be required in case of a qualified institutions placement made through an offer for sale by promoters for compliance with minimum public shareholding requirements specified in SCR Rules, 1957.

Note: The discount of upto 5% can be offered only if same has been specifically approved by the shareholders while approving QIP issue.

Where eligible securities are convertible into or exchangeable with equity shares of the issuer.

The issuer shall determine the price of such equity shares allotted pursuant to such conversion or exchange taking the relevant date as disclosed in the special resolution.

The issue price shall be subject to appropriate adjustments, if the issuer:

(a) makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares;

(b) makes a rights issue of equity shares;

(c) consolidates its outstanding equity shares into a smaller number of shares;

(d) divides its outstanding equity shares including by way of stock split;

(e) re-classifies any of its equity shares into other securities of the issuer;

(f) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

Partly Paid-up Eligible Securities

- The issuer shall not issue or allot partly paid-up eligible securities.
- In case of allotment of non-convertible debt instruments along with warrants, the allottees may pay the full consideration or part thereof payable with respect to warrants, at the time of allotment of such warrants.
- However, on allotment of equity shares on exercise of options attached to warrants, such equity shares shall be fully paid-up.
- The effect on the price of the equity shares of the issuer due to material price movement and confirmation of reported event or information may be excluded as per the framework specified under regulation 30 (11) of the SEBI (LODR) Regulations, 2015 for calculation of the issue price.

"Stock Exchange" means any of the recognised stock exchanges in which the equity shares of the same class of the issuer are listed and in which the highest trading volume in such equity shares has been recorded during the two weeks immediately preceding the relevant date.

Tenure of Convertible Securities

The tenure of the convertible or exchangeable eligible securities issued through qualified institutions placement shall not exceed sixty months from the date of allotment.

Transferability

The eligible securities allotted under the qualified institutions placement shall not be sold by the allottee for a period of one year from the date of allotment, except on a recognised stock exchange.

Minimum Number of Allottees

The minimum number of allottees for each placement of eligible securities shall at least be:

a) two, where the issue size is less than or equal to Rs. 200 and Rs. 50 crore;

b) five, where the issue size is greater than Rs. 200 and Rs. 50 crore.

No single allottee shall be allotted more than 50% of the issue size. Qualified institutional buyers belonging to the same group or who are under same control shall be deemed to be a single allottee.

"Qualified institutional buyers belonging to the same group" shall mean entities where, - (i) any of them controls directly or indirectly, through its subsidiary or holding company, not less than 15% of the voting rights in the other; or (ii) any of them directly or indirectly, by itself, or in combination with other persons exercise control over the others; or (iii) there is a common director, excluding nominee and independent directors amongst the investor, its subsidiary or holding company and any other investor.

APPLICATION AND ALLOTMENT

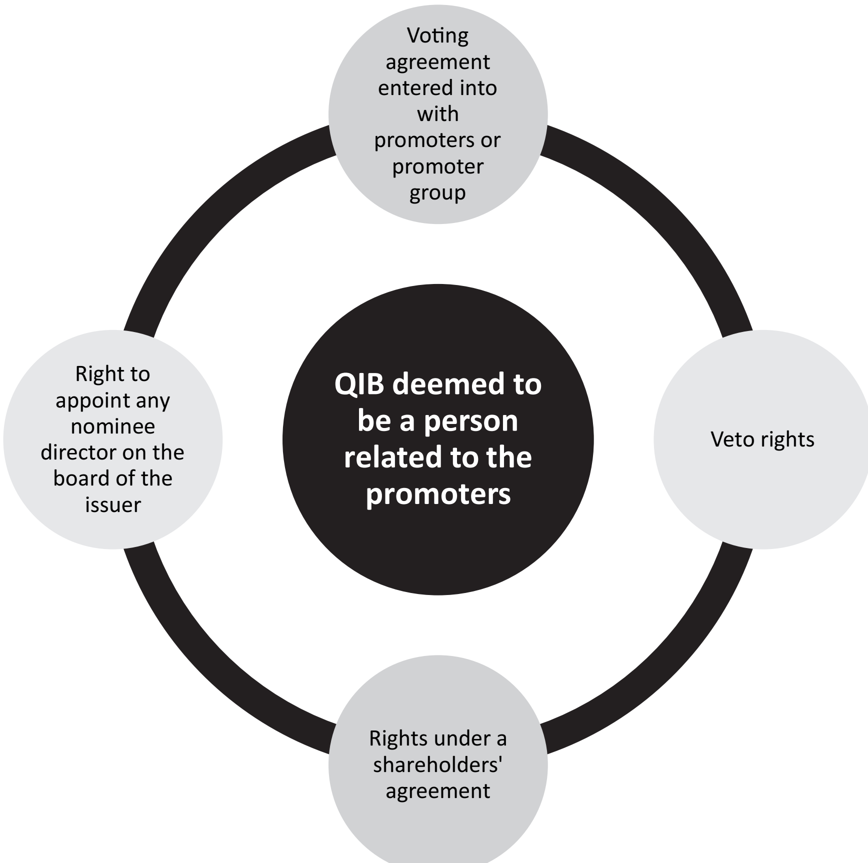
- The applicants in QIP shall not withdraw or revise downwards their bids after the closure of the issue.
- Allotment of specified securities shall be made subject to the following conditions:

  (a) minimum often per cent. of eligible securities shall be allotted to mutual funds. However, any unsubscribed portion of the said minimum percentage or any part thereof may be allotted to other qualified institutional buyers;

  (b) no allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to the promoters of the issuer.

  However, a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the said rights in the capacity of a lender shall not be deemed to be a person related to the promoters.

  A qualified institutional buyer who has any of the following rights shall be deemed to be a person related to the promoters of the issuer:-



DOCUMENTATION FOR QUALIFIED INSTITUTIONAL PLACEMENT

QIPs - Pre Issue

Documents required for granting approvals under Regulation 28(1) of SEBI (LODR), 2015, for the companies coming out with Qualified Institutions Placement (QIPs) - Prior Approval:

1. Covering letter making application for prior In-principle approval for the proposed QIP issue of the company inter alia including the following points:
   a) Whether the proposed QIP issue is for the fresh issue of shares / securities OR an offer for sale of equity shares by the promoter of the company to comply with minimum public shareholding requirement specified under Securities Contracts (Regulation) Rules, 1957 with required details;
   b) whether Company intends to give discount to the investors as per SEBI (ICDR) Regulation, 2018.
2. Copy of the two days prior intimation given by the company to the Exchange about the proposed meeting of the Board of Directors in which fund raising by way of QIP issue is specifically mentioned as required under Regulations 29(1) and (2) of Listing Regulations.
3. Certified true copy of the resolution passed by the Board of Directors of the Company approving the placement of securities with Qualified Institutional Buyers (QIBs) under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.
4. Copy of the notice sent to the shareholders of the company inter alia seeking approval for the proposed QIP issue, if applicable.
5. Certified true copy of a special resolution approving the qualified institutions placement has been passed by its shareholders, if applicable.

   The special resolution shall specifically include the following points:
   a) The allotment is proposed to be made to QIBs through Qualified Institutions Placement in accordance with Chapter VI of SEBI (ICDR) Regulations, 2018.
   b) Discount is proposed to be given to the QIBs in terms of Chapter VI of SEBI (ICDR) Regulations, 2018, if company is opting for the same.
   c) Relevant date referred to in Regulation 171 (b)(ii) of SEBI (ICDR) Regulations, 2018.
6. Draft placement document for issue of specified securities to QIBs. The placement document required to be prepared in accordance with SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, shall contain disclaimer in bold capital letters to the effect that **"the placement is meant only for QIBs on a private placement basis and is not an offer to the public or to any other class of investors."**
7. Abridged shareholding pattern of the Company without Annexures.
8. Due diligence certificate from the Merchant Bankers to the issue inter alia stating that the proposed issue of (Name of the Company) ____, is being made in compliance with Chapter VI of SEBI (ICDR) Regulations, 2018 and the _______ (Name of the Company)____ complies with the requirements of Chapter VI of SEBI (ICDR) Regulations, 2018.
9. Confirmation by the Managing Director/ Company Secretary stating:
   - The Company complies with the provision of Regulation 29(1) and (2) of the SEBI (LODR) Regulations, 2015.
   - The placement of specified securities to the Qualified Institutional Buyers has been made in accordance with Chapter VI of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.
   - The equity shares arising pursuant to the Qualified Institutions Placement shall rank pari passu in all respects including dividend entitlement with the existing equity shares of the Company.
   - The Company shall upload the placement document on its website with appropriate disclaimer to

the effect that the placement is meant only for QIBs on private placement basis and is not an offer to the public or to any other class of investors.

- For the proposed QIP issue, the company has complied with all the statutory requirement including requirements of the Companies Act, 2013, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, RBI etc. and no statutory authority has restrained the company form issuing said securities.
- The company or its promoters or whole time directors are not in violation of the provisions of the SEBI Delisting Regulations, 2021.
- The company, its promoters, its directors are not in violation of the restrictions imposed by SEBI under SEBI circular no. SEBI/HO/ MRD/DSA/CIR/P/2017/92 dated August 01, 2017."
- None of the promoters or directors of an issuer are fugitive economic offender as defined under Regulation 2(1) (p) of SEBI (ICDR) Regulations, 2018.

10. The particulars of other issues (in sequential order) in respect of which approvals are pending with the Exchange.
11. Processing Fee.

Documents required for hosting of Preliminary Placement Document on the Website of the Exchange

After the company decides to open the issue, the company is required to submit the Preliminary Placement Document for uploading on the website of the Stock Exchange before the same is circulated to the QIBs and displayed on the website of the Company.

1. Certified true copy of the resolution in which the Board of the company or the Committee of Directors of the company decided to open the proposed issue.
2. Soft copy of Preliminary Placement document (Not applicable if no changes have been made therein after submission of the same at the time of obtaining prior in-principle approval).
3. Soft copy of the Preliminary Placement Document in pdf format.

QIP - Post Issue

Documents required for granting listing approvals, for the securities issued by the companies under Qualified Institutions Placement (QIPs) - Post Allotment:

1. Letter of Application (i.e. by Listed companies applying for listing of further issue) duly completed along with Distribution Schedule pre and post allotment.
2. Certified true copy of the Board resolution in which the securities were allotted.
3. List of allottees and the number of equity shares allotted to them should be filed with the Stock Exchange.
4. List of allottees who have been allotted more than 5% of the securities offered in the issue giving details such as name of the allottees, nos. of equity shares allotted, % of the issue size, etc. and the number of equity shares.
5. Shareholding Pattern Form duly completed with relevant enclosures giving details before and after the issue.

6. Additional listing fee, if applicable, to be paid on the enhanced capital as per the enclosed schedule of listing fee.

7. Confirmation by the Managing Director/ Company Secretary.

8. PCA/PCS Certificate confirming the floor price and receipt of funds against the placement pursuant to QIP issue.

9. Due diligence certificate from the Merchant Bankers that the placement of securities issued to QIBs by (Name of the Company) has been made in compliance with Chapter VIII of SEBI (ICDR) Regulations, 2009 and the (Name of the Company) complies with the requirements of SEBI (ICDR) Regulations, 2018.

10. Confirmation from the post-issue Merchant Banker giving summary of bids received and details of allocations made to QIBs.

11. Certified true copy of the final Placement Document along with soft copy in pdf format.

12. Detail terms and conditions of the NCDs/ securities which are convertible into or exchangeable with equity shares, as may be applicable. Also provide the reconciliation of such outstanding securities.

13. List of allottees in excel in following format (Clubbing multiple allottees as single allotee if they are under same control or group as per SEBI (ICDR) Regulations, 2018:

S. No.	***Name of the allottee***	***PAN***	***Category***	***Shares allotted to total issue size***	***% of shares allotted to total issue size***

The detailed provisions pertaining to Bonus Issue as covered in Chapter XI of the SEBI (ICDR) Regulations, 2018 including conditions, restrictions and completion of a bonus issue, are covered in Lesson 12 of this study. Students are advised to refer Lesson No. 12 for the same.

SOCIAL STOCK EXCHANGE

Social Stock Exchange means a separate segment of a recognized stock exchange having nationwide trading terminals permitted to register Not for Profit Organizations and / or list the securities issued by Not for Profit Organizations in accordance with provisions of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

In terms of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Not for Profit Organization means a Social Enterprise which is any of the following entities:

(i) a charitable trust registered under the Indian Trusts Act, 1882;

(ii) a charitable trust registered under the public trust statute of the relevant state;

(iii) a charitable society registered under the Societies Registration Act, 1860;

(iv) a company incorporated under section 8 of the Companies Act, 2013;

(v) any other entity as may be specified by SEBI.

Access to Social Stock Exchange

A Social Stock Exchange shall be accessible to institutional investors, non-institutional investors and retail investors.

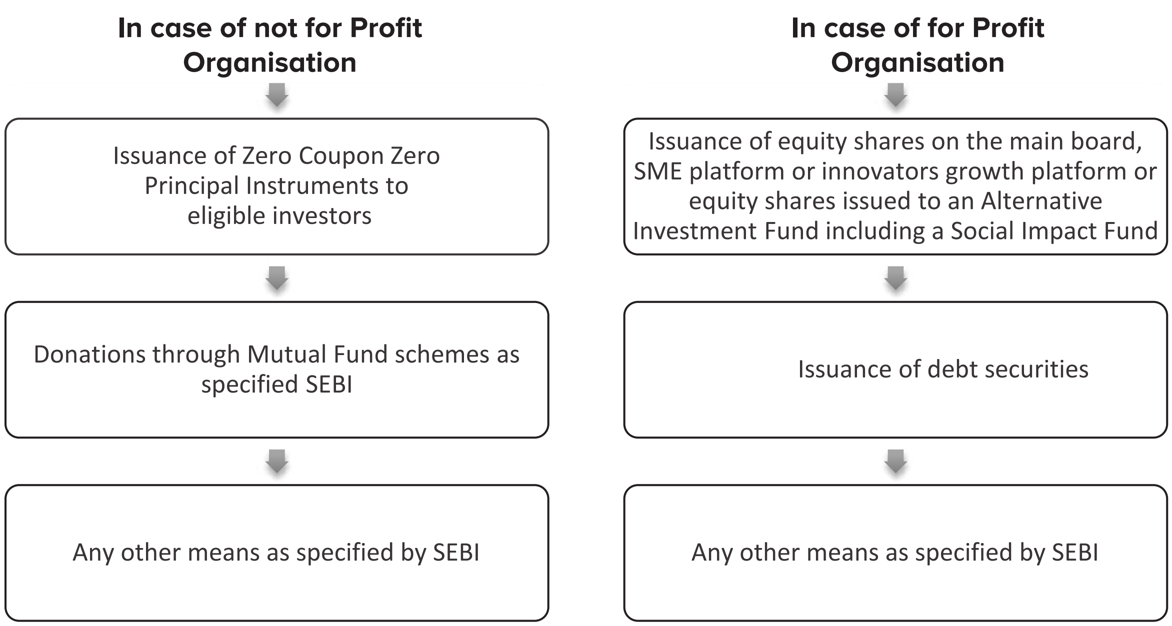
Eligibility conditions for being identified as a Social Enterprise

A Not for Profit Organization or a For Profit Social Enterprise, to be identified as a Social Enterprise, shall establish primacy of its **social intent** by indulging in the activities such as eradicating hunger, poverty, malnutrition and inequality; promoting health care including mental healthcare, sanitation and making available safe drinking water; promoting education, employability and livelihoods; promoting gender equality, empowerment of women and LGBTQIA+ communities; ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation; protection of national heritage, art and culture etc.

Requirements relating to registration for a Not for Profit Organization

The minimum requirements or eligibility requirements for registration of a Not for Profit Organization on a Social Stock Exchange shall be specified by SEBI from time to time.

Fund raising by Social Enterprises



Ineligibility for raising of funds

A Social Enterprise shall not be eligible to register or raise funds through a Social Stock Exchange or Stock Exchange, as the case may be:

(a) if the Social Enterprise, any of its promoters, promoter group or directors or selling shareholders or trustees are debarred from accessing the securities market by the Board;

(b) if any of the promoters or directors or trustees of the Social Enterprise is a promoter or director of any other company or Social Enterprise which has been debarred from accessing the securities market by the Board;

(c) if the Social Enterprise or any of its promoters or directors or trustees is a wilful defaulter or a fraudulent borrower;

(d) if any of its promoters or directors or trustees is a fugitive economic offender;

(e) if the Social Enterprise or any of its promoters or directors or trustees has been debarred from carrying out its activities or raising funds by the Ministry of Home Affairs or any other ministry of the Central Government or State Government or Charitable Commissioner or any other statutory body.

Contents of the fund raising document

The contents of the fund raising document shall be specified by SEBI.

For more details about Social Stock Exchange, the students may refer Lesson 9 of 'CSR and Social Governance', Elective Paper 4.1 of Professional Programme.

GREEN SHOE OPTION

A company desirous of availing green shoe option, should in the resolution of the general meeting authorising the public issue, seek authorization also for the possibility of allotment of further shares to the 'Stabilizing Agent' (SA) at the end of the stabilization period.

> Green Shoe Option (GSO) means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of Regulations 57 of the SEBI (ICDR) Regulations, 2018.

GSO in the system of IPO using book-building method was recognised by SEBI in India through its new guidelines on 14th August 2003. ICICI bank was the first to use Green Shoe Option in its public issue through book building mechanism in India.

ILLUSTRATION

Consider a company planning an IPO of say, 100,000 shares, at a book-built price of Rs. 100/-, resulting in an IPO size of Rs. 100,00,000. As per the ICDR Regulations, the over-allotment component under the Green Shoe mechanism could be up to 15% of the IPO, i.e. up to 15,000 shares, i.e. Green Shoe shares. Prior to the IPO, the stabilising agent would borrow such number of shares to the extent of the proposed Green Shoe shares from the pre- issue shareholders. These shares are then allotted to investors along with the IPO shares. The total shares issued in the IPO therefore stands at 115,000 shares. IPO proceeds received from the investors for the IPO shares, i.e. Rs.100,00,000–100,000 shares at the rate of Rs.100 each, are remitted to the Issuer Company, while the proceeds from the Green Shoe Shares (Rs.15,00,000/-, being 15,000 shares x Rs.100/-) are parked in a special escrow bank account, i.e. Green Shoe Escrow Account. During the price stabilisation period, if the share price drops below Rs.100, the stabilising agent would utilise the funds lying in the Green Shoe Escrow Account to buy these back shares from the open market. This gives rise to the following three situations:

- **Situation #1** - where the stabilising agent manages to buyback all of the Green Shoe Shares, i.e.,15,000 shares;
- **Situation #2** - where the stabilising agent manages to buyback none of the Green Shoe Shares;
- **Situation #3** - where the stabilising agent manages to buy-back some of the Green Shoe Shares, say 10,000 shares.

Let us examine each of these situations separately:

Situation #1 – Where all Green Shoe Shares are bought back: In this situation, funds in the Green Shoe Escrow Account (Rs.15,00,000, in this case) would be deployed by the stabilising agent towards buying up shares from the open market. Given that the prices prevalent in the market would be less than the issue price of Rs. 100, the stabilising agent would have sufficient funds lying at his disposal to complete this operation. Having bought back all of the 15,000 shares, these shares would be temporarily held in a special depository account with the depository participant (Green Shoe Demat Account), and would then be returned back to the lender shareholders, within a maximum period of two days after the stabilisation period.

Situation #2 – Where none of the Green Shoe Shares are bought back: This situation would arise in the (very unlikely) event that the share prices have fallen below the Issue Price, but the stabilising agent is unable to find any sellers in the open market, or in an event where the share prices continue to trade above the listing price, and therefore there is no need for the stabilising agent to indulge in price stabilisation activities.

In either of the above-said situations, the stabilising agent is under a contractual obligation to return the 15,000 shares that had initially been borrowed from the lending shareholder(s). Towards meeting this obligation, the issuer company would allot 15,000 shares to the stabilising agent into the Green Shoe Demat Account (the consideration being the funds lying the Green Shoe Escrow Account), and these shares would then be returned by the stabilising agent to the lending shareholder(s), thereby squaring off his responsibilities.

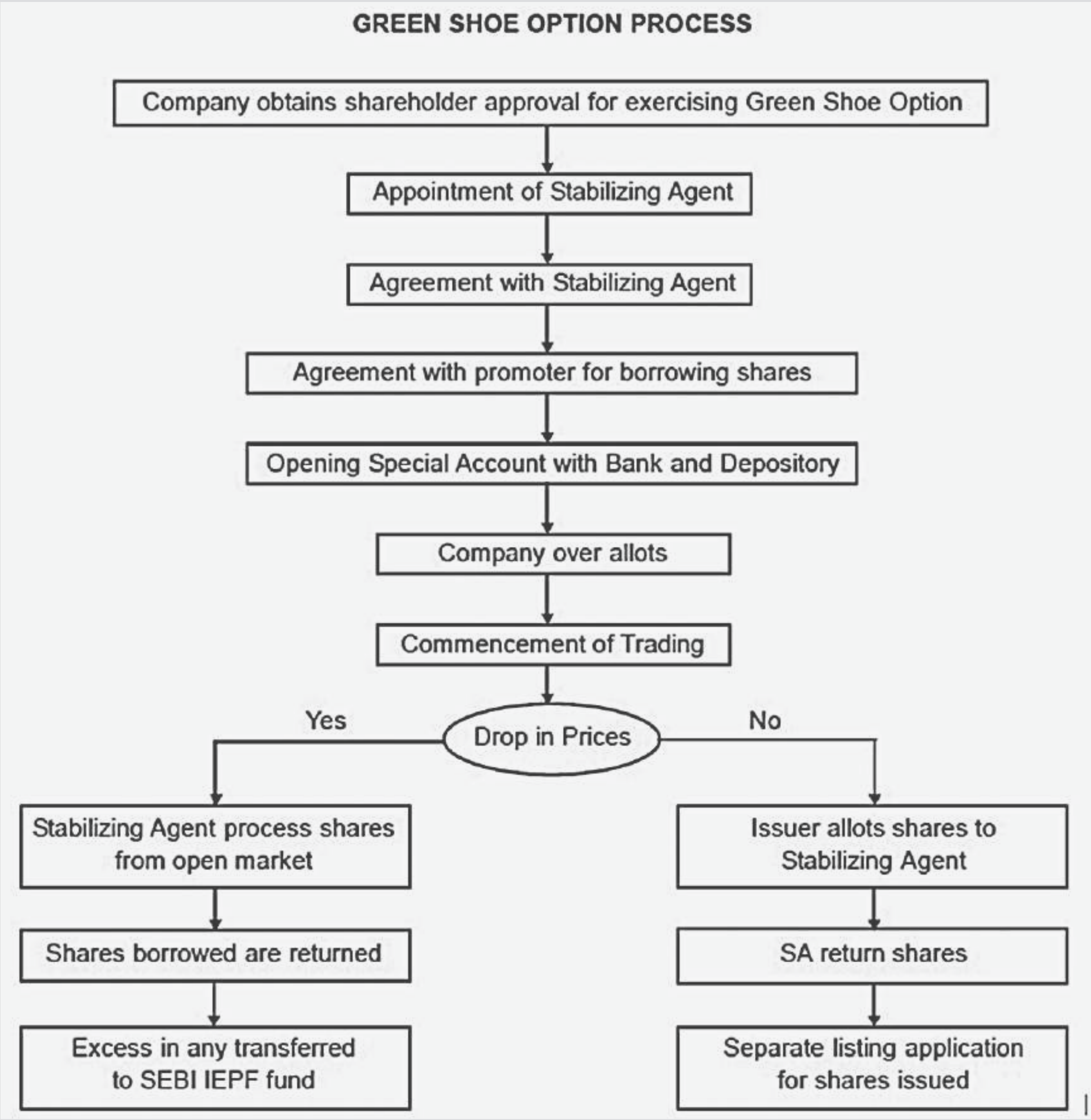
Situation #3 – Where some of the Green Shoe Shares are bought back, say 10,000 shares: This situation could arise in an event where the share prices witness a drop in the initial stages of the price stabilisation period, but recover towards the latter stages.

In this situation, the stabilising agent has a responsibility to return 15,000 shares to the lending shareholder(s), whereas the stabilising activities have yielded only 10,000 shares.

Similar to the instance mentioned in Situation #2 above, the issuer company would allot the differential 5,000 shares into the Green Shoe Demat Account to cover up the shortfall, and the stabilising agent would discharge his obligation to the lending shareholder(s) by returning the 15,000 shares that had been borrowed from them.

Both in Situation #2 and #3, the issuer company would need to apply to the exchanges for obtaining listing/ trading permissions for the incremental shares allotted by them, pursuant to the Green Shoe mechanism.

Any surplus lying in the Green Shoe Escrow Account would then be transferred to the Investor Protection and Education Fund established by SEBI, as required under ICDR Regulations and the account shall be closed thereafter.



LESSON ROUND-UP

- Management of a public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrar to the issue, solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/Statutory agencies such as Registrar of Companies, Reserve Bank of India, SEBI etc.

- SEBI vide its notification dated 11th September, 2018 issued SEBI (ICDR) Regulations, 2018 ('ICDR, 2018') which is effective from 60th day of its publication in Official Gazette. On August 26, 2009 SEBI rescinded the SEBI (DIP) Guidelines, 2000 and notified SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

- Primary Market deals with those securities which are issued to the public for the first time.
- A public issue of specified securities by an issuer can be either an Initial Public Offering (IPO) or a Further Public Offering (FPO). An IPO is done by an unlisted issuer while a FPO is done by a listed issuer.
- The minimum net offer to the public shall be subject to the provision of clause (b) of sub-rule (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957 (SCRR).
- The minimum subscription to be received in an issue shall be not less than 90% of the offer through offer document except in case of an offer for sale of specified securities.
- The promoters should contribute not less than 20% of post-issue capital, in case of a public issue by an unlisted company.
- The promoters shall bring full amount of the promoters' contribution including premium at least one day prior to the date of opening of the issue, which shall be kept in an escrow account with a scheduled commercial bank, which shall be released to the issuer along with the release of the issue proceeds.
- The issuer may mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before filing the prospectus with the Registrar of Companies.
- Rights Issue, Preferential allotment and Qualified Institutions Placement are also governed by ICDR Regulations.
- Unless otherwise provided, SEBI (ICDR) Regulations, 2018 shall apply to a rights issue by a listed issuer, where the aggregate value of the issue is fifty crore rupees or more. However, in case of rights issue of size less than Rs. 50 crore, the issuer shall prepare the letter of offer in accordance with requirements a specified in SEBI (ICDR) Regulations, 2018 and file the same with SEBI for information and dissemination on SEBI's website.
- A rights issue shall be open for subscription for a minimum period of 7 days and for a maximum period of 30 days.
- Qualified Institutions Placement means allotment of eligible securities by a listed issuer to qualified institutional buyers on private placement basis in terms of these regulations. Eligible Securities include equity shares, non-convertible debt instruments along with warrants and convertible securities other than warrants.
- Preferential issue means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis in accordance with Chapter V of SEBI (ICDR) Regulations, 2018 and does not include an offer of specified securities made through employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or depository receipts issued in a country outside India or foreign securities.
- SEBI has stipulated conditions and manner for providing exit opportunity to dissenting shareholders as per Schedule XX of the SEBI (ICDR) Regulations, 2018.
- Green Shoe Option (GSO) means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of Regulations 57 of the SEBI (ICDR) Regulations, 2018.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Discuss briefly the eligibility criteria for making an IPO under SEBI (ICDR), Regulations, 2018?
2. Elucidate the entities not eligible for making an FPO of securities under SEBI (ICDR), Regulations, 2018.
3. Briefly explain the Promoter's Contribution in Public Issue of Securities under SEBI (ICDR) Regulations, 2018.
4. What are the provisions required to be complied with by a company for issue shares on a rights basis under SEBI (ICDR), 2018?
5. Who is dissenting shareholders? Explain the manner of providing exit to dissenting shareholders under the SEBI (ICDR) Regulations, 2018.
6. Define and discuss the conditions for Preferential Issue. When an issuer becomes ineligible to make a such issue ?
7. Write short notes on -
   (a) Minimum subscription
   (b) Minimum promoters' contribution
   (c) Offer Document
   (d) Red-herring Prospectus.
8. Subham Ltd. issued 50 Lakh equity shares at a price of Rs. 200 per share. The company provided Green Shoe Option for stabilizing the post listing price of the shares. The issue was oversubscribed and it was decided that stabilizing agent would borrow maximum number of shares permitted by SEBI (ICDR) regulations.

   Due to rise in price during Green Shoe Option period, only 5 Lakh shares could be bought back at the price of Rs. 180.

   You are required to:

   i. Calculate the number of shares that the stabilizing agent needs to borrow in this case at the time of allotment and explain the same with relevant provisions.
   ii. Explain the responsibility of Issuer Company in the above case with respect to shortfall while exercising Green Shoe Option.
   iii. Calculate the amount if any, to be transferred to Investor Protection and Education Fund.

LIST OF FURTHER READINGS

- SEBI Manual
- Premier on Companies Act, 2013
- Regulations/Rules/Guidelines/Circulars issued by SEBI, RBI, MCA etc. from time to time

OTHER REFERENCES

- www.mca.gov.in
- www.sebi.gov.in
- www.nseindia.com
- www.icsi.edu
- www.ebook.mca.gov.in
- www.bseindia.com

Real Estate Investment Trusts

Lesson 9

KEY CONCEPTS

■ Securitization ■ Mortgage REITs ■ Equity REITs ■ Sponsors ■ Inducted Sponsors ■ Strategic Investor

Learning Objectives

To understand:

- The history of Real Estate Investment Trust (REITs)
- Meaning and structure of REITs
- Regulatory Framework of REITs in India
- Issue and Listing Units by REITs
- Salient features of SEBI (REIT) Regulations, 2014
- Why REIT is an attractive alternative investment instrument in the Indian financial markets?

Lesson Outline

- Introduction and Genesis
- Salient features of SEBI (Real Estate Investment Trust) Regulations, 2014
- Definitions
- Eligibility Criteria
- Issue and Allotment of Units
- Offer Documents and Advertisement
- Guidelines for Public Issue of Units of REITs
- Listing and Trading of Units
- Delisting of Units
- Investment Conditions and Distribution Policy
- Borrowing and Deferred Payment
- Rights and Meetings of Unit Holders
- Disclosures
- Governance Norms for REITs
- Participation by Strategic Investor(s) in REITs
- Power to relax strict enforcement of the Regulations
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- SEBI (Real Estate Investment Trusts) Regulations, 2014
- Guidelines for Public Issue of Units of REITs
- SEBI (Listing Obligation and Disclosures Requirements) Regulations, 2015
- The Trust Act, 1882
- The Registration Act, 1908
- The FEMA, 1999
- The Income Tax Act, 1961

INTRODUCTION

The Real Estate Investment Trust (REIT) is an investment vehicle that invests in rent-yielding completed real estate properties which has the potential to transform the Indian real estate sector.

REIT helps attracting long-term financing from domestic as well as foreign sources. This could improve fund availability to real estate developers and reduce some burden on completed assets by allowing owners of such assets to raise capital from investors against issue of units. Further, for the investors, the REIT can provide a new investment vehicle with ongoing returns, elevated transparency and governance standards.

REIT markets started in US in 1960s, followed by Australia in the early 1970s. From the late 1990s, and particularly the early 2000s, Asian governments have been passing legislation which allows the establishment of REITs, giving tax concessions which replicate the taxation treatment of REITs globally, including in particular the US and Australia.

GENESIS

Real estate investment trusts (REITs) has been one of the most important vehicles for making collective investment in commercial real estate. Emanating in the USA in 1960s as a tax transparent collective investment vehicle, REITs have subsequently been used by several other countries, and have done remarkably well.

In India, SEBI had introduced real estate mutual funds pursuant to recommendations of an AMFI Committee, and thereafter, it came with draft regulations on REITs in 2008. In 2013, a regulatory framework was once again put on public domain. After taking industry inputs, amendments to regulations were made and the draft was approved allowing setting up and listing of REIT's. Post the clarification provided in the budget, SEBI on 26th September 2014 finally notified the final regulations - SEBI (Real Estate Investment Trust) Regulations, 2014.

The introduction of regulatory framework for Real Estate Investment Trusts (REITs) has paved the way for the launch of REIT funds in India.

REITs in India would issue securities, which would be listed on stock exchanges. REITs will invest predominantly incompleted commercial real estate assets, either directly or through SPVs. Initially, REITs are planned to be available only to high networth individuals and institutions to develop the market. Gradually, they will be available for retail investors as well.

Development of REITs in India

Enacted year	*Citation*	*REIT type*	*REIT market*
September 26, 2014	Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 ('REIT Regulations') dated September 26, 2014 - modifications/ amendments	Trust	• The Embassy Office Parks REIT is the first Indian REIT listed on the Indian stock exchange in the year 2019. • The initial public offer of the Embassy REIT raised INR 47.5 billion.

Enacted year	Citation	REIT type	REIT market
	are made from time-to-time via a press release, notifications and circulars		• The Embassy Office Parks REIT is a platform jointly owned by Blackstone Group LP and Bengaluru based developer Embassy Property Developments Private Limited. • Comprising a portfolio featuring seven office parks and four office buildings, and offering an initial distribution yield of around 8.25%, the Embassy Office Park REIT's share price shot up some 34% in its first six months.
			• Mindspace Business Parks REIT filed draft offer document on December 31, 2019, making it the second REIT to attempt a listing on the Indian stock exchange. • Mindspace Business Parks REIT is jointly owned by K Raheja Corp and BlackstoneGroup LP.
			• The Indian REIT market is likely to witness a few more REITs in the next two years. • Brookfield India Real Estate Trust (Brookfield REIT), IIFL REIT and India REIT are also Retail registered with SEBI.

Source: Global REIT Survey 2020

India is the 31st country in the world to enact REIT legislation following action by the SEBI in 2014. However, India's first REIT was launched as recently as 2019. It was a joint venture between Bangalore-based real estate developer Embassy Group and the US- based private equity giant Blackstone (the 2 firms are the sponsors of the REIT). Together, they formed the Embassy Office Parks REIT which raised close to Rs. 4750 crore from its IPO. Even more recently, the Mindspace Business Parks REIT IPO concluded in August 2020 through which the company raised about Rs.4500 crore.

Registered REITs in India as on May 21, 2024

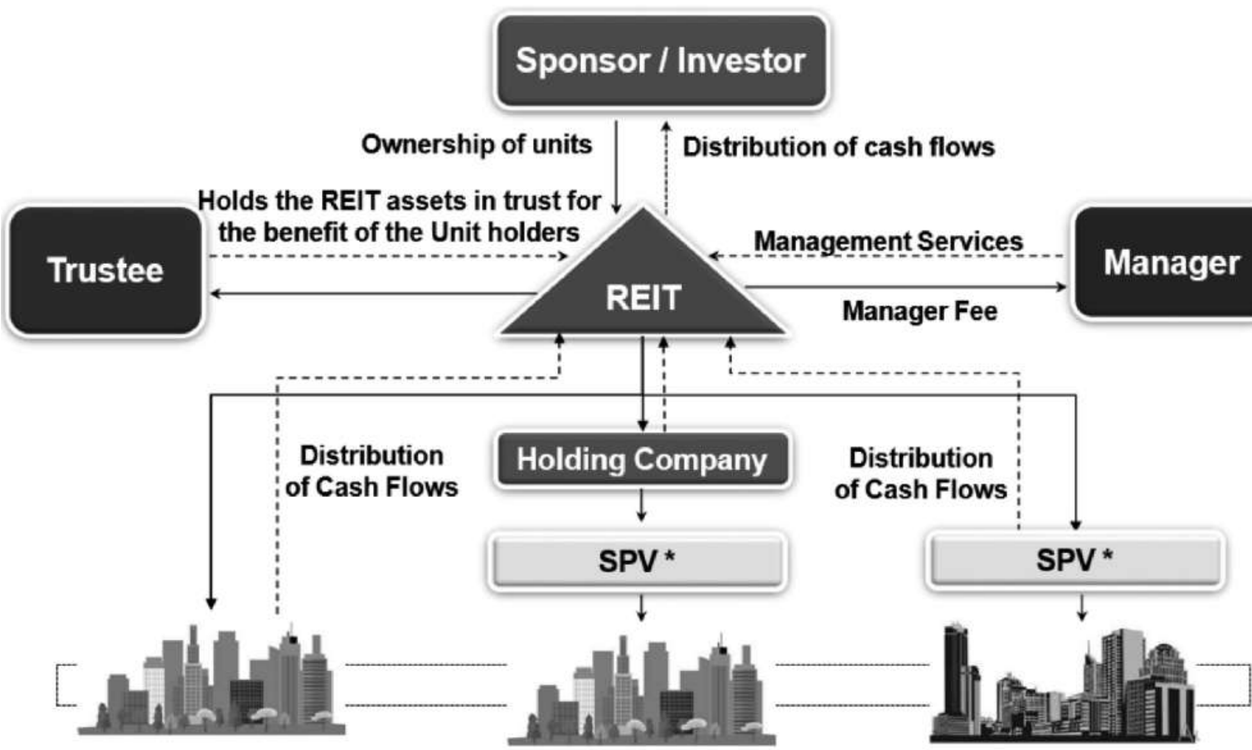
1. **Embassy Office Parks REIT**
2. **Mindspace Business Parks REIT**
3. **Brookfield India Real Estate Trust**
4. **360 One Real Estate Investment Trust**
5. **Nexus Select Trust**

- **India is the 31st country in the world to enact REIT Legislation.**
- **The US REIT Regime was first enacted in 1960 and effective in 1961.**

Difference between REITs and Mutual Funds

Basis	*REITs*	*Mutual Funds*
Meaning	A REIT is a corporation, trust, or association that invests directly in real estate through properties or mortgages. They trade on a stock exchange and are bought and sold like stocks.	Mutual funds are professionally managed pooled investments that invest in a variety of vehicles, such as stock and bonds.
Investment	A large amount of funds to be shelled out if one wish to invest in real estate.	Mutual funds require small amounts to be invested.
Diversification	An Investor can invest only real estaterelated stocks through REITs.	Mutual funds, however, allow you to diversify your portfolio by investing in various sectors.
Legal	The SEBI (Real Estate Investment Trusts) Regulations applies to REITs).	The SEBI (Mutual Funds) Regulations, 1996 applies to Mutual Funds.

REIT Structure



* REITs to hold assets either through Special Purpose Vehicles (SPVs) or directly

SALIENT FEATURES OF SEBI (REIT) REGULATIONS, 2014

Governing Code

- SEBI (Real Estate Investment Trusts) Regulations, 2014.

Legal Structure

- Trust setup under Indian Trusts Act, 1882.

Parties to the REITs

- Sponsor Group, Unitholders, Inducted Sponsor, Manager and Trustee.

Maximum number of sponsors that REITs can have & Unit holding obligation

- Each sponsor shall hold or propose to hold minimum 5% of units of REITs on post-initial offer basis.
- Collectively hold not less than-
  - 15% of units of the REIT, for three years from the date of listing of units in the initial offer: If it exceeds from 15 % by any sponsor or sponsor groups, it shall be held for a period of not less than one year from the date of listing.
  - 5% of total units of REITs from beginning of 4th year till the end of 5th year
  - 3% of total units of REITs from beginning of 6th year till the end of 10th year
  - 2% of total units of REITs from beginning of 11th year till the end of 20th year
  - 1% of total units of REITs after the end of 20th year from the date of listing of units issued in the initial offer

However, the maximum value of the units to be held by the sponsor(s) and sponsor group(s) for compliance shall not exceed five hundred crore rupees.

The units required to be held as mentioned above shall be locked in and shall not be encumbered.

Eligibility for Trustee

- Shall be registered as a Trustee under SEBI (Debenture Trustee) Regulations,1993 and shall not be an associate of Sponsor/Manager.

Listing requirement

- Listing is mandatory for units.

Investment conditions

- Atleast 80% of the value of the REIT assets needs to be invested in completed and revenue generating properties.

Other Permissible Investments

- Not more than 20% of value of the REIT assets can be invested in:-
  a) Developmental properties;
  b) Listed or unlisted debt of companies/body corporate in real estate sector;

c) Mortgage backed securities; d) Equity shares of companies which are listed on a recognized stock exchange in India which derive not less than 75% of their operating income from Real Estate activity as per the audited accounts of previous financial year; e) Government securities; f) Unutilized FSI of a project; g) TDR acquired for the purpose of Utilization; h) Money market instruments or Cash equivalents.
Valuation of assets
● Full valuation on a yearly basis and updating the same on a half yearly basis and declare NAV within 15 days from the date of such valuation/updation.
Distribution of Income
● Atleast 90% of the net distributable income after tax of the REIT/Holdco shall be distributed as dividend to the unit holders atleast on half-yearly basis and shall be made not later than fifteen days.
Mode of Investment in properties
● Directly or through SPVs holding atleast 80% of their assets directly in such properties and shall not invest in other SPVs. ● The REIT shall hold controlling interest and not less than 50% of the equity share capital of the Special Purpose Vehicle.
Initial offer restrictions
● Minimum offer size should be atleast Rs. 250 crore.
Minimum Subscription Amount and unit size
● Under both the initial offer and follow-on offer, rights issue, QIP, minimum subscription size for units of REITs shall be in range of ten thousand rupees to fifteen thousand rupees. ● The units offered to the public in initial offer shall not be less than 25% of the number of units of the REIT on post-issue basis. Can offer less than 25% subject to certain conditions [Reg.14(2A)] ● Trading lot shall be 1 Unit.
Borrowings and Deferred Payments
● The aggregate consolidated borrowings and deferred payments of the REIT, Holders and/or SPVs shall never exceed 49% of the value of the REIT assets. ● In case such borrowings/deferred payments exceed 25%, approval from unit holders and credit rating shall be required.

- **Value of Assets by REIT shall be at least Rs. 500 crores.**
- **Minimum Number of Unit holders other than sponsor(s), its related parties and its associates forming part of public shall be at least 200.**

DEFINITIONS

"Associate" of any person shall be as defined under the Companies Act, 2013 or under the applicable accounting standards and shall also include following:

(i) any person controlled, directly or indirectly, by the said person;

(ii) any person who controls, directly or indirectly, the said person;

(iii) where the said person is a company or a body corporate, any person(s) who is designated as promoter(s) of the company or body corporate and any other company or body corporate with the same promoter(s);

(iv) where the said person is an individual, any relative of the individual.

"Body corporate" shall have the meaning assigned to it in or under sub-section(11) of section 2 of the Companies Act, 2013.

"Bonus issue" means additional units allotted to the unit holders as on the record date fixed for the said purpose, without any cost to the unit holder.

"*Change in control*" means-

(i) in case of a body corporate, -

a) if its shares are listed on any recognized stock exchange, shall be construed with reference to the definition of control in terms of regulations framed under clause (h) of sub-section (2) of section 11 of the Act.

b) if its shares are not listed on any recognized stock exchange, shall be construed with reference to the definition of control as provided in sub-section (27) of section 2 of the Companies Act, 2013.

(ii) in a case other than a body corporate, shall be construed as any change in its legal formation or ownership or change in controlling interest. Here, "controlling interest" means an interest, whether direct or indirect, to the extent of not less than 50% of voting rights or interest.

"Completed property" means property for which occupancy certificate has been received from the relevant authority.

"Floor Space Index" or ***"FSI"*** shall mean the buildable are a on a plot of land as specified by the competent authority.

"Follow-on Offer" means offer of units of a listed REIT to the public for subscription and includes an offer for sale of REIT units by an existing unit holder to the public.

"*group entities of the Manager*" means:

(i) entities or person(s) which are controlled by the Manager;

(ii) entities or person(s) who control the Manager; or

(iii) entities or person(s) controlled by entities or person(s) specified in sub-clause (ii).

"Holdco"* or *"holding company" shall mean a company or LLP -

(i) in which REIT holds or proposes to hold not less than fifty percent of the equity share capital or interest and which it in turn has made investments in other SPV(s), which ultimately hold the property(ies).

(ii) which is not engaged in any other activity other than holding of the underlying SPV(s), holding of real estate/ properties and any other activities pertaining to and incidental to such holdings.

"Independent director" in case of a company means a director, other than a nominee director of the Manager:-

(i) who, in the opinion of the Board of Directors of the Manager, is a person of integrity and possesses relevant expertise and experience;

(ii) who is not or was not a sponsor of the REIT, a promoter of parties to the REIT, their holding, subsidiary or associate or a member of the sponsor group of the REIT;

(iii) who is not related to the REIT, its Holdco and/or SPV, parties to the REIT, its holding company or associate or their promoters or directors;

(iv) who, apart from receiving a director's remuneration, does not have or has had any material pecuniary relationship with the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, the subsidiary or associate or their promoters or directors, during the three immediately preceding financial years or during the current financial year;

(v) none of whose relatives –

- is holding securities of or interest in the REIT, its Holdco and/or SPV, parties to the REIT, their holding Company, subsidiary or associate during the three immediately preceding financial years or during the current financial year of face value in excess of fifty lakh rupees or two percent of the unit capital of the REIT, two percent of the paid-up capital of the parties to the REIT, their holding Company, subsidiary or associate or Holdco and/or SPV respectively or such higher sum as may be specified;
- is indebted to the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, subsidiary or associate or their promoters or directors, during the three immediately preceding financial years or during the current financial year, in excess of such amount as may be specified;
- has given a guarantee or provided any security in connection with the indebtedness of any third person to the REIT, its Holdco or SPV, parties to the REIT, its holding company, subsidiary or associate or their promoters or directors, during the three immediately preceding financial years or during the current financial year, for such amount as may be specified; or
- has any other pecuniary transaction or relationship with the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, subsidiary or associate amounting to two percent or more of its gross turnover or total income.

However, the pecuniary relationship or transaction with the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, subsidiary or associate or their promoters or directors shall not exceed two percent of its gross turnover or total income or fifty lakh rupees or such higher amount as may be specified from time to time, whichever is lower.

(vi) who, neither himself or herself, nor whose relative(s) —

- holds or has held the position of a key managerial personnel or is or has been an employee of the Holdco and/or SPV, parties to the REIT or its holding, subsidiary or associate or any company belonging to parties to the REIT, in any of the three financial years immediately preceding the financial year in which he/she is proposed to be appointed.

  However, in case of a relative who is an employee other than a key managerial personnel, the restriction under this clause shall not apply for his/her employment.
- is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he/she is proposed to be appointed, of-
  1. a firm of auditors or **company secretaries in practice** or cost auditors of the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, subsidiary or associate; or

2. any legal or a consulting firm that has or had any transaction with the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, subsidiary or associate amounting to ten per cent or more of the gross turnover of such firm;

- holds together with his relatives two per cent or more of the total voting power of the REIT, its Holdco and/or SPV, parties to the REIT;
- is a chief executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts or corpus from the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, subsidiary or associate, any of its promoters, directors or that holds two per cent or more of the total voting power of the REIT, its Holdco and/or SPV, parties to the REIT;
- is a material supplier, service provider or customer or a lessor or lessee of the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, subsidiary or associate;

(vii) who is not less than 21 years of age; or

(viii) who possesses such other qualifications as may be specified by the SEBI.

"Net Asset Value" or "NAV" means the value of the REIT assets reduced by the external debt divided by the number of outstanding units as on a particular date.

"Occupancy certificate" means a completion certificate, or such other certificate, as the case may be, issued by the competent authority permitting occupation of any property under any law for the time being in force.

"Real Estate" or" Property" means land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, carparks, etc. and any other assets incidental to the ownership of real estate but does not include mortgage.

However, any asset falling under the purview of infrastructure' as defined vide Notification of Ministry of Finance dated October 07, 2013 including any amendments or additions made there of shall not be considered as 'real estate' or 'property' for the purpose of these Regulations.

Apart from the above, following captured within the above mentioned definition of infrastructure shall be considered under "real estate" or "property",-

(i) hotels, hospitals and convention centers, forming part of composite real estate projects, whether rent generating or income generating;

(ii) common infrastructure for composite real estate projects, industrial parks and SEZ.

"Real estate assets" means properties held by REIT, on a freehold or leasehold basis, whether directly or through a holdco and/or a special purpose vehicle.

"REIT" or "Real Estate Investment Trust" means a person that pools rupees fifty crores or more for the purpose of issuing units to at least two hundred investors so as to acquire and manage real estate asset(s) or property(ies), that would entitle such investors to receive the income generated therefrom without giving them the day-to-day control over the management and operation of such real estate asset(s) or property(ies).

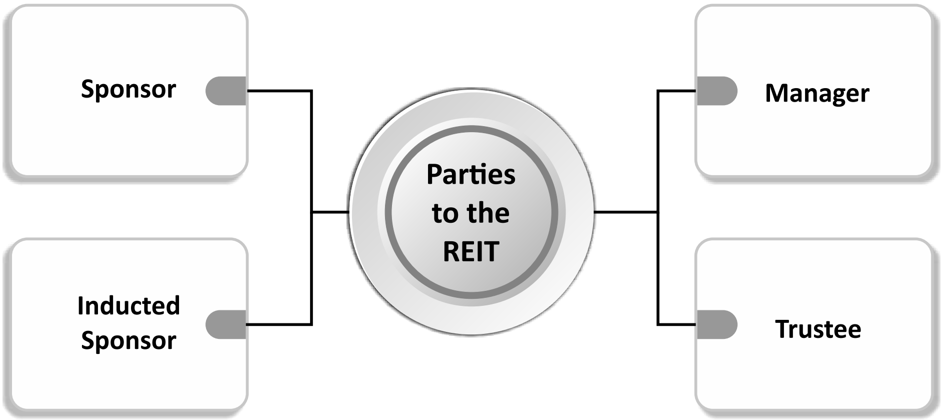
A REIT or Real Estate Investment Trust shall include Small and Medium REIT (SM REIT).

However, any company which acquires and manages real estate asset(s) or property(ies) and offers or issues securities to the investors, shall not be construed as a REIT or Real Estate Investment Trust;"

"REIT assets" means real estate assets and any other assets held by the REIT on a freehold or leasehold basis, whether directly or through a holdco and /or special purpose vehicle.

"Related Party" shall be defined under the Companies Act, 2013 or under the applicable accounting standards and shall also include:

(i) parties to the REIT



(ii) promoters;

(iii) directors; and

(iv) partner of the persons in clause(i).

"Rent Generating Property" means property which has been leased or rented out in accordance with an agreement entered into for the purpose.

"Self-Sponsored Manager" means the Manager of a REIT who has dual responsibilities of both the Manager as well as the sponsor.

"Senior Management" means officers or personnel of the Manager who are members of its core management team excluding the Board of Directors and shall also comprise all members of the management one level below the Chief Executive Officer or Managing Director, Whole Time Director, manager (including Chief Executive Officer or manager, in case they are not part of the Board of Directors) and shall specifically include the Compliance Officer and Chief Financial Officer.

"Special Purpose Vehicle" or "SPV" means any company or LLP:

(i) in which either the REIT or the holdco holds or proposes to hold not less than fifty percent of the equity share capital or interest;

(ii) which holds not less than eighty percent of its assets directly in properties and does not invest in other special purpose vehicles; and

(iii) which is not engaged in any activity other than holding and developing property and any other activity incidental to such holding or development.

"Sponsor" means any person(s) who set(s) up the REIT and designated as such at the time of application made to SEBI and shall include an Inducted Sponsor.

"Sponsor Group" - includes:

(i) the sponsor(s);

(ii) in case the sponsor is a body corporate:

a. entities or person(s) which are controlled by such body corporate;

b. entities or person(s) who control such body corporate;

c. entities or person(s) which are controlled by person(s) as referred at clause b.

(iii) in case sponsor is an individual:

a. an immediate relative of such individual (i.e., any spouse of that person, or any parent, brother, sister or child of the person or of the spouse); and

b. entities or person(s) which are controlled by such individual.

"Transferable Development Rights" **or "*TDR*"** shall mean development rights issued by the competent authority under relevant laws in lieu of the area relinquished or surrendered by the owner or developer or by way of declared incentives by the Government or authority.

*"**Valuer**"* means any person who is a "registered valuer" under section 247 of the Companies Act, 2013 or as specified by SEBI from time to time.

ELIGIBILITY CRITERIA

No person shall act as a REIT unless it is registered with SEBI under the REIT Regulations. The following conditions shall be considered before grant of registration:

(a) Applicant

The applicant must be a sponsors or on behalf of trust and Trust Deed shall be duly registered in India under the provisions of the Registration Act, 1908 containing its main objective as undertaking activity of REIT in accordance with the REIT Regulations and includes responsibilities of the Trustee in accordance with of the provisions of REIT Regulations. Persons have been designated as sponsor(s), manager and trustee and all such persons are separate entities.

(b) Sponsor

- Each sponsor shall hold or propose to hold not less than five percent of the number of units of the REIT on post-initial offer basis. Further, each sponsor and sponsor group shall be clearly identified in the application of registration to SEBI and in the offer document/placement memorandum, as applicable.
- For each sponsor group not less than one person shall be identified as a sponsor.
- Out of the entities categorized as sponsor group, only the following entities may be considered:
  a) a person or entity who is directly or indirectly holding an interest or share holding in any of the assets or SPVs or holdcos proposed to be transferred to the REIT.
  b) a person or entity who is directly or indirectly holding units of the REIT on post-issue basis.
  c) a person or entity whose experience is being utilized by the sponsor for meeting with the eligibility conditions required under REIT regulations.
- The sponsor(s), on a collective basis, have a networth of not less than one hundred crore rupees: However, each sponsor has a networth of not less than twenty crore rupees; and
- The sponsor or its associate(s) has not less than five years' experience in development of real estate or fund management in the real estate industry.

However, where the sponsor is a developer, at least two projects of the sponsor have been completed.

(c) Manager

- In case, the Manager is a body corporate or a company, the networth of the manager shall not be less than Rs. 10 crore or in case, the manager is a LLP, the value of net tangible assets shall not be less than ten crore rupees;
- The Manager or its associate must have at least 5 years of experience in fund management/ advisory services/property management in the real estate industry or in development of real estate. Further, the manager must have at least 2 key personnel who each have not less than 5 years of experience in fund management/advisory services/ property management in the real estate industry or in development of real estate;
- The manager shall not less than half, of its directors in the case of a company or of members of the governing board in case of an LLP, as independent and not directors or members of the governing board of the manager of another REIT; and
- The manager must have entered into an investment management agreement with the trustee which provides for the responsibilities of the manager in accordance with REIT Regulations.

How does an REIT work?

REITs raise funds from a large number of investors and directly invest that sum in income-generating real estate properties (which could be offices, residential apartments, shopping centres, hotels and warehouses). The trusts are listed in stock exchanges so that investors can buy units in the trust. REITs are structured as trusts. Thus, the assets of an REIT are held by an independent trustee on behalf ofunit holders.

(d) Trustee

It should be registered with SEBI under SEBI (Debenture Trustees) Regulations, 1993. It is not an associate of the sponsor(s) or manager and the trustee has such wherewithal respect to infrastructure, personnel, etc. to the satisfaction of SEBI and in accordance with circulars or guidelines as may be specified by SEBI.

(e) The unit holder of the REIT shall not enjoy superior voting or any other rights over another unit holder and there are no multiple classes of units of REIT. However, subordinate units may be issued only to the sponsors and its associates, where such subordinate units shall carry only inferior voting or any other rights compared to other units.

Further, unitholders holding not less than 10% of the total outstanding units of the REIT, either individually or collectively, shall be entitled to nominate one director on the board of directors of the Manager as specified by the SEBI. The director so nominated shall recuse from voting on any transaction in which such nominee director or associate of such nominee director or the unitholder who nominated such nominee director or the associate of such unitholder is a party.

Such unitholders' shall comply with the stewardship code as specified in these regulations.

Also, the Manager of the REIT shall, within ten days from the end of each calendar month, review whether the Eligible Unitholder(s) who have exercised the board nomination right, continue to have/ hold the required number of units of REIT and make a report of the same. The Manager of the REIT shall submit such report to the Trustee of the REIT.

(f) The applicant has clearly described at the time of application for registration, details pertaining to proposed activities of the REIT.

(g) The REIT and parties to the REIT are fit and proper persons based on the criteria as specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008.

(h) Whether any previous application for grant of certificate by the RIET or the parties to the REIT or their directors/members of governing board has been rejected by SEBI.

(i) Whether any disciplinary action has been taken by SEBI or any other regulatory authority against the REIT or the parties to the REIT or their directors/ members of governing board under any Act or the regulations or circulars or guidelines made thereunder.

ISSUE AND ALLOTMENT OF UNITS

<table>
<tr><th colspan="3">Issue and Allotment of Units - Summary</th></tr>
<tr><td>Initial Offer of Units</td><td colspan="2">Only by Public Issue</td></tr>
<tr><td>Further Offer of Units</td><td colspan="2">By any means (Public Issue/Right Issue/QIP etc.)</td></tr>
<tr><td>Minimum Value of REIT</td><td colspan="2">Rs. 500 crore (minimum value of REIT should be complied any time before the allotment of units)</td></tr>
<tr><td>Minimum Number of Unit holders</td><td colspan="2">200</td></tr>
<tr><td>Minimum offer size for Initial issue of units</td><td colspan="2">Rs. 250 crores</td></tr>
<tr><td rowspan="4">Minimum Public Holding</td><td>Post Issue Capital</td><td>Minimum Public Shareholding</td></tr>
<tr><td>Less than Rs. 1600 crore</td><td>At least 25% of the total of the outstanding units of the REIT</td></tr>
<tr><td>Rs. 1600 crore and more but less than Rs.4000 crore</td><td>At least Rs. 400 crore</td></tr>
<tr><td>Rs. 4000 crore and more</td><td>At least 10% of the total of the outstanding units</td></tr>
<tr><td>Offer Document</td><td colspan="2">● Draft Offer Document to be filed to SEBI to receive observations (If any)
● Get Due Diligence Certificate
● Comply with the observation received and file the other document with Stock Exchange</td></tr>
<tr><td>Offer Period</td><td colspan="2">● Final Offer Document to be filed with Stock Exchange before opening of the offer
● Maximum 30 days</td></tr>
</table>

Allotment of Units	• Only in demat form • With in 4 days from the date of closing of issue (Allotment or Refund)
When to refund money?	• Minimum subscription not achieved (90%) • Oversubscribed amount (can keep upto 25%) • Applicants are less than 200 in number
Amount for General Purpose	• Maximum 10% of the amount raised by issuance of units

1. A REIT shall make an initial offer of its units by way of public issue only.
2. No initial offer of units by the REIT shall be made unless,
   - the REIT is registered with SEBI under the REIT Regulations;
   - the value of the REIT assets owned by the REIT is not less than Rs. 500 crores;

     > It may be noted that such value shall mean the value of the specified portion of the holding of REIT in the underlying assets or SPVs.

   - the minimum number of unit holders other than sponsor(s), its related parties and its associates forming part of public shall be not less than two hundred;
   - maximum subscription from any investor other than sponsor(s), its related parties and its associates shall not be more than 25 percent of the total unit capital; and
   - the offer size is not less than Rs. 250 crores.
3. The requirement of ownership of assets i.e. minimum Rs. 500 crores and size of REIT i.e. minimum Rs. 250 crores may be complied at any point of time before allotment of units in accordance with offer document/placement memorandum subject to a binding agreement with the relevant party(ies), that such requirements shall be fulfilled prior to such allotment of units and, a declaration to SEBI and to the designated stock exchanges to that effect and adequate disclosures in this regard in the offer document.
4. For a REIT raising funds through an initial offer, the units proposed to be offered to the public through such initial offer:

   (a) shall be not less than 25% of the total of the outstanding units of the REIT and the units being offered by way of the offer document, if the post issue capital of the REIT calculated at offer price is less than Rs. 1,600 crores.

   However, this requirement shall be complied alongwith the minimum requirement of offer size i.e. Rs. 250 crores.

   (b) shall be of the value of atleast Rs. 400 crore, if the post issue capital of the REIT calculated at offer price is equal to or more than Rs. 1600 crore and less than Rs. 4000 crore

   (c) shall be not less than 10% of the total of the outstanding units of the REIT and the units being offered by way of the offer document, if the post issue capital of the REIT calculated at offer price is equal to or more than Rs. 4000 crore.

   However, any units offered to sponsor or the manager or their related parties or their associates shall not be counted towards units offered to the public. Further, any listed REIT which has public holding below 25%, such REIT shall increase its public holding to atleast 25%, with in a period of three years from the date of listing pursuant to initial offer.

5. Any subsequent issue of units by the REIT may be by way of follow-on offer, preferential allotment, qualified institutional placement, rights issue, bonus issue, offer for sale or any other mechanism and in the manner as may be specified by SEBI.

6. REIT, through the merchant banker, shall file a draft offer document along with the prescribed fees with the designated stock exchange(s) and SEBI, not less than 30 working days before filing offer document with the designated stock exchange and SEBI.

   REIT shall pay non-refundable filing fees of 0.1% in case of initial and follow-on offer and 0.05% in case of rights issue, of the total issue size including intended retention of oversubscription at the time of filing of draft Offer document with the SEBI.

7. The draft offer document filed with SEBI shall be made public, for comments, by hosting it on the websites of SEBI, designated stock exchanges and merchant bankers associated with the issue for a period of not less than 21 days.

8. The draft offer document and/or final offer document shall be accompanied by a due diligence certificate signed by the lead merchant banker.

9. SEBI may communicate its comments to the lead merchant banker and, in the interest of investors, may require the lead merchant banker to carry out such modifications in the draft offer document as it deems fit.

10. The lead merchant banker shall ensure that all comments received from SEBI on the draft offer document are suitably taken into account prior to the filing of the offer document with the designated stock exchanges.

11. In case no observations are issued by SEBI on the draft offer document within 21 working days, then REIT may file the offer document or follow-on offer document with SEBI and the exchange(s).

12. The offer document shall be filed with the designated stock exchanges and SEBI not less than 5 working days before opening of the offer.

13. The initial offer or follow-on offer or right issue shall be made by the REIT with in a period of not more than one year from the date of issuance of observations by the SEBI.

    However, if the initial offer or follow-on offer or right issue is not made within the specified time period, a fresh draft offer document shall be filed. The REIT shall not be required to file draft offer document with the SEBI in case of a fast track rights issue, subject to the fulfillment of the conditions as specified by the SEBI from time to time.

14. The REIT may invite for subscriptions and allot units to any person, whether resident or foreign. In case of foreign investors, such investment shall be subject to guidelines as may be specified by RBI and the government from time to time.

15. The application for subscription shall be accompanied by a statement containing the abridged version of the offer document, detailing the risk factors and summary of the terms of issue.

16. Under both the initial offer and follow-on public offer, the minimum subscription amount which a REIT shall accept from any investor shall fall in range of Rs. 10,000 to Rs. 15,000.

    Under both the initial offer and follow-on public offer, the minimum subscription amount which a REIT shall accept from any investor shall fall in range of Rs. 10,000 to Rs. 15,000.

17. Initial offer and follow-on offer shall not be open for subscription for a period of more than thirty days.

18. In case of over-subscriptions, the REIT shall allot units to the applicants on a proportionate basis rounded off to the nearest integer subject to minimum subscription amount per subscriber as specified above.

19. The REIT shall allot units or refund application money as the case may be, within 12 working days from the date of closing of the issue.

20. The REIT shall issue units only in dematerialized form to all the applicants.

The REIT shall issue units only in dematerialized form to all the applicants.

21. The price of REIT units issued by way of public issue shall be determined through the book building processor any other process in accordance with the circulars or guidelines issued by SEBI and in the manner as may be specified by SEBI.

22. The REIT shall refund money:-

    (a) to all applicants in case it fails to collect subscription amount of exceeding 90% of the fresh issue size as specified in the offer document.

    (b) to applicants to the extent of over subscription in case the money's received is in excess of the extent of over-subscription as specified in the offer document. The right to retain such over subscription cannot exceed 25% of the issue size. The Offer Document shall contain adequate disclosures towards the utilisation of such over subscription proceeds, if any, and such proceeds retained on account of over subscription shall not be utilised towards general purposes.

    (c) to all applicants in case the number of subscribers to the initial offer forming part of the public is less than 200.

23. If the manager fails to allot, or list the units, or refund the money within the specified time, then the manager shall pay interest to the unit holders at 15% per annum, till such allotment/listing/refund and such interest shall not be recovered in the form of fees or any other form payable to the manager by the REIT.

24. Units may be offered for sale to public:-

    a) If such units have been held by the existing unit holders for a period of at least one year prior to the filing of draft offer document with SEBI.

       However, the holding period for the equity shares, compulsorily convertible securities from the date such securities are fully paidup or partnership interest in the holdco and/or SPV against which such units have been received shall be considered for the purpose of calculation of one year period.

    b) Subject to other circulars or guidelines as may be specified by SEBI in this regard.

25. The amount for general purposes, as mentioned in objects of the issue in the draft document filed with SEBI, shall not exceed to 10 % of the amount raised by the REIT by issuance of units.

The amount for general purposes, as mentioned in objects of the issue in the draft document filed with SEBI, shall not exceed to 10 % of the amount raised by the REIT by issuance of units.

26. If the REIT fails to make its initial offer within three years from the date of registration with SEBI, it shall surrender its certificate of registration to SEBI and cease to operate as a REIT. SEBI if it deems fit, may extend the period by another one year. Further, the REIT may later re-apply for registration, if it so desires.

27. SEBI may specify by issue of guidelines or circulars any other requirements, as it deems fit, pertaining to issue and allotment of units by a REIT.

OFFER DOCUMENT AND ADVERTISEMENTS

The Offer document of the REIT shall contain material, true, correct and adequate disclosures to enable the investors to make an informed decision.

Any advertisement material relating to any issue of units of the REIT shall not be misleading and shall not contain any thing extraneous to the contents of the offer document. If an advertisement contains positive highlights, it shall also contain risk factors with equal importance in all aspects including print size.

The advertisements shall be in accordance with the offer document and any circulars or guidelines as may be specified by the SEBI in this regard.

GUIDELINES FOR PUBLIC ISSUE OF UNITS OF REITS

On December 19, 2016, SEBI had issued detailed guidelines relating to the public issue of units of RETIs, and the advertisement relating to the offer. These guidelines are placed below:

Filing of offer document

- The draft offer document has to be filed with SEBI and the designated stock exchanges (DSE).
- The lead merchant bankers (LMB) have to submit a certificate confirming that the agreement is entered between the manager on behalf of the REIT and MB, and a due diligence certificate in the prescribed form has to be filed with the draft offer document.
- The draft offer document shall be hosted on the websites of SEBI, DSEs and merchant bankers, for comment within 21 days of filing.
- SEBI may specify changes or issue observations, pursuant to which the draft offer document has to be suitably modified prior to the filing with SEBI and designated stock exchange.
- After filing offer document with SEBI, manager shall issue pre-issue advertisement on the websites of sponsor, manager and stock exchanges. Manager may also issue such advertisement in newspapers.

Allocation in public issue

- Institutional investors shall not be allocated more than 75% in a public offering of the REITs units.
- Other investors, including retail investors, have to be allocated at least 25% of the REITs units.

Anchor Investors

Who is an Anchor Investor?

"Anchor Investor" means a qualified institutional buyer who makes an application for a value of at least ten crore rupees in a public issue on the SEBI main board made through the book building process or makes an application for a value of at least two crore rupees for an issue made in accordance with Chapter IX of the SEBI (ICDR) Regulations, 2018.

- Manager of the REIT, in consultation with merchant banker may allocate up to 60% of the portion available for allocation to institutional investors to anchor investors.

- The anchor investors will have to make an application of a value of at least Rs. 10 crore in the public issue.
- Allocation to anchor investor shall be on a discretionary basis, and subject to the minimum of two investors for allocations of upto Rs. 250 crore and minimum five investors for allocations exceeding Rs. 250 crore.
- The bidding for anchor investor shall open one day before the issue opening date and the allocation must be completed on the same day.
- The number of units allocated and the allocation price must be disclosed on the websites of the stock exchange(s), sponsor(s), manager and merchant banker(s).
- If the price fixed as a result of book building is higher than the price at which the allocation is made to Anchor Investor, the Anchor Investor shall bring in the additional amount within 2 days of the date of closure of the issue.
- The lock-in period shall be thirty days on the units allotted to anchor investors from the date of allotment.
- Neither the merchant bankers(s) nor any associate of the merchant bankers, other than mutual funds sponsored by entities which are associate of the merchant bankers or insurance companies promoted by entities which are associate of the merchant bankers or pension funds of entities which are associate of the merchant bankers or Alternate Investment Funds (AIFs)sponsored by the entities which are associate of the merchant bankers or FPIs other than Category III sponsored by the entities which are associate of the merchant bankers, shall apply under the Anchor Investors category.

Security Deposit

The manager, on behalf of REIT, will have to deposit before the opening of subscription, and keep deposited with the stock exchanges, an amount calculated at the rate of 0.5% of the amount of units offered for subscription to the public or Rs. 5 crore, whichever is lower.

Opening of an issue and subscription period

- The issue shall open after at least five working days from the date of filing of the final offer document with SEBI.
- The lead merchant banker shall submit a due diligence certificate in prescribed format, immediately before the opening of the issue.
- The public issue shall remain open for at least three working days, but not more than thirty days. Further, in case the price band in a public issue made through the book building process is revised, the bidding (issue) period disclosed in the final offer document shall be extended for a minimum period of one working day, provided that the total bidding period shall not exceed thirty days.
- Price revision can be done maximum twice during the bidding period.
- The manager on behalf of the REIT may issue advertisements for issue opening and issue closing.

Price and Price Band

- The floor price or the price band has to be announced at least two working days before the opening of the bid on the website of the sponsor, manager, stock exchanges, REIT and in all newspapers in which the pre-issue advertisement was released.
- Differential pricing shall not be offered to any investor.

- The Manager on behalf of the REIT shall, in consultation with merchant banker(s), determine the issue price based on the bids received.
- Once the final price (cut-off price) is determined, all those bidders whose bids have been found to be successful (i.e. at and above the final price or cut-off price) shall be entitled for allotment of units

Bidding process

- The REIT shall accept bids using only the Application Supported by Blocked Amount(ASBA) facility for making payment. Further, the bidding process shall be done only through an electronic bidding platform provided by recognised stock exchanges.
- An investor, intending to subscribe to a public issue, shall submit a completed bid-cum-application form to Self-Certified Syndicate Banks (SCSBs), with whom the bank account to be blocked is maintained or with any intermediaries as prescribed in the guidelines. Intermediaries accepting the application forms shall be responsible for uploading the bid along with other relevant details in application forms on the electronic bidding system of stock exchange(s) and submitting the form to SCSBs for blocking of funds (except in case of SCSBs, where blocking of funds will be done by respective SCSBs only) Stock Exchanges to provide transparent electronic bidding facility.
- The merchant banker shall ensure that adequate infrastructure is available with syndicate members for data entry of the bids in a timely manner.
- The bidding terminals shall contain an online graphical display of demand and bid prices updated at periodic intervals, not exceeding thirty minutes.
- The manager on behalf of the REIT may decide to close the bidding by institutional investors one day prior to the closure of the issue subject to the condition that bidding shall be kept open for a minimum of three days for all categories of applicants and suitable disclosures made in the draft offer document and offer document.
- No investor shall either withdraw or lower the size of bids at any stage.
- The identity of Institutional Investors except anchor investors making the bidding shall not be made public.

Allotment Procedure and Basis of Allotment

- On receipt of the sum payable on application, the manager on behalf of the REIT shall allot the units in to the applicants.
- Allotment of units other than anchor investors shall be on proportionate basis within the specified investor categories, subject to minimum allotment, as per REIT regulations.
- In case of under-subscription in any investor category, the unsubscribed portion may be allotted to applicants in the other categories.

Public communications, publicity materials, advertisements and research materials

- Public communication shall not contain any matter extraneous to the offer document, and shall be truthful and fair.

Other conditions

- No REIT shall make a public issue of units, if the REIT or parties to the REIT or the promoter(s) or director(s) of parties to the REIT is debarred from accessing the securities market by SEBI, or is on the list of wilful defaulters published by the Reserve Bank of India.

- Managers have to appoint a compliance officer for monitoring compliance of securities laws and for redressal of investor grievances.

LISTING AND TRADING OF UNITS

1. After the initial offer it shall be mandatory for all units of REITs to be listed on a recognized stock exchange having nation wide trading terminals within a period of six working days from the date of closure of the offer. (Ref. SEBI circular dated April 28, 2022)
2. The listing of the units of the REIT shall be in accordance with the listing agreement entered into between the REIT and the designated stock exchange.
3. In the event of non-receipt of listing permission from the stock exchange(s) or withdrawal of Observation Letter issued by SEBI, wherever applicable, the units shall not be eligible for listing and the REIT shall be liable to refund the subscription monies, if any, to the respective allottees immediately along with interest at the rate of 15% per annum from the date of allotment.
4. The units of the REIT listed in recognized stock exchanges shall be traded, cleared and settled in accordance with the bye-laws of concerned stock exchanges and such conditions as may be specified by SEBI.
5. Trading lot for the purpose of trading of units of the REIT shall be 1 unit.
6. The REIT shall redeem units only by way of a buy-back or at the time of delisting of units.
7. The units of REIT shall remain listed on the designated stock exchange unless delisted under REIT Regulations.
8. The minimum public holding for the units of the listed REIT shall be in accordance with point 4 as discussed under Issue and Allotment of Units of this lesson, failing which action may be taken as may be specified by SEBI and by the designated stock exchange including delisting of units under REIT Regulations.

   However, in case of breach of the conditions specified here, the trustee may provide a period of six months to the manager to rectify the same, failing which the manager shall apply for delisting of units.
9. Any person other than the sponsor(s) holding units of the REIT prior to initial offer shall hold the units for a period of not less than one year from the date of listing of the units subject to circulars or guidelines as may be specified by SEBI.
10. SEBI and the designated stock exchanges may specify any other requirements pertaining to listing and trading of units of the REIT by issuance of guidelines or circulars.

DELISTING OF UNITS

1. The manager shall apply for delisting of units of the REIT to SEBI and the designated stock exchanges if,-
   (a) the public holding falls below the specified limit as prescribed under REIT Regulations.
   (b) if there are no projects or assets remaining under the REIT for a period exceeding six months and REIT does not propose to investing any project in future. The period may be extended by further six months, with the approval of unit holders in the manner as specified in REIT Regulations.

(c) SEBI or the designated stock exchanges require such delisting for violation of the listing agreement or these regulations or the Act.

(d) The sponsor(s) or trustee requests such delisting and such request has been approved by unit holders in accordance with the REIT Regulations.

(e) The unit holders may also apply for such delisting in accordance with these regulations.

(f) SEBI or the designated stock exchanges require such delisting for violation of the listing agreement, these regulations or the Act or in the interest of the unit holders.

2. SEBI and the designated stock exchanges may consider such application for approval or rejection as may be appropriate in the interest of the unit holders.

3. SEBI, instead of requiring delisting of units, if it deems fit, may provide additional time to the REIT or parties to the REIT to comply with REIT Regulations.

4. SEBI may reject the application for delisting and take any other action, as it deems fit under REIT Regulations or the Act for violation of the listing agreement or REIT Regulations or the Act.

5. The procedure for delisting of units of REIT including provision of exit option to the unit holders shall be in accordance with the listing agreement and in accordance with procedure as may be specified by SEBI and by the designated stock exchanges from time to time.

6. SEBI may require the REIT to windup and sell its assets in order to redeem units of the unit holders for the purpose of delisting of units and SEBI may through circulars or guidelines specify the manner of such winding up or sale.

7. After delisting of its units, the REIT shall surrender its certificate of registration to SEBI and shall no longer undertake activity of a REIT.

   However, the REIT and parties to the REIT shall continue to be liable for all their acts of omissions and commissions with respect to activities of the REIT notwithstanding such surrender.

INVESTMENT CONDITIONS AND DISTRIBUTION POLICY

1. The Investment by a REIT shall only be in holdco and/ or SPVs or properties or securities or TDR in India and in accordance with the investment strategy as detailed in the offer document as may be amended subsequently.

> The Investment by a REIT shall only be in holdco and/ or SPVs or properties or securities or TDR in India and in accordance with the investment strategy as detailed in the offer document as may be amended subsequently.

2. The REIT shall not invest in vacant land or agricultural land or mortgages other than mortgage backed securities. However, this shall not apply to any land which is contiguous and extension of an existing project being implemented in stages.

3. The REIT may invest in properties through SPVs subject to the following:

   (a) no other shareholder or partner of the SPV shall exercise any rights that prevents the REIT from complying with the provisions of the REIT Regulations and an agreement has been entered into with such shareholders or partners to that effect prior to investment in the SPV.

   However, the shareholders agreement or partnership agreement shall provide for an appropriate mechanism for resolution of disputes between the REIT and the other shareholders or partners in the SPV.

Further, the provisions of REIT Regulations shall prevail in case of inconsistencies between such agreement(s) and the obligations cast upon a REIT under REIT Regulations.

(b) the manager, in consultation with the trustee, shall appoint at least such number of nominees on the board of directors or the governing board of such SPVs, as applicable, which are in proportion to the shareholding or holding interest of the REIT in the SPV.

(c) the manager shall ensure that in every meeting including annual general meeting of the SPV, the voting of the REIT is exercised.

4. The REIT may invest in properties through holdco subject to the following,-

(a) the ultimate holding interest of the REIT in the underlying SPV(s) is not less than 26%.

(b) no other shareholder or partner of the holdco or the SPV(s) shall exercise any rights that prevent the REIT, the holdco or the SPV(s) from complying with the provisions of REIT Regulations and an agreement has been entered into with such shareholders or partners to that effect prior to investment in the holdco and/or SPVs.

However, the shareholders' agreement or partnership agreement shall provide for an appropriate mechanism for resolution of disputes between the REIT and the other shareholders or partners in the holder and/or SPV. Further, the provisions of REIT Regulations, shall prevail in case of inconsistencies between such agreement(s) and the obligations cast upon a REIT under REIT Regulations.

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(c) the manager, in consultation with the Trustee, shall appoint atleast such members of nominees on the Board of directors or governing board of the holdco and/or SPV in proportion to the shareholding or holding interest in the REIT/holdco in the SPV;

(d) the manager shall ensure that in every meeting including annual general meeting of the holdco and/ or SPV(s), the voting of the REIT is exercised.

5. Not less than 80% of value of the REIT assets shall be invested in completed and rent and/or income generating properties subject to the following:

(a) if the investment has been made through a holdco and/or SPV, whether by way of equity or debt or equity linked instruments or partnership interest, only the portion of direct investments in properties by such holdco and/or SPVs shall be considered and the remaining portion shall be included as prescribed under clause(6).

(b) if any project is implemented in stages, the part of the project which is completed and rent and/or income generating shall be considered and the remaining portion including any contiguous land and extension of an existing project being implemented in stages shall be included under clause (a) of sub-regulation (5) of Investment Conditions and Distribution Policy.

6. Not more than 20% of value of the REIT assets shall be invested in assets other than as provided in clause (5) and such other investment shall only be in:

- properties, whether directly or through company or through LLP which are:

  (i) under-construction properties which shall be held by the REIT for not less than three years after completion;

(ii) under-construction properties which are a part of the existing income generating properties owned by the REIT which shall be held by the REIT for not less than three years after completion;

(iii) completed and not rent generating properties which shall be held by the REIT for not less than three years from date of purchase.

- listed or unlisted debt of companies or body corporate in real estate sector. However, this shall not include any investment made in debt of the holdco and/or SPVs.
- mortgage backed securities.
- equity shares of companies which are listed on a recognized stock exchange in India which derive not less than 75% of their operating income from real estate activity as per the audited accounts of the previous financial year.
- unlisted equity shares of companies which derive not less than 75% of their operating income from real estate activity as per the audited accounts of the previous financial year.

  However, the investments, made through unlisted equity shares of a company, in under construction properties and/or completed and not rent generating properties, shall be in compliance with clause 6(a).
- Government securities.
- unutilized FSI of a project where it has already made investment.
- TDR acquired for the purpose of utilization with respect to a project where it has already made investment.
- money market instruments or cash equivalents.

7. The investment conditions as specified above shall be complied at the time of Offer document and thereafter.

8. Not less than 51% of the consolidated revenues of the REIT, holdco and the SPV, other than gains arising from disposal of properties, shall be, at all times, from rental, leasing and letting real estate assets or any other income incidental to the leasing of such assets.

9. Conditions specified in above clauses shall be monitored on a half-yearly basis and at the time of acquisition of an asset. Further, if such conditions are breached on account of market movements of the price of the underlying assets or securities or change in tenants or expiry of lease or sale of properties, the manager shall inform the same to the trustee and ensure that the conditions as specified in REIT Regulations are satisfied within six months of such breach.

   The period may be extended by another six months subject to approval from investors.

10. A REIT shall hold any completed and rent generating property, whether directly or through holdco or SPV, for a period of not less than three years from the date of purchase of such property by the REIT or holdco or SPV.

11. For any sale of property, whether by the REIT or holdco or the SPV or for sale of shares or interest in the SPV by the holdco or REIT exceeding 10% of the value of REIT assets in a financial year, the manager shall obtain approval from the unit holders.

12. A REIT shall not invest in units of other REITs.

A REIT shall not invest in units of other REITs.

13. A REIT shall not undertake lending to any person, other than the holding company/ Special purpose vehicle(s) in which the REIT has invested in, subject to disclosures specified in REIT Regulations and the investment in debt securities shall not be considered as lending.

A REIT shall not undertake lending to any person, other than the holding company/ Special purpose vehicle(s) in which the REIT has invested in, subject to disclosures specified in REIT Regulations and the investment in debt securities shall not be considered as lending.

14. With respect to investment in leasehold properties, the manager shall consider the remaining term of the lease, the objectives of the REIT, the lease profile of the REIT's existing real estate assets and any other factors as may be relevant, prior to making such investment.

15. In case of any co-investment with any person(s) in any transaction,

    a) The investment by the other person(s) shall not be at terms more favourable than those to the REIT.

    b) The investment shall not provide any rights to the person(s) which shall prevent the REIT from complying with the provisions of these regulations.

    c) The agreement with such person(s) shall include the minimum percentage of distributable cash flows that will be distributed and entitlement of the REIT to receive not less than prorata distributions and mode for resolution of any disputes between the REIT and the other person(s).

DISTRIBUTION POLICY FOR UNITHOLDERS

Regulation 18 states that the REITs need to distribute at least 90% of their cash flows to the unit holders. Such distribution shall be declared once in every 6 months. Such distribution shall be disbursed within 15 days of declaration. If the REITs fails to distribute the cash flow within 15 days, the manager shall liable to a penal interest @ 15% p.a

16. With respect to distributions made by the REIT and the holdco and/or SPV,

    - Not less than 90% of net distributable cash flows of the SPV shall be distributed to the REIT or holdco in proportion of its holding in the SPV subject to applicable provisions in the Companies Act, 2013 or the Limited Liability Partnership Act, 2008.

    - With regard to distribution of net distributable cash flows by the holdco to the REIT, subject to applicable provisions in the Companies Act, 2013 or the Limited Liability Partnership Act, 2008, the following shall be complied:

        (i) with respect to the cash flows received by the holdco from underlying SPVs, 100% of such cash flows received by the holdco shall be distributed to the REIT; and

        (ii) with respect to the cash flows generated by the holdco on its own, not less than 90% of such net distributable cash flows shall be distributed by the holdco to the REIT.

    - Not less than ninety percent of net distributable cash flows of the REIT shall be distributed to the unit holders.

      Such distributions shall be declared and made not less than once every six months in every financial year and shall be made not later than fifteen days from the date of such declaration.

    - If any property is sold by the REIT or holdco or SPV or if the equity shares or interest in the holdco/ SPV are sold by the REIT, then,-

(i) if the REIT proposes to reinvest sale proceeds, if any, into another property, it shall not be required to distribute any sale proceeds from such sale to the unit holders;

(ii) if the REIT proposes not to invest the sales proceeds made into any other property within a period of 1 year, it shall be required to distribute not less than ninety percent of the sales proceeds in accordance with the provisions of Listing and trading of units as prescribed under REIT Regulations.

17. If the distributions are not made within fifteen days of declaration, then the manager shall be liable to pay interest to the unit holders at the rate of 15% per annum till the distribution is made and such interest shall not be recovered in the form of fees or any other form payable to the manager by the REIT.

18. Any amount remaining unclaimed or unpaid out of the distributions declared by a REIT shall be transferred to the 'Investor Protection and Education Fund' constituted by the SEBI in such manner as may be specified by the SEBI. However, the amount transferred to IEPF shall not bear may interest.

19. No schemes shall be launched under the REIT.

20. SEBI may specify any additional conditions for investments by the REIT as it deems fit.

BORROWING AND DEFERRED PAYMENTS

1. A REIT, whose units are listed on a recognized stock exchange, may issue debt securities in the manner specified by the SEBI. However, such debt securities shall be listed on recognized stock exchange(s).

2. The aggregate consolidated borrowings and deferred payments of the REIT, holdco and/or the SPV(s), net of cash and cash equivalents shall not exceed 49% of the value of the REIT assets. However, such borrowings and deferred payments shall not include any refundable security deposits to tenants.

> *Explanation:*
>
> - Investment by REITs in overnight mutual funds, characterized by their investments in overnight securities, having maturity of one day, shall be considered as cash and cash equivalent.
> - The amount of cash and cash equivalent shall be excluded from the value of the assets of the REIT.

3. If the aggregate consolidated borrowings and deferred payments of the REIT, holdco and/or the SPV(s) net of cash and cash equivalents exceed 25% of the value of the REIT assets, for any further borrowing,-

   (a) credit rating shall be obtained from a credit rating agency registered with the SEBI; and

   (b) approval of unit holders shall be obtained in the manner as specified in REIT Regulations.

4. If the conditions specified in point (1) and (2) mentioned above are breached on account of market movements of the price of the underlying assets or securities, the manager shall inform the same to the trustee and ensure that the conditions as specified in this regulation are satisfied within six months of such breach.

Borrowing Limits of REITs

As per Regulation 20, REITs can borrow money subject to maximum limit of 49% of the value of REITs assets. Regulation 20(3) provides that where the borrowing of the REITs net of cash and cash equivalents exceed 25% of the value of REITs asset any further borrowings shall be subject to obtaining of credit rating & approval of unitholders.

RIGHTS AND MEETING OF THE UNIT HOLDERS

1. The unit holder shall have the rights to receive income or distributions as provided for in the Offer document or trust deed.

2. With respect to any matter requiring approval of the unit holders:

   (a) a resolution shall be considered as passed when the votes cast by unit holders, so entitled and voting, in favour of the resolution exceed a certain percentage, as specified in this regulation, of the votes cast against;

   (b) the voting may also be done by postal ballot or electronic mode;

   (c) a notice of not less than 21 days either in writing or through electronic mode shall be provided to the unit holders;

   (d) voting by any person who is a related party in such transaction as well as associates of such person(s) shall not be considered on the specific issue;

   (e) manager shall be responsible for all the activities pertaining to conducting of meeting of the unit holders, subject to overseeing by the trustee.

   However, in case of issues pertaining to manager such as change in manager including removal of the manager or change in control of the manager, then trustee shall convene and handle all activities pertaining to conduct of the meetings. Further, in case of issues related to trustee such as change in the trustee, the trustee shall not be involved in any manner in the conduct of the meeting.

3. An annual meeting of all unit holders shall be held not less than once a year within 120 days from the end of financial year and the time between two meetings shall not exceed 15 months.

4. With respect to the annual meeting of unit holders,-

   (a) any information which is required to be disclosed to the unit holders and any issue, in the ordinary course of business, may require approval of the unit holders may be taken up in the meeting including,-

      - latest annual accounts and performance of the REIT;
      - approval of auditor and fees of such auditor, as may be required;
      - latest valuation reports;
      - appointment of valuer, as may be required;
      - any other issue including special issues as specified in clause (6).

   (b) For any issue taken up in such meetings which require approval from the unit holders, votes cast in favour of the resolution shall be more than the votes cast against the resolution.

5. In case of, -

   ➢ any approval from unit holders required for investment conditions, related party transactions and valuation of assets under REIT Regulations.

   ➢ any transaction, other than any borrowing, value of which is equal to or greater than 25% of the REIT assets.

   ➢ any borrowing in excess of limit as specified under the REIT Regulations.

   ➢ any issue of units after initial offer by the REIT, in whatever form, other than any issue of units which may be considered by SEBI under clause (6).

- increasing period for compliance with investment conditions to one year in accordance with the REIT Regulations.
- any issue, in the ordinary course of business, which in the opinion of the sponsor(s) or trustee or manager, is material and requires approval of the unit holders, if any.
- any issue for which SEBI or the designated stock exchange requires approval.

Approval from unit holders shall be required where the votes cast in favour of the resolution shall be more than the votes cast against the resolution.

6. In case of:

(a) any change in manager including removal of the manager or change in control of the manager;

(b) any material change in investment strategy or any change in the management fees of the REIT;

(c) the sponsor(s) or manager proposing to seek delisting of units of the REIT;

(d) any issue, not in the ordinary course of business, which in the opinion of the sponsor(s) or manager or trustee requires approval of the unit holders;

(e) any issue for which SEBI or the designated stock exchanges requires approval;

(f) any issue taken upon request of the unit holders including:

(i) removal of the manager and appointment of another manager to the REIT;

(ii) removal of the auditor and appointment of another auditor to the REIT;

(iii) removal of the valuer and appointment of another valuer to the REIT;

(iv) delisting of the REIT if the unit holders have sufficient reason to believe that such delisting would act in the interest of the unit holders;

(v) any issue which the unit holders have sufficient reason to believe that acts detrimental to the interest of the unit holders;

(vi) change in the trustee if the unit holders have sufficient reason to believe that acts of such trustee is detrimental to the interest of the unit holders.

Approval from unit holders shall be required where the votes cast in favour of the resolution shall be not less than one and half times the votes cast against the resolution.

(g) No person, other than sponsor(s), its related parties and its associates, shall acquire units of a REIT which taken together with units held by him and by persons acting in concert with him in such REIT, exceeds 25% of the value of outstanding REIT units unless approval from seventy five per cent of the unit holders by value excluding the value of units held by parties related to the transaction, is obtained.

However, if the required approval is not received, the person acquiring the units shall provide an exit option to the dissenting unit holders to the extent and in the manner as may be specified by the SEBI.

7. With respect to the right(s) of the unit holders,-

(a) not less than 25% of the unit holders by value, other than any party related to the transactions and its associates, shall apply, in writing, to the trustee for the purpose;

(b) on receipt of such application, the trustee shall require the manager to place the issue for voting in the manner as specified in the REIT Regulations;

(c) with respect to clause (6) (g) (vi) as mentioned above, not less than 60% of the unit holders by value shall apply, in writing, to the manager for the purpose.

8. In case of any change in sponsor or inducted sponsor or change in control of sponsor or inducted sponsor or conversion to Self Sponsored Manager:

- prior to such changes, approval from seventy-five per cent of the unit holders by value excluding the value of units held by parties related to the transaction shall be obtained.
- if required approval is not received,-

  (a) in case of change of sponsor or inducted sponsor, the proposed inducted sponsor who proposes to buy the units shall provide the dissenting unit holders an option to exit by buying their units in the manner specified by SEBI;

  (b) in case of change in control of the sponsor or inducted sponsor, the said sponsor or inducted sponsor shall provide the dissenting unit holders an option to exit by buying their units in the manner as specified by the SEBI;

  Here, change in sponsor or inducted sponsor shall mean any change due to entry of a new sponsor with or without exit of an existing sponsor.

  (c) in case of conversion to Self-Sponsored Manager, the Manager shall provide the dissenting unit holders an option to exit by buying their units in the manner specified by the SEBI.

  If on account of such sale, the number of unit holders forming part of the public falls below two hundred or below, the trustee may provide a period of one year to the manager to rectify the same, failing which the manager shall apply for delisting of the units of the REIT in accordance with the REIT Regulations.

9. The existing sponsor(s) proposing to disassociate as sponsor(s) by seeking to convert the Manager to Self-Sponsored Manager shall comply with the following conditions:

(i) the REIT has been listed for a period of at least five years;

(ii) the REIT has undertaken not less than twelve distributions on a continuous basis and has complied with the distribution norms as per these Regulations in the preceding five years;

(iii) the REIT is rated AAA by a registered credit rating agency for a continuous period of five years immediately preceding exit of the sponsor;

(iv) during the period of preceding five years, the REIT has not breached, at any time, the maximum leverage thresholds specified in these regulations;

(v) the Manager is meeting the net worth criteria for the sponsor as specified in these regulations;

(vi) the minimum unitholding requirement applicable to sponsor(s) and sponsor group(s) shall be complied with, on or after the date of conversion of the Manager to Self- Sponsored Manager, by the Manager, shareholders of the Manager and/or group entities of Manager:

Explanation: Manager, shareholders of the Manager and/or group entities of Manager may acquire units of the REIT for the purpose of compliance of the above condition.

(vii) the sponsor(s) or its associate(s) do not own or control the Manager of the REIT on or after the date of conversion of the Manager to Self-Sponsored Manager;

(viii) the Sponsor has not transferred / sold assets to the REIT in the last three years and no assets/ projects shall be acquired by the REIT from the outgoing sponsor(s) for a period of one year from the date of conversion to Self-Sponsored Manager;

(ix) at least one of the sponsor(s) proposing to disassociate should have been a sponsor of the REIT for a minimum period of five years;

(x) the REIT shall not have any under-construction properties acquired from the sponsor that have not commenced commercial operations;

(xi) unitholders approval in terms of point no. (8) above and consent of the Trustee has been obtained for conversion to Self-Sponsored Manager;

(xii) such other condition as may be specified by the SEBI.

DISCLOSURES

1. The manager shall ensure that the disclosures in the offer document are in accordance with Schedule II of the REIT Regulations and any circulars or guidelines issued by SEBI in this regard.
2. The manager shall submit an annual report to all unit holders of the REIT with respect to activities of the REIT, within three months from the end of the financial year.
3. The manager shall submit a half-yearly report to all unit holders of the REIT with respect to activities of the REIT within forty five days from the end of the half year ending on September 30th.
4. Such annual and half yearly reports shall contain disclosures as specified under Schedule IV of the REIT Regulations.
5. The manager shall disclose to the designated stock exchanges, any information having bearing on the operation or performance of the REIT as well as price sensitive information which includes but is not restricted to the following,-
   – Acquisition or disposal of any properties, value of which exceeds 5% of value of the REIT assets;
   – Additional borrowing, at level of holdco or SPV or the REIT, resulting in such borrowing exceeding 5% of the value of the REIT assets during the year;
   – Additional issue of units by the REIT;
   – Details of any credit rating obtained by the REIT and any change in such rating;
   – Any issue which requires approval of the unit holders;
   – Any legal proceedings which may have significant bearing on the functioning of the REIT;
   – Notices and results of meetings of unit holders;
   – Any instance of non-compliance with the REIT Regulations including any breach of limits specified under these regulations.
   – Any material issue that in the opinion of the manager or trustee needs to be disclosed to the unitholder.
     - The manager shall submit such information to the designated stock exchanges and unit holders on a periodical basis as may be required under the listing agreement.
     - The manager shall disclose to the designated stock exchanges, unit holders and SEBI such information and in the manner as may be specified by SEBI.

GOVERNANCE NORMS FOR REITs

Applicability of SEBI (LODR) Regulations, 2015

The corporate governance norms applicable for listed companies shall be applicable to REITs as specified in Regulation 26A of SEBI (REITs) Regulations, 2014.

For the purposes of this regulation, the interpretation of certain expression as mentioned in SEBI (LODR) Regulations, 2015 shall be read as under while reading with REITs Regulations:

Expression in SEBI (LODR) Regulations, 2015	***To be read as, while reading with REITs Regulations***
promoters	parties to the REIT
listed entity	Manager
company secretary	compliance officer
executive director	non-independent director
non-executive director	independent director
Board of Directors of the listed entity	Board of Directors of Manager
subsidiary of listed entity	HoldCo and/or SPV of REIT

Additional Requirements

(1) The Board of Directors of the Manager shall comprise of not less than six directors and have not less than one woman independent director.

(2) The quorum for every meeting of the Board of Directors of the Manager shall be one-third of its total strength or three directors, whichever is higher, including at least one independent director.

Explanation - The participation of the directors by video conferencing or by other audio-visual means shall be counted for the purpose of quorum and shall be recorded by the Manager.

(3) The Board of Directors of the Manager shall review compliance reports every quarter pertaining to all laws applicable to the REIT as well as steps taken to rectify instances of non-compliances.

(4) The minimum information as specified in SEBI (REITs) Regulations, 2014 shall be placed before the Board of Directors of the Manager.

(5) The Compliance Officer, Chief Executive Officer and the Chief Financial Officer shall provide the compliance certificate to the Board of Directors of the Manager as specified in SEBI (REITs) Regulations along with supporting evidence thereof.

(6) The Board of Directors of the Manager shall set forth clearly the recommendation of the Manager in the notice to the unit holders for each item as mentioned in point no. 6 under Rights and meetings of Unit holders.

Vigil Mechanism

(1) The Manager shall formulate a vigil mechanism, including a whistle blower policy for directors and employees to report genuine concerns.

(2) The vigil mechanism shall provide for adequate safeguards against victimization of Director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

(3) An independent service provider may be engaged by the Manager for providing or operating the vigil mechanism who shall report to the audit committee.

(4) The audit committee shall review the functioning of the vigil mechanism.

Secretarial Compliance Report

(1) The Manager shall submit a secretarial compliance report given by a **practicing company secretary** to the stock exchanges, in such form as specified, within sixty days from end of each financial year.

(2) The secretarial compliance report shall be annexed with the annual report of the REIT.

Quarterly Compliance Report on Corporate Governance

(1) The Manager shall submit a quarterly compliance report on governance in the format as may be specified by the SEBI to the recognized stock exchange(s) within twenty-one days from the end of each quarter.

(2) The quarterly compliance report shall be signed either by the compliance officer or the chief executive officer of the Manager.

Grievance Redressal Mechanism

(1) The Manager shall redress investor grievances promptly but not later than twenty-one calendar days from the date of receipt of the grievance and in such manner as specified by the SEBI.

(2) The Board may also recognize a body corporate for handling and monitoring the process of grievance redressal within such time and in such manner as may be specified.

Liability for Action in case of Default

A REIT or parties to the REIT or any other person in volved in the activity of the REIT who contravenes any of the provisions of the Act or the REIT Regulations, notifications, guidelines, circulars or instructions issued there under by the Board shall be liable for one or more actions specified there in including any action provided under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

PARTICIPATION BY STRATEGIC INVESTOR(s) IN REITs

SEBI vide its circular dated 18th January, 2018 issued guidelines on participation by the strategic investors in InvITs and REITs.

This circular seeks to give clarifications on the participation by the 'strategic investors' in the public issue of the REITs and the InvITs.

'Strategic Investor' means:

1. an infrastructure finance company registered with RBI as a NBFC ;
2. a Scheduled Commercial Bank;

3. an multilateral and/or bilateral financial institution;
4. a systemically important NBFC registered with RBI;
5. a foreign portfolio investors;
6. an insurance company registered with the Insurance Regulatory and Development Authority of India;
7. a mutual fund.

who invest either jointly or severally not less than 5% of the total offer size of the REIT or such amount as may be specified by SEBI with applicable provisions of the FEMA Act, 1999 and the rules or regulations or guidelines made thereunder.

Participation by the 'strategic investors' in the public issue of the REITs

Holding requirements	Issue price of the units and utilisation of funds	Lock-in period
• Holding by strategic investors-Minimum 5%, maximum 25% • Holding by public, other than strategic investors and sponsors-Minimum 25% • Holding by sponsor-Minimum 5%, maximum 70%.	• The price at which units are offered to the strategic investors must not be less than the price determined in the public issue. • It must be ensured that the subscription amount is kept in the separate account until the public issue is opened.	• The unit subscribed by strategic investors, pursuant to the unit subscription agreement, will be locked-in for a period of 180 days from the date of listing in the public issue.

SMALL AND MEDIUM REITS (SM REITS) (CHAPTER VIB OF THE REGULATIONS)

Applicability

The provisions of SEBI REITs Regulations, except chapters II, IV, V and regulation 22 under chapter VI, shall mutatis mutandis be applicable to unless otherwise provided. However, any reference to the "manager" or the "sponsor" of the REIT under the applicable provisions of these regulations shall be construed as a reference to an "investment manager" of the SM REIT.

Definitions

- "*investment manager*" means a company incorporated in India, which sets up SM REIT and manages assets and investments of the SM REIT and undertakes operational activities of the SM REIT;
- "*liquid net worth*" means net worth deployed in liquid assets, which are unencumbered.

  Here, "*liquid asset*" means cash, units of overnight or liquid mutual fund schemes, fixed deposits, government securities, treasury bills and repo on government securities;
- "*Small and Medium REIT*" or "*SM REIT*" means a REIT that pools money from investors under one or more schemes in accordance with these regulations.

- "*scheme*" means a distinct and separate scheme of an SM REIT launched for owning of real estate assets or properties through special purpose vehicles;
- "*scheme offer document*" means any document described or issued as a scheme offer document including any notice, circular, advertisement or other document inviting offers for subscription or purchase of units of a scheme from the public;
- "*special purpose vehicle*" or "*SPV*" means any company which is a wholly owned subsidiary of the scheme of the SM REIT and the SPV shall not have any other capital or ownership interest in it;
- "*trustee*" means a trustee registered under Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993, who holds the assets of SM REIT and its schemes in trust and for the benefit of the unit holders, in accordance with these regulations.

Registration of SM REIT and Grant of Certificate

- An application for grant of certificate of registration as SM REIT shall be made, by the investment manager on behalf of the Trust as specified in the Schedule IA to these regulations along with a non-refundable application fee of Rupees One lakh. Further, a non-refundable registration fees of rupees ten lakhs shall be paid within 15 days from the date of receipt of intimation from the SEBI.
- In order to protect the interests of investors, the SEBI may appoint any person to take charge of records, documents of the SM REIT and also determine the terms and conditions of such an appointment.
- The SEBI shall take into account requirements as specified in these regulations for considering the grant of certificate of registration and the registration may be granted with such conditions as may be deemed appropriate by the SEBI.

Eligibility criteria

The SEBI shall consider the following, namely,–

(a) the applicant is the investment manager on behalf of the trust and the instrument of trust is in the form of a deed duly registered in India under the provisions of the Registration Act, 1908;

(b) the trust deed has its main objective as undertaking activity of SM REIT through one or more schemes and includes responsibilities of the trustee;

(c) separate persons have been designated as investment manager of the SM REIT and trustee of the SM REIT;

(d) with regard to the investment manager,–

- the investment manager is clearly identified in the application for grant of certificate of registration to the SEBI and in the scheme offer document;
- the investment manager has a net worth of not less than Rs. 20 crore (including Rupees 10 crores in the form of positive liquid net worth)
- the investment manager has at least two years' experience in the real estate industry or real estate fund management: however, in case the investment manager is unable to meet the requirement, it shall employ at least two key managerial personnel, each of whom have not less than five years' experience in the real estate industry or real estate fund management;
- not less than half of the directors of the investment manager are independent and are not directors of the manager or investment manager of another REIT or SM REIT, as the case may be; and

- the investment manager has entered into an investment management agreement with the trustee, which provides for the responsibilities of the investment manager in accordance with these regulations;

(e) the trustee is not an associate of the investment manager;

(f) no unit holder of the scheme of the SM REIT enjoys superior voting or any other rights over another unit holder in the same scheme and there are no multiple classes of units of scheme of the SM REIT;

(g) the rights of each unitholder in the scheme are pro-rata and pari-passu;

(h) the applicant has clearly described at the time of application for registration, details pertaining to proposed activities of the SM REIT;

(i) the SM REIT and the parties to the SM REIT are fit and proper persons based on the criteria as specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008;

(j) whether any previous application for grant of certificate by the applicant or the parties to the SM REIT or their directors, for registration as a REIT or an SM REIT, has been rejected by the SEBI;

(k) whether any disciplinary action has been taken by the Board or any other regulatory authority against the SM REIT or the parties to the SM REIT or their promoters or directors under any Act or the regulations or circulars issued thereunder.

Migration of existing persons, entities or structures

1) An applicant may apply for registration of existing persons, entities or structures owning real estate asset(s) or property(ies) in the nature of SM REIT within six months from the date of notification of this chapter i.e March 08, 2024 or within such period as may be specified by the SEBI.

2) For migration of such existing persons, entities or structures under these regulations:

   a. The applicant shall submit details of existing persons, entities or structures proposed to be migrated and a migration plan along with the application for certificate of registration; and

   b. The applicant shall complete the migration of existing persons, entities or structures within six months from the date of grant of registration or within such period as may be specified by the SEBI.

3) The applicant shall comply with the provisions of this chapter in relation to the scheme being migrated, unless otherwise provided.

Eligible issuers

(1) An SM REIT shall not be eligible to make an initial offer of units of a scheme if:

   (a) the SM REIT or the parties to the SM REIT are debarred from accessing the securities market or dealing in securities by the SEBI;

   (b) any of the promoters, promoter group or directors of the parties to the SM REIT are debarred from accessing the securities market or dealing in securities by the SEBI;

   (c) any of the promoters or directors of the parties to the SM REIT is a promoter or director of another company which is debarred from accessing the securities market by the SEBI; (This is not applicable to a person who was appointed as a director only by virtue of nomination by a debenture trustee in other company.)

(d) the SM REIT or the parties to the SM REIT or any of the promoters or directors of the parties to the SM REIT are wilful defaulters;

(e) any of the promoters or whole-time directors of the parties to the SM REIT is a promoter or whole-time director of another company which is a wilful defaulter;

(f) any of the promoters or directors of the parties to the SM REIT is a fugitive economic offender; or

(g) any fine or penalties levied by the SEBI or stock exchanges is pending to be paid by the SM REIT at the time of filing the scheme offer document:

However, the clauses (a), (b) and (c) shall not be applicable if the period of debarment is over as on the date of filing of the scheme offer document with the SEBI and the designated stock exchange.

(2) No offer of units by a scheme of the SM REIT shall be made unless,–

(a) the size of the asset proposed to be acquired in a scheme of the SM REIT is at least rupees fifty crores and less than rupees five hundred crores; and

(b) the minimum number of unitholders of the scheme of the SM REIT other than the investment manager, its related parties and associates of the SM REIT are not less than two hundred investors:

This shall not be applicable to the migration of existing persons, entities or structures as on the date of this chapter coming into force which are included as part of the migration plan in case the applicant is applying for a certificate of registration under regulation 26N (1).

Appointment of merchant banker

The investment manager shall appoint one or more merchant bankers registered with the SEBI to carry out the obligations relating to the issue.

Conditions for initial offer

1. The investment manager shall identify the real estate assets or properties it proposes to acquire or provide the features of the real estate assets or properties including location or such other details for the particular scheme in the draft scheme offer document.
2. The investment manager shall, through a merchant banker, file the draft scheme offer document with the Board, along with fees specified in Schedule IIA and with the designated stock exchange.
3. The minimum price of each unit of the scheme of the SM REIT shall be rupees ten lakhs or such other amount as may be specified by the SEBI from time to time.
4. Each scheme of the SM REIT shall be identified by a separate name, which shall not be misleading and shall not portray any guaranteed returns to the investors.
5. The value of real estate assets or properties in each scheme shall be at least fifty crore rupees.
6. The investment manager and the trustee shall ensure that the assets of each scheme, the bank accounts, investment or demat accounts and the books of accounts of each scheme are segregated and ring-fenced.
7. The investment manager and the trustee shall ensure that the property documents evidencing the title to the real estate assets or properties along with the related papers shall be duly maintained in safe-deposit boxes, at a scheduled commercial bank and be annually inspected by the trustee.

8. The draft scheme offer document filed with the SEBI shall be made public, for comments, if any, by hosting it on the websites of the SEBI, designated stock exchanges and merchant bankers associated with the issue, for a period of not less than twenty-one days.

9. The SEBI may issue observations, if any, to the merchant banker within thirty days from the later of:

   (a) the date of receipt of the draft scheme offer document;

   (b) the date of receipt of satisfactory reply from the merchant banker, where the SEBI has sought any clarification or additional information from the merchant banker;

   (c) the date of receipt of clarification or information from any regulator or agency, where the SEBI has sought any clarification or information from such regulator or agency; or

   (d) the date of receipt of a copy of in-principle approval letter issued by the designated stock exchange(s).

10. The merchant banker shall ensure that the observations issued by the SEBI are addressed in the scheme offer document prior to launch of the scheme.

Investment conditions

1. The SPV shall directly and solely own all assets that are acquired or proposed to be acquired by the scheme of the SM REIT, of which SPV is the wholly owned subsidiary.

2. The scheme of the SM REIT shall invest at least 95% of the value of the schemes' assets for each of its schemes in completed and revenue generating properties and shall not invest in under-construction or non-revenue generating real estate assets:

   However, up to 5% of the value of the schemes' assets may be invested in liquid assets, which are unencumbered.

3. The scheme of SM REIT shall not be permitted to lend to any entity other than lending to its own SPV.

4. The SPV shall not be permitted to lend to any entity.

Modes of fund raising

1. The scheme of the SM REIT may raise funds from any investor whether Indian, or foreign by way of issuance of units. However, the investment by foreign investors shall be subject to the guidelines as may be specified by Reserve Bank of India and the Government of India from time to time.

2. The scheme of a SM REIT and the SPV(s) thereunder may undertake leverage if the option to undertake leverage is disclosed in the scheme offer document filed for initial offer.

3. With regard to modes of fund raising by a scheme of SM REIT, the following shall apply:

   (a) The scheme of the SM REIT shall raise capital only by way of issuance of units pertaining to the particular scheme.

   (b) For a scheme of SM REIT opting to utilize leverage in accordance with sub- regulation (2), the scheme may undertake leverage through borrowings or issuance of debt securities under SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

4. With regard to modes of fund raising by a SPV of a scheme of SM REIT, the following shall apply:

   (a) The SPV shall raise capital only from equity investment from the scheme of SM REIT.

   (b) The SPV may raise funds by way of borrowings from the scheme of SM REIT.

(c) For a scheme of SM REIT opting to utilize leverage in accordance with sub- regulation (2), the SPV(s) under such scheme may undertake leverage through external borrowings or issuance of debt securities under Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

5. For a scheme of SM REIT opting to utilize leverage in accordance with sub-regulation (2), the total borrowings and deferred payments net of cash and cash equivalents, at the scheme level, shall not exceed 49% of the value of the scheme assets: Provided that if the total borrowings and deferred payments net of cash and cash equivalents, at the scheme level, exceeds 25% of the value of the scheme assets, then for any further borrowings, -

   (a) credit rating shall be obtained from a credit rating agency registered with the SEBI; and

   (b) approval of unit holders shall be obtained in the manner as specified in regulation 26ZM.

Maintenance of website

- The investment manager shall, at all times, maintain a functioning website of SM REIT. The investment manager shall specify on the website, the details of all the schemes of the SM REIT and details of the real estate assets and properties proposed to be acquired or acquired and held under each scheme.
- The investment manager shall provide the link to the scheme offer document for the investors on the website of the SM REIT. It shall be ensured that the trademark, brand name, website and other medium of communication of the SM REIT are used exclusively for the activities of SM REIT and no links or information about any other entity, structure or person shall be made available on its website or on any other medium of communication.

Issue period

The issue period shall not be more than thirty days.

Dematerialization

(1) The SM REIT shall issue units of its scheme only in dematerialized form.

(2) The investments of scheme of the SM REIT in SPV(s) shall be held in dematerialized form.

Lock-in requirements

1) The minimum unitholding requirement applicable to the investment manager for the period of first three years commencing from the date of listing of units in the initial offer till the end of the third year from the date of listing of units in the initial offer, shall be as under:

   a) in a scheme of the SM REIT which has opted not to undertake leverage as per disclosures in the scheme offer document filed for initial offer, the investment manager shall hold at least five per cent. of the total outstanding units at all times;

   b) in a scheme of the SM REIT which has opted to undertake leverage as per disclosures in the scheme offer document filed for initial offer, the investment manager shall hold at least fifteen per cent. of the total outstanding units at all times:

   Provided that any holding in excess of fifteen per cent or five per cent., as the case may be, shall be held by the investment manager for a period of at least one year from the date of listing of units issued in the initial offer.

2) The investment manager shall hold at least five per cent. of the total outstanding units in each scheme

of the SM REIT, at all times, for a period of two years commencing from the fourth year of the date of listing of units in the initial offer till the end of fifth year from the date of listing of units issued in the initial offer.

3) The investment manager shall hold at least three per cent. of the total outstanding units in each scheme of the SM REIT, at all times, for a period of five years commencing from the sixth year of the date of listing of units in the initial offer till the end of tenth year from the date of listing of units issued in the initial offer.

4) The investment manager shall hold at least two per cent. of the total outstanding units in each scheme of the SM REIT, at all times, for a period of ten years commencing from the eleventh year of the date of listing of units in the initial offer till the end of twentieth year from the date of listing of units issued in the initial offer.

5) The investment manager shall hold at least one per cent. of the total outstanding units in each scheme of the SM REIT, at all times, after the completion of twentieth year from the date of listing of units issued in the initial offer.

6) The units in which holding is required to be maintained under this regulation shall be unencumbered and locked-in.

   However, the units issued to investors against swap of securities allotted prior to the date of this chapter coming into force by an SM REIT that has received a certificate of registration pursuant to an application made under sub-regulation (1) of regulation 26N, shall not be considered for calculating the total outstanding units of the schemes of the SM REIT under this regulation.

Allotment and listing

1) The units of the scheme of the SM REIT shall be mandatorily listed on the recognized stock exchange(s) having nationwide trading terminals.

2) The units of the SM REIT of the particular scheme shall be allotted and listed with such timelines as may be specified by the SEBI from time to time:

   However, if the investment manager fails to allot or list units within the specified timelines, the investment manager shall pay interest to investors at the rate of 15% per annum and such interest shall not be recovered in the form of fees or any other form payable to the investment manager by the SM REIT.

3) The listing of the units of the scheme of the SM REIT shall be in accordance with the listing agreement entered into between the SM REIT and the designated stock exchange.

4) The units of the scheme of the SM REIT listed in designated stock exchanges shall be traded, cleared and settled in accordance with the bye-laws of concerned stock exchanges and such conditions as may be specified by the SEBI.

5) No person, other than investment manager, its related parties and its associates, shall hold units of a scheme of the SM REIT which taken together with units held by him and by persons acting in concert with him in such scheme of the SM REIT, exceed 25% of the total outstanding units of such scheme of the SM REIT.

Filing of post issue report

The merchant banker shall submit post-issue report, along with due diligence certificate, within seven working days of the date of finalization of allotment or within seven working days of refund of money in case of failure of issue, as per the format and in such manner as may be specified by the SEBI.

Minimum public unit holding

1) The minimum offer and allotment to the public in each scheme of SM REIT shall be at least 25% of the total outstanding units of such scheme.

2) The minimum public holding for the units of each scheme of SM REIT shall be in accordance with point (1) above, failing which action may be taken as may be specified by the SEBI and by the designated stock exchange including delisting of units under regulation 26ZI.

Distributions

1) With respect to distributions made by the scheme of SM REIT and SPV, the investment manager shall ensure, –

   (a) not less than 95% of net distributable cash flows of the SPV are distributed to the scheme of SM REIT subject to applicable provisions in the Companies Act, 2013:

   However, the amount retained by the SPV shall be utilized only in such manner as may be specified by the SEBI from time to time;

   (b) 100% of the net distributable cash flows of the scheme of SM REIT shall be distributed to the unit holders;

   (c) the distributions are declared at least once in every quarter of the financial year and not later than fifteen working days from the end of the quarter;

   (d) the distributions are paid to the unitholders within seven working days of such declaration.

2) If the investment manager fails to make payment within the said timelines, then the investment manager shall pay interest at the rate of 15% per annum to the unitholders, for the delayed period and such excess interest shall not be recovered by the investment manager from the SM REIT in any form.

Related party transactions

The SM REITs shall not enter into any transaction with related parties including transactions for facility management and property management:

This regulation shall not apply to payment of fees by the SM REIT to the investment manager and the trustee for carrying on the activities of the REIT.

Rights and meetings of unit holders

1) The unitholders of the scheme shall have the right to receive distributions as provided for in the scheme offer document.

2) With respect to any matter requiring approval of the unit holders, –

   (a) a resolution shall be considered as passed when the votes cast by unit holders, so entitled and voting, in favour of the resolution exceed a certain percentage or criteria;

   (b) the unitholders of the scheme shall have the right to vote in any unitholders' meeting of that particular scheme of SM REIT;

   (c) in case the scheme of the SM REIT proposes to purchase a property or proposes to sell a property at a value which is greater than 105% or less than 95% of the value of property as assessed by the valuer respectively, approval from unitholders shall be required wherein votes cast in favour of the resolution shall be at least three times the number of votes cast, against the resolution;

(d) the investment manager shall also provide the option to the unitholders to vote either by way of post or through electronic mode;

(e) a notice of not less than twenty one clear days shall be provided to the unit holders:

Provided that a meeting of the unit holders of each scheme may be called after giving shorter notice, if consent, in writing or by electronic mode, is accorded thereto, by not less than 95% of the unit holders of the scheme entitled to vote at such meeting;

(f) no person who is interested in any transaction as well as associates of such person(s) shall vote on any matter related to that transaction;

(g) investment manager shall be responsible for all the activities pertaining to the meeting of the unit holders of scheme, subject to oversight of the trustee:

Provided that in issues pertaining to the investment manager including change in the investment manager, removal of the investment manager, change in control of the investment manager, the trustee shall convene and handle all activities pertaining to conduct of the meetings of unit holders:

Provided further that in respect of issues pertaining to the trustee including change in the trustee, the trustee shall not be involved in any manner in the conduct of the meeting.

3) An annual meeting of unit holders of each scheme shall be held at least once every year, within one hundred and twenty days from the end of financial year and the time between two meetings shall not exceed fifteen months.

4) The investment manager or the trustee, as applicable, of the SM REIT shall conduct the meetings in accordance with the procedure as may be specified by the Board.

5) The investment manager of a SM REIT may conduct meeting of unitholders of each scheme through video conferencing or through other audio-visual means.

6) In the annual meeting of unitholders of each scheme, the investment manager shall place following matters before the unit holders for consideration of:

(a) latest annual accounts and audit report of the SM REIT and its schemes, and a report on performance of the scheme of the SM REIT;

(b) the appointment of, and the fixing of the fees of the auditor and the valuer; and

(c) the latest valuation reports.

7) The matters mentioned in sub-regulation (6) of this regulation shall require approval of unitholders of the scheme, where votes cast in favour of the resolution shall be more than the votes cast against the resolution.

8) Any information that is required to be disclosed to the unitholders of each scheme may also be taken up in the annual meeting of the unitholders of such scheme.

9) Approval from unitholders of the concerned scheme shall be required, where votes cast in favour of the resolution shall be more than the votes cast against the resolution, in case of following items,–

(a) any transaction, value of which is equal to or greater than ten per cent. of the value of the assets of the particular scheme of SM REIT;

(b) any borrowing in excess of limit specified under proviso to sub-regulation (5) of regulation 26U;

(c) any issue for which the Board or the recognized stock exchanges require such approval under this sub-regulation;

(d) any issue, in the ordinary course of business, which in the opinion of the Investment Manager or Trustee, is material and requires approval of the unitholders.

10) Approval from the unitholders of the scheme of the SM REIT shall be required, where votes cast in favour of the resolution shall not be less than one and a half times the votes cast against the resolution in case of the following items, –

(a) any change in investment manager including removal of the investment manager or change in control of the investment manager;

(b) any material change in investment strategy or any change in the fees payable to the investment manager by the SM REIT;

(c) any issue of units after initial offer by a scheme of SM REIT, in whatever form;

(d) the trustee and investment manager proposing to seek voluntary delisting of units of the scheme of the SM REIT;

(e) any issue, not in the ordinary course of business, which in the opinion of the investment manager or trustee requires approval of the unitholders;

(f) any issue, which in the opinion of the Board or the recognized stock exchanges, requires approval under this sub-regulation;

(g) removal of the auditor or valuer and appointment of another auditor or valuer to the SM REIT;

(h) change in the trustee;

(i) delisting of the scheme of the SM REIT if the unit holders have sufficient reason to believe that such delisting would act in the interest of the unitholders; and

(j) extension of time period as specified under clause (b) of sub-regulation (1) of regulation 26ZI.

(2) The unitholders of the scheme of SM REIT may request any matter to be taken up in the unitholders' meeting of such scheme if ten per cent. of the unitholders of a particular scheme by value, apply in writing, to the trustee and the trustee shall require the investment manager to place the matter for voting in accordance with these regulations:

Provided that the request of the unitholders of a scheme for change in the trustee shall be sent, in writing, to the investment manager, who shall, on receipt of such a request, place the matter for voting in the manner as specified in accordance with these regulations.

POWER TO RELAX STRICT ENFORCEMENT OF THE REGULATIONS

The SEBI may, exempt any person or class of persons from the operation of all or any of the provisions of these regulations for a period as may be specified but not exceeding twelve months, for furthering innovation in technological aspects relating to testing new products, processes, services, business models, etc. in live environment of regulatory sandbox in the securities markets.

Any exemption granted by the SEBI as mentioned above shall be subject to the applicant satisfying such conditions as may be specified by the SEBI including conditions to be complied with on a continuous basis.

"Regulatory Sandbox" means a live testing environment where new products, processes, services, business models, etc. may be deployed on a limited set of eligible customers for a specified period of time, for furthering innovation in the securities market, subject to such conditions as may be specified by the SEBI.

LESSON ROUND-UP

- SEBI notified Real Estate Investment Trusts (REITs) Regulations, 2014 to encourage and invests in real estate directly, either through properties or mortgages.
- Real Estate Investment Trusts (REITs) Regulations, 2014 comprises of nine chapters and seven schedules.
- REITs are setup as trust under the provisions of the Indian Trusts Act, 1882 and are registered with SEBI. It has four Parties-Sponsor(s) Group, Inducted Sponsor, Manager and Trustee to avoid any conflict of interest issues.
- REIT structure in India comprises of Sponsor, Trustee and Manager.
- These regulations provide certain eligibility requirements for grant of certificate, if those requirements are satisfied, SEBI shall grant the certificate of registration under these Regulations.
- It is mandatory for all REITs to lists its units on a recognized stock exchange and REITs shall make continuous disclosures in terms of the listing agreement. The units of REITs shall continue to be listed unless delisted in terms of the REIT Regulations.
- A REIT can invest only in SPVs or properties or securities or TDR in India in accordance with these Regulations and in accordance with the investment strategy as detailed in the offer document as may be amended subsequently.
- The REIT shall not invest in vacant land or agricultural land or mortgages other than mortgage backed securities, provided that this shall not apply to any land which is contiguous and extension of an existing project being implemented in stages.
- REIT, through a valuer, shall undertake full valuation on a yearly basis and updation of the same on a half yearly basis and declare Net Asset Value within 15 days from the date of such valuation/updation.
- The manager shall submit an annual report to all unit holders of the REIT with respect to activities of the REIT, within three months from the end of the financial year.
- The manager shall submit a half-yearly report to all unit holders of the REIT with respect to activities of the REIT within forty five days from the end of the half year ending on September 30th.
- SEBI has issued guidelines on participation by the strategic investors in InvITs and REITs.
- SEBI vide its circular dated April 13, 2018 issued guidelines for issue of debt securities by InvITs and REITs.

GLOSSARY

Contract: A contract is a legally binding agreement between two parties, and in order to have a valid Contract of Sale in real estate there must be: an offer, an acceptance, competent parties, consideration, legal purpose, written documentation, description of the property, and signatures of the principals.

Floor Space: It means the buildable area on a plot of land as specified by the competent authority.

Index Leasing : A mean of obtaining the physical and partial economic use of a property for a specified period without obtaining an ownership interest.

Mortgage: A mortgage is a pledge of real estate collateral to secure a debt. Also, it is a legal document describing and defining the pledge. The mortgage may also include the terms of repayment of the debt.

Occupancy Certificate: It means a completion certificate or such other certificate, as the case may be, issued by the completion authority permitted occupation of any property under any law for the time being in force.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What are the investment benefits of REITs?
2. REITs are different from mutual funds. Explain.
3. How does REITs work? What are the benefits of Investing in units by REITs?
4. Elucidate the various conditions required to be fulfilled by a person to be registered as trustee under the SEBI (Real Estate Investment Trusts) Regulation, 2014?
5. Explain the major provisions of SEBI (Real Estate Investment Trusts) Regulation, 2014?
6. Discuss the Rights of Unit holders under SEBI (Real Estate Investment Trusts) Regulations, 2014?
7. What do you mean by Strategic Investor with reference to the public issue of REITs? Define.
8. Briefly discuss the disclosures required to be made by a manger under the SEBI (Real Estate Investment Trusts) Regulations, 2014.

LIST OF FURTHER READINGS

- Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014
- EPRA Global REIT Survey 2020
- SEBI Annual Report 2019-20

OTHER REFERENCES

- https://www.sebi.gov.in/web/?file=https://www.sebi.gov.in/sebi_data/attachdocs/feb-2021/1614320616049.pdf#page=1&zoom=page-width,-15,850
- https://prodapp.epra.com/media/EPRA_Global_REIT_Survey_2020_1597930925323.pdf
- De'construct'ing InvITs and REITs by Cyril a march and mangald as; https://www.cyrilshroff.com/ wp-content/uploads/2017/01/De_construct_ing-InvITs-and-REITs-.pdf

Infrastructure Investment Trusts

Lesson 10

KEY CONCEPTS

■ Holdco ■ Declassification of Sponsor ■ SPV ■ Sponsor/Inducted Sponsor ■ Strategic Investor ■ Anchor Investor ■ Senior Management ■ Independent Director ■ Change in Control

Learning Objectives

To understand:

- Meaning of Infrastructure Investment Trust (InvIT)
- Difference between REITs and InvITs
- Intermediaries involved in an InvIT
- Regulatory Framework of InvITs in India
- Conceptual understanding on Important Terminologies
- Issue and Listing units by InvITs
- Basics of the systems, procedures and rules that are essential for entities seeking to list InvITs in India

Lesson Outline

- Introduction
- How units of an InvIT are differ with Traditional Investments?
- Difference between REITs and InvITs
- Structure of InvIT
- SEBI (Infrastructure Investment Trusts) Regulations, 2014
- Key Stakeholder
- Eligibility Criteria
- Offer and Listing of Units
- Guidelines for Public Issue of Units of InvITs
- Guidelines for preferential issue of units by InvITs
- Listing and Trading of Units
- Delisting of Units
- Investment Conditions and Distribution Policy
- Rights and Meetings of Unit Holders
- Governance Norms for InvITs
- Minimum Information to be placed before Board of Directors of the Investment Manager
- Power to relax strict enforcement of Regulations
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- SEBI (Infrastructure Investment Trusts) Regulations, 2014
- Guidelines for Public Issue and Preferential Issue of Units of InvITs
- SEBI(Listing Obligation and Disclosures Requirements) Regulations, 2015
- The Trust Act, 1882
- The Registration Act, 1908
- The FEMA, 1999
- The Income Tax Act, 1961

INTRODUCTION

An Infrastructure Investment Trust (InvITs) is Collective Investment Scheme similar to a mutual fund, which enables direct investment of money from individual and institutional investors in infrastructure projects to earn a small portion of the income as return. SEBI (Infrastructure Investment Trusts) Regulations, 2014 provides a regulatory framework for registration and regulation of InvITs in India. The regulations, *inter alia*, prescribe conditions for making a public offer and private placement, initial and continuous disclosures, investment conditions, unit-holder approval requirements, related party disclosures, etc.

InvITs work like mutual funds or real estate investment trusts (REITs) in features. InvITs can be treated as the modified version of REITs designed to suit the specific circumstances of the infrastructure sector. The purpose of InvITs is to encourage and provide additional financing for investment in the infrastructure sector in India. It aims to provide stable long term cash flows to its unit holders; suited for long term capital such as Pension Funds and Insurance Companies. InvITs support diversification of ownership of infrastructure assets such as power transmission, roads, ports, renewable projects etc.

Often, infrastructure projects such as roads or highways take some time to generate steady cash flows. Meanwhile, the infrastructure company has to pay interest to banks for the loans taken by it. An InvIT essentially gives the company the leeway to fulfil its debt obligations quickly.

An infrastructure investment trust is a trust formed under the Trusts Act and registered under the Registration Act. In accordance with the Trusts Act, a trust is an obligation attached to the ownership of property. The obligation is created by the author of the trust, accepted by the owner of property and owed to the beneficiaries identified in the Trust Deed. In the context of an InvIT, the trust is created by the Sponsor, the ownership of the property vests in the Trustee and the beneficiaries are the Unit holders of the InvIT.

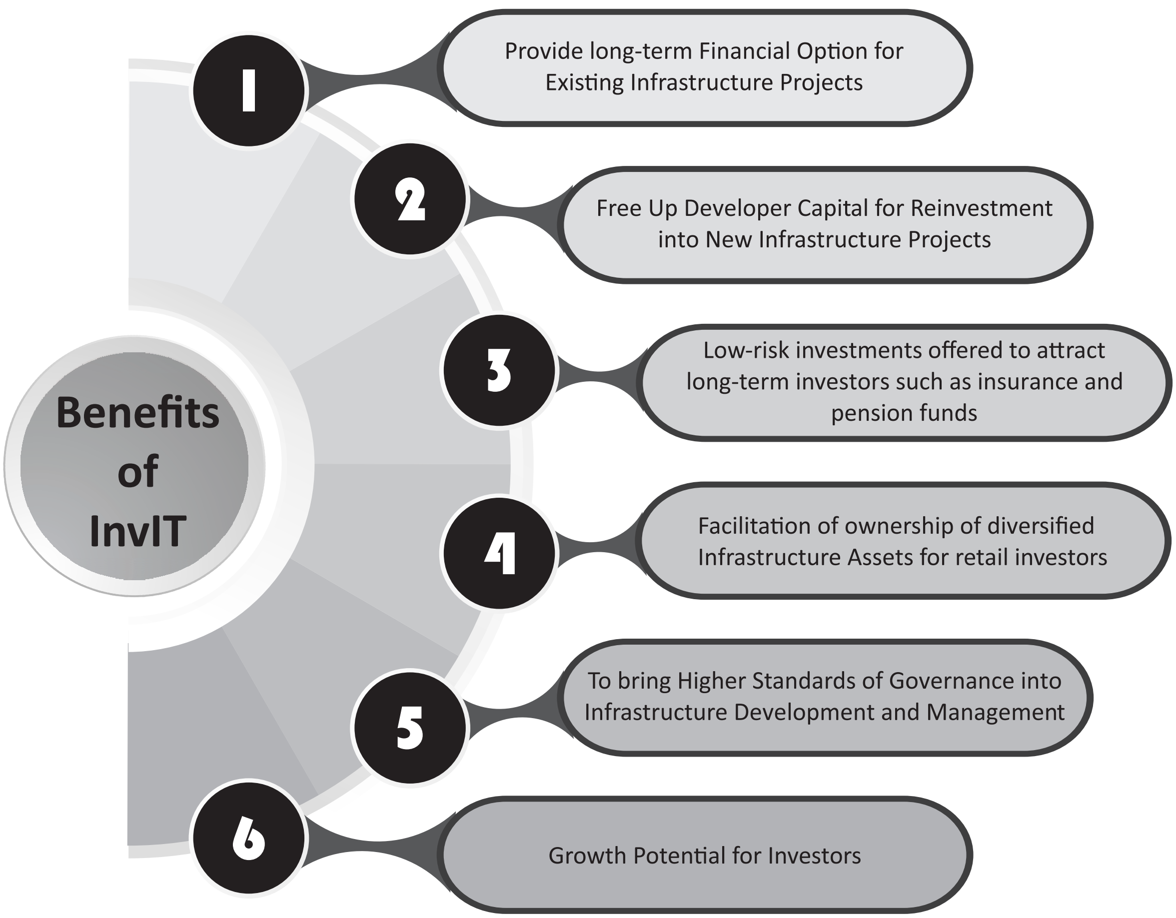
An InvIT, is a private trust set-up under the Indian Trusts Act, 1882, and registered with SEBI as an InvIT.

There is also a project manager which actually executes the projects. It is over seen by the investment manager. Lastly, since the instrument is essentially a trust, the company will also appoint a trustee, who has to ensure that the functions of the InvIT, investment manager and project manager comply with SEBI laws.

SEBI introduced infrastructure investment trust (InvIT) regulations for infrastructure projects keeping in mind the huge infrastructure needs of our country. India Grid Trust had in 2016 filed a draft offer document with SEBI for India’s first ever power sector InvIT. As on May 22, 2024, following InvITs are registered with SEBI in India.

1. IRB InvIT Fund
2. India Grid Trust
3. India Infrastructure Trust
4. Digital Fibre Infrastructure Trust
5. Oriental Infra Trust
6. IndInfravit Trust
7. IRB Infrastructure Trust
8. Indian Highway Concessions Trust
9. National Highways Infra Trust
10. Roadstar Infra Investment Trust
11. POWERGRID Infrastructure Investment Trust
12. Shrem InvIT
13. Athaang Infrastructure Trust
14. Highways Infrastructure Trust
15. Anzen India Energy Yield Plus Trust
16. Bharat Highways InvIT
17. Cube Highways Trust
18. Schoolhouse InvIT
19. Data Infrastructure Trust
20. Intelligent supply chain infrastructure trust
22. NDR InvIT Trust
21. National Infrastructure Trust
23. NX-Infra Trust
24. Sustainable Energy Infra Trust.
25. TVS Infrastructure Trust

How does it benefit investors?



How units of an InvIT are differ with Traditional Investments ?

Comparative Analysis
InvITs vis-à-vis traditional investments

	InvIT Units	*Direct Investment in Infrastructure segment*	*Infrastructure Company Equity Shares*
Investment Characteristics	• Minimum lot size of 1 unit • Freely transferable listed securities • Professionally managed • No entry / exit load	• Nothing less than one crore (For strata units) • Illiquid & non- transparent market • Hassles in managing assets • Transaction costs involved	• Minimum lot size of 1 share • Freely transferable listed securities • No entry / exit load
Return Profile	• Returns driven by capital appreciation and regular cash distribution (90% mandatory)	• Returns driven by a timely and profitable exit	• Returns driven by capital appreciation and dividends (Not mandatory)
Tax Efficiency	• Dividends: Exempted# • Interest: Taxable# • Rent: Taxable#	• Rent is taxable	• Dividends are taxable

Notes: #Investors need to check which type of income they receive and applicable tax treatment

Distinguish between REITs and InvITs

Particulars	*REITs*	*InvITs*
Meaning	REITs serves as an investment tool that helps own and operate income- generating real estate properties. Such properties serve as a stream of annual revenue and mostly include warehouses, healthcare centres, commercial buildings, malls, etc.	InvITs is planned to pool money from investors to invest it in assets generating cash flow. Moreover, they invest in projects like roadways, highways and other high-value infrastructural units.
Growth prospect	The growth prospects of REITs rely on the redevelopment or acquisition of assets, new construction, etc.	Their growth prospect depends mainly on the success of acquisition and concession of assets.

Income Stability	REITs tend to provide a steady flow of income mostly because their income yielding properties come with extensive rental contracts.	The stability of income for InvITs depends mainly on those factors that tend to affect the capacity of usage and also the scalability of tariffs. Hence, in most cases, income is quite uncertain.
Associated risks	REITs are better insulated from regulatory/ political risks. REITs tend to hold properties that are either leased or owned on a freehold basis.	The infrastructure sector is prone to react to regulatory policies and political interference. Thus, parking funds in infrastructure investment trusts often prove risky.

Parties and Intermediaries involved in an InvIT

Trustee: An independent debenture trustee registered with SEBI and responsible for holding the InvIT assets in trust for, and for the benefit of, the unit holders of the InvIT.

Sponsor: Typically, a body corporate, LLP, promoter or a Company with a net worth of, atleast Rs. 100 crores classifies as a sponsor. When it comes to a public-private partnership projects, sponsors serve as a Special Purpose Vehicle (SPV)

Investment Manager: As a body corporate or LLP, an investment manager supervises all the operational activities and day to day activities of the InvIT.

Project Manager: The Project Manager is responsible for the execution of an infrastructure project and achieving project milestones in accordance with the project documents or concession agreement.

Compliance Officer: The officer who is responsible for the Compliance related to InvIT.

Lead Member: It means Lead member of the Concessionaire SPV for PPP projects as defined in the project documents.

Custodian: It means a person registered under (Custodian of Securities) Regulations, 1996.

Merchant Banker is one who looks after the entire process of issue of units.

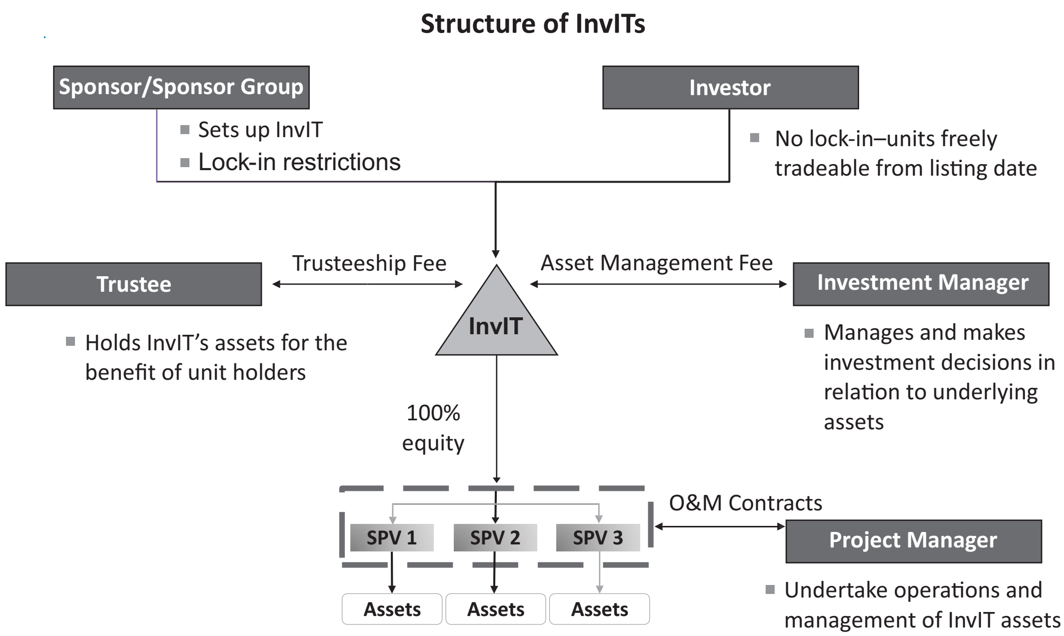
Auditor: is one who conducts the audit of accounts of InvIT.

Valuer: is one who undertakes valuation of the assets.

Special Purpose Vehicle (SPV) is a Company or LLP who holds not less than 80% of its assets directly in properties and in which InvIT or the holding company holds or proposes to hold not less than 50% of Equity share capital or interest. Also, any Company or LLP which is not engaged in any activity other than holding and developing property and any other activity incidental to such holding or development.

Unitholders are the one who holds units of the InvIT.

Structure of InvIT



Listing and trading of units of Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs) on recognized stock exchanges in International Financial Services Centers (IFSC)

The stock exchanges operating in IFSC may permit dealing in following types of securities and products in such securities in any currency other than Indian rupee, with a specified trading lot size on their trading platform subject to prior approval of the SEBI:

i. Equity shares of a company incorporated outside India;

ii. Depository receipt(s);

iii. Debt securities issued by eligible issuers;

iv. Currency and interest rate derivatives;

v. Index based derivatives;

vi. Such other securities as may be specified by the SEBI.

SEBI vide its circular dated September 16, 2020 decided to permit 'Units of InvITs and REITs by whatever name called in the Permissible Jurisdictions' as permissible security under sub- clause (vi) of Clause 7 of SEBI (IFSC) Guidelines, 2015

List of Permissible Jurisdictions and International Exchanges are mentioned below:

1. United States of America - NASDAQ, NYSE
2. Japan - Tokyo Stock Exchange
3. South Korea - Korea Exchange Inc.
4. United Kingdom excluding British Overseas Territories-London Stock Exchange
5. France - Euronext Paris
6. Germany - Frankfurt Stock Exchange
7. Canada - Toronto Stock Exchange.

Difference between Sponsor/Sponsor Group of InvIT andPromoter of a Company

Sponsor/Sponsor Group of InvIT- The Sponsor is the author of the InvIT and is responsible for transferring or undertaking to transfer the initial portfolio of assets to the InvIT and is responsible for the formation transactions involved in setting-up and establishing an InvIT. Sponsor is required to lock-in 15% or 25% (as the case may be) ofthe outstanding units of an InvIT, held by it, for a period of three years and any additional unitholding for a period of one year.

However, **'promoter'** shall include a person who has control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise; or in accordance with whose advice, directions or instructions the board of directors of the issuer is accustomed to act: however, a person who is acting merely in a professional capacity shall not be deemed as Promoter.

A financial institution, scheduled commercial bank, mutual fund, venture capital fund, alternative investment fund, foreign venture capital investor, insurance company registered with the Insurance Regulatory and Development Authority of India or any other category as specified by the SEBI, shall not be deemed to be a promoter merely by virtue of the fact that twenty per cent or more of the equity share capital of the issuer is held by such person unless such person satisfy other requirements prescribed under SEBI (ICDR) Regulations, 2018.

SEBI (INFRASTRUCTURE INVESTMENT TRUSTS) REGULATIONS, 2014

The Securities and Exchange Board of India (SEBI) notified the Infrastructure Investment Trusts (InvITs) Regulations on 26 September 2014, thereby paving the way for introduction of an internationally acclaimed investment structure in India. The Finance Minister has also made necessary amendments to the Indian taxation regime to provide the tax pass through status, which is one of the key requirements for feasibility of InvITs. The Infrastructure Investment Trusts (InvITs) Regulations, 2014, provide a positive push to the Indian Capital Markets and Infrastructure sector. It also creates liquidity to some extent for the Infrastructure players. Further, it would provide investors an opportunity to invest in Indian stabilized assets through an Indian listed platform.

SEBI (Infrastructure Investment Trusts) Regulations, 2014 provides a regulatory framework for registration and regulation of InvITs in India. The regulations, *inter alia*, prescribe conditions for making a public offer and private placement, initial and continuous disclosures, investment conditions, unit-holder approval requirements, related party disclosures, etc.

DEFINITIONS

"Change in control" –

(i) in case of a body corporate, -

a) if its shares are listed on any recognized stock exchange, shall be construed with reference to the definition of control in terms of regulations framed under clause (h) of sub-section (2) of section 11 of the Act;

b) if its shares are not listed on any recognized stock exchange, shall be construed with reference to the definition of control as provided in sub-section (27) of section 2 of the Companies Act, 2013.

(ii) in a case other than a body corporate, shall be construed as any change in its legal formation or ownership or change in controlling interest. Here, "controlling interest" means an interest, whether direct or indirect, to the extent of not less than 50% of voting rights or interest.

"Completed and revenue generating project" means an infrastructure project, which prior to the date of its acquisition by, or transfer to, the InvIT, satisfies the following conditions:

(i) the infrastructure project has achieved the commercial operations date as defined under the relevant project agreement including concession agreement, power purchase agreement or any other agreement of a similar nature entered into in relation to the operation of the project or in any agreement entered into with the lenders;

(ii) the infrastructure project has received all the requisite approvals and certifications for commencing operations; and

(iii) the infrastructure project has been generating revenue from operations for a period of not less than one year.

"Concession Agreement" means an agreement entered into by a person with a concessioning authority for the purpose of implementation of the project as provided in the agreement.

"Concessioning Authority" means the public sector concessioning authority in PPP projects.

"Eligible Infrastructure Project" means an infrastructure project which, prior to the date of its acquisition by, or transfer to, the InvIT, satisfies the following conditions, –

- For PPP projects,–

  a) the Infrastructure Project is a completed and revenue generating project; or

  b) the Infrastructure Project, which has achieved commercial operations date and does not have the track record of revenue from operations for a period of not less than one year; or

  c) the Infrastructure Project is a pre-COD project.

- In non-PPP projects, the infrastructure project has received all the requisite approvals and certifications for commencing construction of the project.

"*group entities of the Investment Manager*" means:

(i) entities or person(s) which are controlled by the Investment Manager;

(ii) entities or person(s) who control the Investment Manager;

(iii) entities or person(s) which are controlled by entities or person(s) specified in point (ii) above.

"holdco" or ***"holding company"*** means a company or LLP,-

(i) in which InvIT holds or proposes to hold controlling interest and not less than fifty one per cent of the equity share capital or interest and which in turn has made investments in other SPV(s), which ultimately hold the infrastructure assets;

(ii) which is not engaged in any other activity other than holding of the underlying SPV(s), holding of infrastructure projects and any other activities pertaining to and incidental to such holdings.

"Independent director" in case of a company means a director, other than a nominee director of the Manager:-

(i) who, in the opinion of the Board of Directors of the Manager, is a person of integrity and possesses relevant expertise and experience;

(ii) who is not or was not the promoter of parties to the InvIT, its holding company, the subsidiary or associate or a member of the sponsor group of the InvIT;

(iii) who is not related to the InvIT, its Holdco and/or SPV, parties to the InvIT, its holding company, the subsidiary or associate or their promoters or directors;

(iv) who, apart from receiving a director's remuneration, does not have or has had any material pecuniary relationship with the InvIT, its Holdco and/or SPV, parties to the InvIT, its holding company, the subsidiary or associate or their promoters or directors, during the three immediately preceding financial years or during the current financial year;

(v) none of whose relatives –

- is holding securities of or interest in the InvIT, its Holdco and/or SPV, parties to the InvIT, their holding Company, subsidiary or associate during the three immediately preceding financial years or during the current financial year of face value in excess of fifty lakh rupees or two percent of the unit capital of the InvIT, two percent of the paid-up capital of the parties to the InvIT, their holding Company, subsidiary or associate or Holdco and/or SPV respectively or such higher sum as may be specified;
- is indebted to the InvIT, its Holdco and/or SPV, parties to the InvIT, its holding company, subsidiary or associate or their promoters or directors, during the three immediately preceding financial years or during the current financial year, in excess of such amount as may be specified;
- has given a guarantee or provided any security in connection with the indebtedness of any third person to the InvIT, its Holdco or SPV, parties to the InvIT, its holding company, subsidiary or associate or their promoters or directors, during the three immediately preceding financial years or during the current financial year, for such amount as may be specified; or
- has any other pecuniary transaction or relationship with the REIT, its Holdco and/or SPV, parties to the REIT, its holding company, subsidiary or associate amounting to two percent or more of its gross turnover or total income.

However, the pecuniary relationship or transaction with the InvIT, its Holdco and/or SPV, parties to the InvIT, its holding company, subsidiary or associate or their promoters or directors shall not exceed two percent of its gross turnover or total income or fifty lakh rupees or such higher amount as may be specified from time to time, whichever is lower.

(vi) who, neither himself or herself, nor whose relative(s) —

- holds or has held the position of a key managerial personnel or is or has been an employee of the Holdco and/or SPV, parties to the InvIT or its holding, subsidiary or associate or any company belonging to parties to the InvIT, in any of the three financial years immediately preceding the financial year in which he/she is proposed to be appointed.

  However, in case of a relative who is an employee other than a key managerial personnel, the restriction under this clause shall not apply for his/her employment.

- is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he/she is proposed to be appointed, of-
  1. a firm of auditors or **company secretaries in practice** or cost auditors of the InvIT, its Holdco and/or SPV, parties to the InvIT, its holding company, subsidiary or associate; or
  2. any legal or a consulting firm that has or had any transaction with the InvIT, its Holdco and/or SPV, parties to the InvIT, its holding company, subsidiary or associate amounting to ten per cent or more of the gross turnover of such firm.
- holds together with his relatives two per cent or more of the total voting power of the InvIT, its Holdco and/or SPV, parties to the InvIT;
- is a chief executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts or corpus from the InvIT, its Holdco and/or SPV, parties to the InvIT, its holding company, subsidiary or associate, any of its promoters, directors or that holds two per cent or more of the total voting power of the InvIT, its Holdco and/or SPV, parties to the InvIT;
- is a material supplier, service provider or customer or a lessor or lessee of the InvIT, its Holdco and/or SPV, parties to the InvIT, its holding company, subsidiary or associate.

(vii) who is not less than 21 years of age; or

(viii) who possesses such other qualifications as may be specified by the SEBI.

"Inducted sponsor" means any company or LLP or body corporate which has been inducted as a sponsor in accordance with sub-regulation (7) of regulation 22.

"Infrastructure" includes all infrastructure sub-sectors as defined vide notification of the Ministry of Finance dated October 07, 2013 and shall include any amendments or additions made thereof and "Infrastructure project" means any project in the infrastructure sector.

"InvIT" shall mean a trust registered as such under the InvIT Regulations.

"InvIT assets" means assets owned by the InvIT, whether directly or through a holdco and/or SPV, and includes all rights, interests and benefits arising from and incidental to ownership of such assets.

"Infrastructure Developer" in case of PPP projects shall mean the lead member of the concessionaire SPV.

"Institutional Investor" means -

(i) a qualified institutional buyer; or

(ii) family trust or systematically important NBFCs registered with RBI or intermediaries registered with SEBI, all with net-worth of more than five hundred crore rupees, as per the last audited financial statements.

"NAV" or "Net Asset Value" means the value of the InvIT assets reduced by the external debt" divided by the number of outstanding units as on a particular date. While calculating the number of outstanding units, any outstanding subordinate units shall not be included.

"Parties to the InvIT" shall include the sponsor groups, investment manager, project manager(s) and the trustee.

"PPP Project" means an infrastructure project undertaken on a Public- Private Partnership basis between a public concessioning authority and a private SPV concessionaire selected on the basis of open competitive bidding or on the basis of an MoU with the relevant authorities.

"Pre-COD project" means an infrastructure project which:

a) has not achieved commercial operation date as defined under the relevant project agreements including

(i) the concession agreement;

(ii) power purchase agreement; or

(iii) any other agreement of a similar nature entered into in relation to the operation of a project; or

(iv) any agreement entered into with the lenders; and

b) has,

(i) achieved completion of at least fifty per cent of the construction of the infrastructure project as certified by an independent engineer of such project; or

(ii) expanded not less than 50% of the total capital cost set forth in the financial package of the relevant project agreement.

"Related Parties" shall be defined under the Companies Act, 2013 or under the applicable accounting standards and shall also include, –

(i) Parties to the InvIT;

(ii) Promoters, directors and partners of the person mentioned in clause (i).

"*Self-sponsor Investment Manager*" means the Investment Manager of an InvIT who has dual responsibilities of both the investment manager as well as the sponsor.

"Senior Management" means the officers and personnel of the investment manager who are members of its core management team, excluding the Board of Directors, and shall also comprise all members of the management, one level below the Chief Executive Officer or Managing Director or Whole Time Director or manager (including Chief Executive Officer and manager, in case they are not part of the Board of Directors) and shall specifically include the Compliance Officer and Chief Financial Officer.

"*Sponsor group*" includes-

(i) the sponsor(s);

(ii) entities or person(s) which are controlled by such sponsor;

(iii) entities or person(s) who control such body corporate;

(iv) entities or person(s) which are controlled by entities or person(s) specified in point (iii) above.

"SPV" or ***"Special Purpose Vehicle"*** means any company or LLP,

(i) in which either the InvIT or the holdco holds or proposes to hold controlling interest and not less than fifty one per cent of the equity share capital or interest;

In case of PPP projects where such acquiring or holding is disallowed by government or regulatory provisions under the concession agreement or such other agreement, this clause shall not apply and shall be subject to provisions of InvIT Regulations.

(ii) which holds not less than ninety percent of its assets directly in infrastructure projects and does not invest in other SPVs; and

(iii) which is not engaged in any other activity other than activities pertaining to and incidental to the underlying infrastructure projects.

"Strategic Investor" means-

a) an infrastructure finance company registered with Reserve Bank of India as a Non-Banking Financial Company;

b) a Scheduled Commercial Bank;

c) a multilateral and/or bilateral development financial institution;

d) a systemically important Non-Banking Financial Companies registered with Reserve Bank of India;

e) a foreign portfolio investors,

f) an insurance company registered with the Insurance Regulatory and Development Authority of India;

g) a mutual fund who invest, either jointly or severally, not less than 5% of the total offer size of the InvIT or such amount as specified by the SEBI from time to time, subject to the compliance with the applicable provisions, if any, of the Foreign Exchange Management Act, 1999 and the rules or regulations or guidelines made thereunder.

"Subordinate unit" means an instrument issued by an InvIT which can be reclassified as an ordinary unit";

"Unit or ordinary unit" means beneficial interest of the InvIT.

"Under-Construction Project" means an infrastructure project whether PPP or non-PPP, which has either not achieved commercial operation date as defined under the relevant project agreements including: the concession agreement; power purchase agreement; or any other agreement of a similar nature entered into in relation to the operation of a project; or in any agreement entered into with the lenders; or has achieved commercial operation date and does not have the track record of revenue from operations for a period of not less than one year.

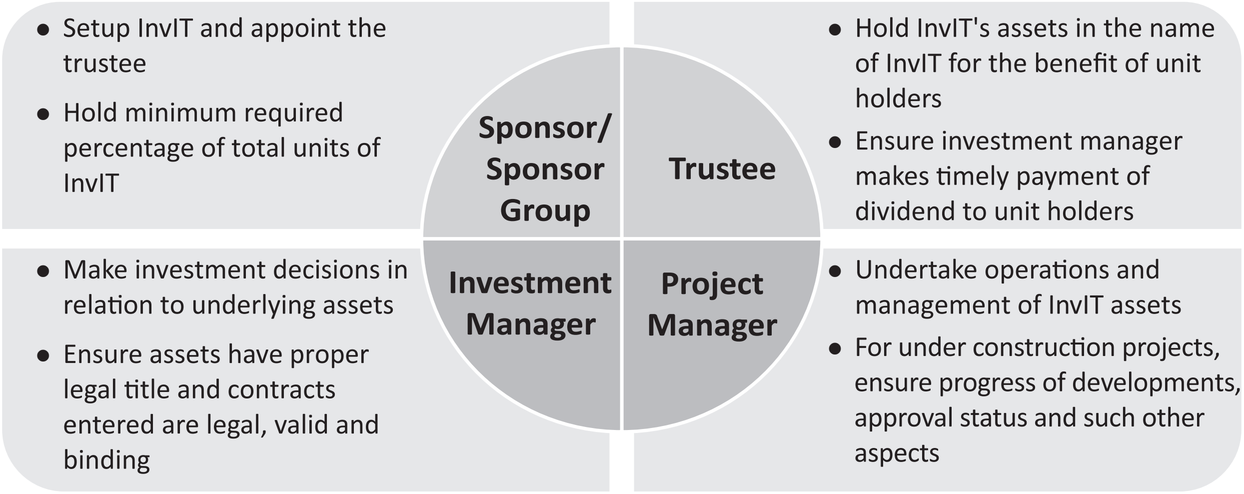
"Valuer" means any person who is a "registered valuer" under section 247 of the Companies Act, 2013 or as specified by SEBI from time to time.

"Value of the InvIT assets" means value of assets of the InvIT as assessed by the valuer based on value of the infrastructure and other assets owned by the InvIT, whether directly or through holdco and/or SPV.

KEY STAKEHOLDERS

The key stakeholders and typical InvIT structure can be represented by the following chart:

InvIT Structure



- No individual can be sponsor of InvIT. A company, limited liability partnership or body corporate, which is the settlor and author of the trust is designated as the 'sponsor' of an InvIT.

Key Features of SEBI (InvIT) Regulations, 2014 and Compliances

Governing Code

- SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Legal Structure

- Trust being setup under Indian Trusts Act, 1882.

Parties to the InvITs

- Sponsor Group, unit holders, Inducted Sponsor, Manager and Trustee.

Maximum number of sponsors that InvITs can have & Unit holding obligation

- Each sponsor shall hold or propose to hold minimum 5% of units of InvITs on post-initial offer basis.
- Collectively hold not less than-
  - 15% of units of the InvITs, for three years from the date of listing of units in the initial offer: If it exceeds from 15 % by any sponsor or sponsor groups, it shall be held for a period of not less than one year from the date of listing.
  - 5% of total units of InvITs from beginning of 4th year till the end of 5th year
  - 3% of total units of InvITs from beginning of 6th year till the end of 10th year
  - 2% of total units of InvITs from beginning of 11th year till the end of 20th year
  - 1% of total units of InvITs after the end of 20th year from the date of listing of units issued in the initial offer

However, the maximum value of the units to be held by the sponsor(s) and sponsor group(s) for compliance shall not exceed five hundred crore rupees.

The units required to be held as mentioned above shall be locked in and shall not be encumbered.

Subordinate units shall not be considered in computing total outstanding units of the InvIT while calculating the minimum unitholding requirements.

Subordinate units shall not be eligible for meeting the minimum unitholding requirement.

Eligibility for Trustee

- Shall be registered as a Trustee under SEBI (Debenture Trustee) Regulations,1993 and shall not be an associate of Sponsor/Manager.

Listing requirement

- Listing is mandatory for units.

Investment conditions
● Not less than 80% of value of the InvIT assets shall be invested in eligible infrastructure projects either directly or through holdcos or through SPVs; ● in completed and revenue generating infrastructure projects A Project SPV may be a company or an LLP in which either the InvIT or the Holdco (as defined below) holds or proposes to hold controlling interest and not less than 51% of the equity share capital or interest. However, in case of PPP Projects where such acquiring or holding is disallowed by government or regulatory provisions under the concession agreement or such other agreement, this clause shall not apply and shall be subject to provisions of the InvIT Regulations. It also includes a company or an LLP in (i) which hold not less than 90% of its assets directly in infrastructure projects and does not invest in other Project SPVs; and (ii) which is not engaged in any other activity other than activities pertaining to and incidental to the underlying infrastructure projects.
An InvIT may invest in infrastructure projects through a Project SPV subject to certain investment restrictions, including (i) the partner or shareholder of the Project SPV should not have any rights which may prevent the InvIT from complying with the InvIT Regulations; and (ii) the Investment Manager, in consultation with the Trustee, should appoint majority of the board of directors or governing boards of the Project SPVs, as may be applicable. (iii) the holding interest of the InvIT in the Project SPV(s) should be at least 26%; and (iv) the Investment Manager, in consultation with the Trustee, should appoint majority of the board of directors or governing boards of the Project SPVs, as may be applicable.
Other Permissible Investments
● Not more than 20% of value of the INVIT assets shall be invested in following: ➢ Under construction infrastructure project not more than 10% ➢ listed or unlisted debt of companies or body corporate in infrastructure sector ➢ Listed equity shares of companies which derive not less than 80% of their operating income from infrastructure sector ➢ government securities ➢ Money market instruments, liquid mutual funds or cash equivalents.
Valuation of assets
● Full valuation on a yearly basis and updating the same on a half yearly basis and declare NAV within 15 days from the date of such valuation/updation.
Distribution of Income
● At least 90% of the net distributable income after tax of the InvIT/Holdco shall be distributed as dividend to the unit holders at least on half-yearly basis and shall be made not later than fifteen days.

Initial offer restrictions
• Minimum offer size should be at least Rs. 250 crore.
Minimum Subscription Amount and unit size
• Under both the initial offer and follow-on offer, rights issue, QIP, minimum subscription size for units of InvIT shall be in range of ten thousand rupees to fifteen thousand rupees. • The units offered to the public in initial offer shall not be less than 25% of the number of units of the InvIT on post-issue basis. Can offer less than 25% subject to certain conditions • Trading lot shall be 1 unit. • Value of Assets by InvIT shall be at least Rs. 500 crores. • Minimum Number of Unit holders other than sponsor(s), its related parties and its associates forming part of public shall be at least 200.

ELIGIBILITY CRITERIA

Any person shall not act as an InvIT unless it has obtained a certificate of registration from the SEBI under these regulations. An application for grant of certificate of registration as InvIT shall be made by the sponsor on behalf of the Trust in such form and in such a manner as prescribed in these regulations.

The following conditions shall be considered before grant of registration:

Applicant	➢ The applicant is the sponsor on behalf of the trust and the trust deed must be registered in India under the provisions of the Registration Act, 1908 containing undertaking activity of InvIT as main objective and includes responsibilities of the trustee.
Sponsor/Sponsor Group	➢ Each sponsor and sponsor group shall be clearly identified in the application of registration to the SEBI and in the offer document/ placement memorandum, as applicable. However, for each sponsor group not less than one person shall be identified as a sponsor: ➢ Each Sponsor has a net worth of at least INR 100 crores in case of body corporate or a company or net intangible assets of INR 100 crores in case of a Limited Liability Partnership (LLP). ➢ Minimum experience of at least 5 years and has completed at least two projects.
Investment Manager	➢ Net worth of at least INR 10 crores in case of body corporate or a company or net intangible assets of INR 10 crores in case of a LLP; ➢ Minimum experience of 5 years in fund management/advisory services/ development in infrastructure sector/combined experience of the directors/ partners/employees of the investment manager in fund management or advisory services or development in the infrastructure sector is not less than 30 years;

	➢ Two or more key personnel, having more than 5 years of experience in fund management/advisory services/development in infrastructure sector; ➢ One or more employee who has at least 5 years of experience in relevant sub-sector in which InvIT proposes to invest; ➢ Not less than half of its directors/members should be independent and they should not be directors/members of another InvIT; An office in India from where operations pertaining to InvIT is proposed to be conducted; ➢ The investment manager has entered into an investment management agreement with the trustee which provides for the responsibilities of the investment manager.
Project Manager	➢ The project manager has been identified and shall be appointed in terms of the project implementation/management agreement; However, the project implementation agreement/management agreement shall be submitted along with the draft offer document/or the placement memorandum.
Trustees	➢ Registered with SEBI and is not an associate of sponsor/investment manager; ➢ Sufficient resources with respect to infrastructure, personnel etc. as specified by SEBI; and ➢ Holds InvIT assets in trusts for the benefit of unit holders.
Other Conditions	➢ There shall be only one class of units and all units shall carry equal voting rights and distribution rights associated with such units. ➢ The unitholder(s) holding not less than 10% of the total outstanding units of the InvIT, either individually or collectively, shall - (i) be entitled to nominate one director on the board of directors of the Investment Manager, in such manner as specified by the SEBI. However, the director so nominated shall recuse from voting on any transaction where such nominee director or associate of such nominee director or the unitholder who nominated such nominee director or associate of such unitholder is a party; (ii) comply with stewardship code specified in Schedule VIII of these regulations which states the following principles: 1. They must act in the best interests of the InvIT and its unitholders as a whole; 2. They should formulate a comprehensive policy on the discharge of their stewardship responsibilities and review and update the same periodically; 3. They should have a policy to manage issues of conflict of interest while fulfilling their stewardship responsibilities; 4. They should periodically monitor the InvIT and its investee entities viz. HoldCo(s) and SPV(s);

	5. They should have a policy on intervention in the InvIT and its HoldCo(s) and SPV(s); 6. They should have a policy on voting. ➢ The applicant has clearly described at the time of registration, details pertaining to proposed activities of the InvIT; ➢ The InvIT and parties to the InvIT are fit and proper persons based on the criteria as specified in Schedule II of SEBI (Intermediaries) Regulations, 2008; ➢ Whether any previous application for grant of certificate made by the InvIT or the parties to the InvIT or their directors/members of governing board has been rejected by SEBI; ➢ Whether any disciplinary action has been taken by SEBI or any other regulatory authority against the InvIT or the parties to the InvIT or their directors/members of governing board under any Act or the regulations or circulars or guidelines made thereunder.

OFFER AND LISTING OF UNITS

1.	***No initial offer of units by an InvIT shall be made unless*** ***1. The InvIT is registered with SEBI;*** ***2. The value of InvIT assets is not less than Rs. 500 crore. Such value shall mean the value of the specific portion of the holding of InvIT in the underlying assets or holdco or SPVs;*** ***3. The offer size is not less than Rs. 250 crore.*** However, the requirement of ownership of assets and offer size may be complied at any point of time before allotment of units in accordance with offer document/placement memorandum subject, to a binding agreement with the relevant party(ies) that such the requirements shall be fulfilled prior to such allotment of units and a declaration to SEBI and to the designated stock exchanges to that effect, where applicable and adequate disclosures in this regard in the offer document or placement memorandum.
2.	***The minimum offer and allotment to public through an offer document/placement memorandum shall be:*** ***1. Atleast 25% of the total outstanding units of the InvIT, if the post issue capital of the InvIT calculated at offer price is less than Rs. 1600 crore:*** ***However, the offer price shall not be less than Rs. 250 crore.*** ***2. Of the value of atleast Rs. 400 crore, if the post issue capital of the InvIT calculated at offer price is to or more than Rs. 1600 crore and less than rupees four thousand crore;*** ***3. Atleast 10% of the total outstanding units of the InvIT, if the post issue capital of the InvIT calculated at offer price is equal to or more than Rs. 4000 crore.***
	However, any units offered to sponsor or the investment manager or the project manager or their related parties or their associates shall not be counted towards units offered to the public.

Further that any listed InvIT which has public holding below 25% on account of clauses (b) and (c) above, such InvIT shall increase its public holding to at least 25%, within a period of three years from the date of listing pursuant to initial offer.

Post Issue Capital of the InvIT	***Minimum Public Shareholding***
Less than Rs. 1600 crore	At least 25% of the total outstanding units of the InvIT
Rs. 1600 crore and more but less than Rs. 4000 crore	Of the value of atleast Rs 400 crore
Rs. 4000 crore and more	At least 10% of the total outstanding units of the InvIT

3. ***If the InvIT, raises funds by way of private placement***

a) it shall do it through a placement memorandum;

b) from institutional investors and body corporate only, whether Indian or foreign.

However, in case of foreign investors, such investment shall be subject to guidelines as may be specified by RBI and the government from time to time;

c) with minimum investment from any investor of rupees one crore;

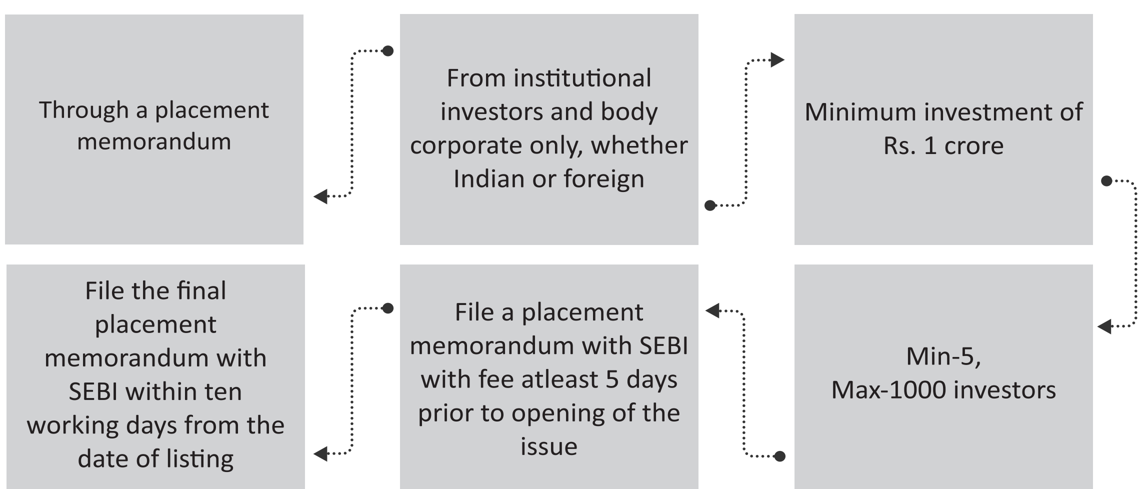
Apart the above, if such an privately placed InvIT invests or proposes to invest not less than 80% of the value of the InvIT assets in completed and revenue generating assets, the minimum investment from an investor shall be Rs. 25 crores;

d) from not less than 5 and not more than 1000 investors maximum subscription form any investor other than sponsor related parties and its associates, in initial offer shall not be less than 25% of the total unit capital;

e) shall file a placement memorandum with SEBI along with the fee as specified in the SEBI InvIT Regulations, at least 5 days prior to opening of the issue;

However, such opening of the issue shall not be at a date later than 3 months from the receipt of in-principle approval for listing, from exchange(s);

f) it shall file the final placement memorandum with SEBI within a period of ten working days from the date of listing of the units issued therein.



4.	***If the InvIT raises funds by public issue InvITs*** (a) ***it shall be by way of initial public offer;*** (b) ***any subsequent issue of units after initial public offer may be by way of follow-on offer, preferential allotment, qualified institutional placement, rights issue, bonus issue, offer for sale or any other mechanism and in the manner as may be specified by SEBI;*** (c) ***minimum subscription amount from any investor in initial and follow-on offer shall fall with in range of Rs. 10,000 to Rs. 15,000;*** However, maximum subscription from any investor other than sponsor(s), its related parties and its associates, in initial offer shall not be more than 25% of the total unit capital. (d) ***prior to initial public offer and follow-on offer, the merchant banker shall file the draft offer document along with prescribed fees with the designated stock exchange(s) and SEBI not less than thirty working days before filing the offer document with the designated stock exchange and SEBI;*** (e) ***the draft offer document filed with SEBI shall be made public, for comments, if any, by hosting it on the websites of SEBI, designated stock exchanges, InvIT and merchant bankers associated with the issue for a period of not less than 21 days;*** (f) ***SEBI may communicate its comments to the lead merchant banker and, in the interest of investors, may require the lead merchant banker to carry out such modifications in the draft offer document as it deems fit;*** (g) ***the lead merchant banker shall ensure that all comments received from SEBI on the draft offer document are suitably addressed prior to the filing of the offer document with the designated stock exchanges;*** (h) ***in case no observations are issued by SEBI in the draft offer document within 21 working days from the date of receipt of satisfactory reply from the lead merchant bankers or manager, the InvIT may file the offer document or follow on offer document with SEBI and the stock exchange(s);*** (i) ***the draft offer document and offer document shall be accompanied by a due diligence certificate signed by the lead merchant banker;*** (j) ***the offer document shall be filed with the designated stock exchanges and SEBI not less than five working days before opening of the offer;*** (k) ***the InvIT may open the initial public offer or follow-on offer or right issue within a period of not more than one year from the date of issuance of observations by SEBI. However, if the initial public offer or follow-on offer or right issue is not made within the prescribed time period, a fresh draft offer document shall be filed;*** Further, the InvIT shall not be required to file draft offer document with the SEBI in case of a fast track rights issue, subject to the fulfillment of the conditions as specified by the SEBI from time to time. (l) ***the InvIT may invite for subscriptions and allot units to any person, whether resident or foreign. However, in case of foreign investors, such investment shall be subject to guidelines as may be specified by RBI and the government from time to time;*** (m) ***the application for subscription shall be accompanied by a statement containing the abridged version of the offer document detailing the risk factors and summary of the terms of issue;***

(n) ***initial public offer and follow-on offer shall not be open for subscription for a period of more than 30 days;***

(o) ***in case of over-subscriptions, the InvIT shall allot units to the applicants on a proportionate basis rounded off to the nearest integer subject to minimum subscription amount per subscriber;***

(p) ***the InvIT shall allot units or refund application money, as the case may be, within twelve working days from the date of closing of the issue;***

(q) ***the InvIT shall issue units in only in dematerialized form to all the applicants;***

(r) ***the price of InvIT units issued by way of public issue shall be determined through the book building process or any other process in accordance with the guidelines issued by SEBI and in the manner as may be specified by SEBI;***

(s) ***the InvIT shall refund money, –***

(a) all applicants in case it fails to collect subscription of atleast 90% of the fresh issue size as specified in the offer document.

(b) applicants to the extent of over subscription in case the money received is in excess of the extent of over-subscription as specified in the offer document, money shall be refunded to applicants to the extent of the over subscription.

(c) all applicants in case the number of subscribers to the initial public offer forming part of the public less than 20.

Note : - It may be noted that in case of Clause (b), right to retain such over subscription cannot exceed twenty five percent of the issue size. Further, that the offer document shall contain adequate disclosures towards the utilisation of such oversubscription proceeds, if any, and such proceeds retained on account of oversubscription shall not be utilised towards general purposes.

(t) ***If the investment manager fails to allot or list the units or refund the money within the specified time, then the investment manager shall pay interest to the unit holders at the rate of 15% per annum, till such allotment or listing or refund and such interest shall be not be recovered in the form of fees or any other form payable to the investment manager by the InvIT;***

(u) ***units may be offered for sale to public subject to other guidelines as may be specified by SEBI in this regard;***

(v) ***The amount for general purposes, as mentioned in objects of the issue in the draft offer document filed with SEBI, shall not exceed 10% of the amount raised by the InvIT by issuance of units.***

If the InvIT fails to make any offer of its units, whether by way of public issue or private placement, within three years from the date of registration with SEBI, it shall surrender its certificate of registration to SEBI and cease to operate as an InvIT.

However, SEBI, if it deems fit, may extend the period by another one year. Further, the InvIT may later re-apply for registration, if it so desires.

No InvIT shall undertake any activity related to privately placed unlisted InvITs.

No InvIT shall raise funds through public issue if any subordinate units have been issued and are outstanding.

Question: Is there a mandatory listing requirement under the InvIT Regulations?

Answer: Yes, an InvIT is required to list its units under the InvIT Regulations. Under the extant InvIT Regulations, if an InvIT fails to offer its Units (either through a public offer or a private placement) within three years from the date of registration of the InvIT with SEBI, it is required to surrender its certificate of registration and should cease to operate as an InvIT.

SEBI may specify by issue of guidelines or circulars any other requirements, as it deems fit, pertaining to issue and allotment of units by an InvIT, whether by way of public issue or private placement.

FRAMEWORK FOR ISSUANCE OF SUBORDINATE UNITS

Applicability

- Applicable to subordinate units issued.
- Disclosure requirements mentioned in this framework shall also apply to any subordinate units issued prior to notification of this Chapter.
- The provisions of these regulations applicable to ordinary units shall apply mutatis mutandis to issuance of subordinate units.

Issuance of Subordinate Units

- The subordinate units shall only be issued by a privately placed InvIT upon acquisition of an infrastructure project.
- The subordinate units shall be issued only to the sponsor, its associates and the sponsor group and shall be deemed to be a part of the consideration for acquisition of the infrastructure project from such sponsor, its associates and the sponsor group.
- The subordinate units shall not carry any voting rights or distribution rights.
- The subordinate units shall be issued in a dematerialized form with an International Securities Identification Number, distinct from that of the ordinary units.
- The subordinate units shall be listed on a recognised stock exchange after their reclassification into ordinary units.
- The subordinate units may be issued by way of an initial offer or any offer subsequent to the initial offer, either along with the issue of ordinary units or without the issue of ordinary units.
- The issue of subordinate units made after the initial offer by the InvIT shall require the approval of the unitholders where votes cast in favour of the resolution shall not be less than one and a half times the votes cast against the resolution. However, any unitholder who is party to the acquisition of the infrastructure project including the sponsor, its associates and sponsor group, shall not be entitled to vote.
- The price of subordinate units shall be determined according to the pricing guidelines applicable for issuance of ordinary units.
- Prior to issuance of subordinate units, the investment manager shall obtain in-principle approval from the recognised stock exchange for listing of such subordinate units after their reclassification into ordinary units.

- The enabling provisions authorising the issuance of subordinate units shall be specified in the Trust Deed.
- The investment manager shall disclose the terms and conditions governing subordinate units in the Term Sheet.
- The investment manager shall disclose the impact of potential reclassification of subordinate units into ordinary units in the Term Sheet in such manner as specified by the SEBI.
- The investment manager shall disclose the Term Sheet in the placement memorandum, the explanatory statement to the notice for unitholders meeting as well as any document which may be disclosed to investors including prospective investors.
- The InvIT shall also disclose the Term Sheet, the placement memorandum and the notice for unitholders meeting including the explanatory statement on its website and shall file the same with the recognised stock exchange.
- The amount of subordinate units issued at the time of acquisition of an infrastructure project by the InvIT shall not exceed 10% of the acquisition price of the infrastructure project.
- The total number of outstanding subordinate units issued by an InvIT at any point of time shall not exceed 10% of the total number of outstanding ordinary units issued by such InvIT.
- The terms and conditions of the subordinate units shall not be varied after their issuance.

Transfer of subordinate units

- The subordinate units shall be locked in till its reclassification into ordinary units
- The subordinate units shall not be transferable to any person except the sponsor, its associates and the sponsor group entities.
- The subordinate units shall not be encumbered in favor of any person except the sponsor, its associates and the sponsor group entities.
- The depository shall not register the transfer or encumbrance of a subordinate unit in favour of any person unless such a person is a sponsor of the InvIT, associate of such sponsor or belongs to the sponsor group of the InvIT.
- The investment manager shall disclose any inter-se transfer or inter-se encumbrance of subordinate units to the recognised stock exchange within one working day of such transfer or encumbrance.
- In case of a change in the sponsor, the outgoing sponsor shall transfer the subordinate units held by it, if any, to another sponsor, its associates or sponsor group.

Entitlement date, entitlement event and performance benchmark

- The entitlement date, the entitlement event and the performance benchmark for reclassification of subordinate units to ordinary units shall be clearly defined and specified in the Term Sheet.
- The performance benchmark for reclassification of subordinate units shall be quantifiable, objective and based on the audited financial statements.
- The minimum time period between the issuance of subordinate units and entitlement date for reclassification of the subordinate units to ordinary units shall be three years.
- The entitlement date may be extended in the manner specified in the Term Sheet, subject to the following conditions:

(a) the entitlement date shall not be extended for more than one year at a time and shall not be extended more than two times in total;

(b) the extension of the entitlement date may be done only for cases where a possibility of such extension is clearly contemplated, duly approved and disclosed in the Term Sheet prior to the issuance of subordinate units;

(c) the extension of entitlement date shall be allowed only in case of any unforeseen circumstances as mentioned in the Term Sheet such as impossibility on account of a force majeure event or illegality on account of change in law or an order of any court or authority;

(d) the explanatory statement to the notice of unitholders meeting convened for seeking approval for the extension in entitlement date shall disclose the reasons for proposing such extension and the potential impact on account of such extension on the ordinary unitholders, including any potential dilution of their beneficial interest in the InvIT; and

(e) the extension of the entitlement date shall require the approval of the unitholders as per the regulations.

Progress related to achievement of performance benchmark

(1) The investment manager shall monitor the progress related to the achievement of performance benchmark and shall report such progress annually or with such frequency as may be specified by the Board, after certification by the statutory auditor of the InvIT and approval of the trustee and the audit committee of the investment manager.

(2) The investment manager shall disclose the progress related to achievement of performance benchmark in the Annual Report of the InvIT

(3) The investment manager shall disclose the diluted NAV and the diluted distribution per unit to the stock exchange along with NAV and distribution per unit till the time subordinate units are outstanding.

"Diluted NAV" or "Diluted Net Asset Value" means the value of the InvIT assets reduced by the external debt divided by the total number of outstanding ordinary units and subordinate units; and

"***Diluted Distribution per unit"*** means the value of total distribution, divided by the total number of outstanding ordinary units and subordinate units.

Process for reclassification of subordinate unit

(1) The status of achievement of performance benchmark shall be certified by the statutory auditor of the InvIT for reclassification of subordinate units to ordinary units and shall be reviewed by the trustee and the audit committee of the investment manager.

(2) If the performance benchmark is achieved at the end of the entitlement date, including extended period, if any; the subordinate units shall be reclassified into equal number of ordinary units on a *pari passu basis* in accordance with the terms and conditions of subordinate units mentioned in the Term Sheet.

Explanation 1. - The reclassification can happen for all subordinate units either together or on a piecemeal basis in accordance with the terms and conditions and on the achievement of performance benchmarks as disclosed in the Term Sheet.

Explanation 2. - The subordinate units may be reclassified into ordinary units, in part or in full in accordance with the terms and conditions and on the achievement of performance benchmarks as disclosed in the Term Sheet.

(3) If the performance benchmark is not achieved at the end of the entitlement date, including extended period, if any, the subordinate units shall be extinguished without any payment to the holder of subordinate units.

(4) The board of directors of the investment manager shall consider reclassification of subordinate units into ordinary units or extinguishment of the subordinate units depending on the achievement of the performance benchmark and pass a resolution making the necessary recommendation to this effect to the trustee.

(5) The recommendation for reclassification of the subordinate units into ordinary units or extinguishment of the subordinate units, as the case may be, shall be considered by the trustee and after ensuring compliance with the provisions of these regulations, the trustee may approve reclassification of the subordinate units into ordinary units or extinguishment of the subordinate units, as the case may be, and intimate the same to the investment manager.

(6) Pursuant to the approval of the trustee, the investment manager shall make the necessary intimation to the recognised stock exchange, depositories and the Registrar and Transfer Agent.

(7) The investment manager shall ensure that the record date is disclosed as part of the intimation made under this regulation, at least two working days prior to the record date, excluding the date of intimation and the record date.

Record date here means the date from when subordinate units shall be reclassified as ordinary units.

(8) The subordinate units upon being reclassified as ordinary units shall be listed on the recognised stock exchange(s) upon receipt of final listing and trading approval from such stock exchange(s).";

GUIDELINES FOR PUBLIC ISSUE OF UNITS OF INVITs

On May 11, 2016, SEBI had issued detailed guidelines relating to the public issue and allotment of units by an InvIT, and the advertisement relating to the offer. These guidelines are placed below :

Filing of offer document

- The draft offer document has to be filed with SEBI and the designated stock exchanges (DSE).
- The lead merchant bankers(LMB) have to submit a certificate confirming that the agreement is entered between the investment manager on behalf of the InvIT and LMB, and a due diligence certificate in the prescribed form has to be filed with the draft offer document.
- The draft offer document shall be hosted on the websites of SEBI, DSEs, InvIT and merchant bankers, for comment within 21 days of filing.
- SEBI may specify changes or issue observations within the prescribed time, pursuant to which the draft offer document has to be suitably modified and filed with SEBI as offer document.
- After filing offer document with SEBI, Merchant Banker shall issue pre-issue advertisement on the websites of sponsor, investment manager and stock exchanges. Merchant Banker may also issue such advertisement in newspapers.

Allocation in public issue

- Institutional investors shall not be allocated more than 75% in a public offering of the InvIT units.
- Other investors, including retail investors, have to be allocated at least 25% of the InvIT units.

Anchor Investors

Who is an Anchor Investor?

"Anchor Investor" means a qualified institutional buyer who makes an application for a value of at least ten crore rupees in a public issue on the SEBI main board made through the book building process or makes an application for a value of at least two crore rupees for an issue made in accordance with Chapter IX of the SEBI (ICDR) Regulations, 2018.

- A strategic investor may participate in an offer as an anchor investor.
- The investment manager, on behalf of the InvIT, may allocate up to 60% of the portion available for allocation to institutional investors to anchor investors.
- The anchor investors will have to make an application of a value of at least INR 10 crore in the public issue.
- Allocation to anchor investor shall be on a discretionary basis, and subject to the minimum of two investors for allocations of upto Rs. 250 crore and minimum five investors for allocations exceeding Rs. 250 crore.
- The bidding for anchor before the issue opening date and the allocation must be completed on the same day.
- The number of units allocated and the allocation price must be disclosed on the websites of the stock exchange(s), sponsor(s), investment manager and merchant banker(s).
- If the price fixed as a result of book building is higher than the price at which the allocation is made to Anchor Investor, the Anchor Investor shall bring in the additional amount within 2 days of the date of closure of the issue.
- The lock-in period shall be thirty days for anchor investors other than a strategic investor. However, lock-in should be one year for strategic investors investing as anchor investors.
- Neither the merchant bankers nor any person related to the merchant bankers in the concerned public issue can apply under the anchor investor category, except mutual funds, insurance companies and pension funds.

Security Deposit

The investment manager, on behalf of the InvIT, will have to deposit before the opening of subscription, and keep deposited with the stock exchanges, an amount calculated at the rate of 0.5% of the amount of units offered for subscription to the public or Rs. 5 crore, whichever is lower.

Opening of an issue and subscription period

- The issue shall open after at least five working days from the date of filing of the final offer document with SEBI.
- The lead merchant banker shall submit a due diligence certificate in prescribed format, immediately before the opening of the issue.
- The public issue shall remain open for at least three working days, but not more than thirty days. Further, in case the price band in a public issue made through the book building process is revised, the bidding (issue) period disclosed in the final offer document shall be extended for a minimum period of one day, provided that the total bidding period shall not exceed thirty days.
- In case of a price band revision, the bidding period shall be extended for at least one day, provided that the total

- bidding period does not exceed thirty days.
- The investment manager on behalf of the InvIT may issue advertisements for issue opening and issue closing.

Price and Price Band

- The floor price or the price band has to be announced at least two working days before the opening of the bid on the website of the sponsor, investment manager, stock exchanges, InvIT and in all newspapers in which the pre-issue advertisement was released.
- Differential pricing shall not be offered to any investor.
- The final price of the units ("cut-off price") may be determined in consultation with the lead book runner.

Bidding process

- The InvIT shall accept bids using only the Application Supported by Blocked Amount(ASBA) facility for making payment. Further, the bidding process shall be done only through an electronic bidding platform provided by recognised stock exchanges.
- An investor, intending to subscribe to a public issue, shall submit a completed bid-cum-application form to Self-Certified Syndicate Banks (SCSBs), with whom the bank account to be blocked is maintained or with any intermediaries as prescribed in the guidelines. Intermediaries accepting the application forms shall be responsible for uploading the bid along with other relevant details in application forms on the electronic bidding system of stock exchange(s) and submitting the form to SCSBs for blocking of funds (except in case of SCSBs, where blocking of funds will be done by respective SCSBs only) Stock Exchanges to provide transparent electronic bidding facility.
- The lead merchant banker shall ensure that adequate infrastructure is available with syndicate members for data entry of the bids in a timely manner.
- The bidding terminals shall contain an online graphical display of demand and bid prices updated at periodic intervals, not exceeding thirty minutes.
- The Investment manager on behalf of the InviT may decide to close the bidding by qualified institutional buyers one day prior to the closure of the issue subject to the condition that bidding shall be kept open for a minimum of three days for all categories of applicants and suitable disclosures made in the draft offer document and offer document.
- No investor shall either withdraw or lower the size of bids at any stage.
- The identity of Institutional Investors other than strategic investors making the bidding shall not be made public.

Basis of allotment

- On receipt of the sum payable on application, the investment manager on behalf of the InvIT shall allot the units in to the applicants.
- Allotment of units other than anchor investors shall be on proportionate basis within the specified investor categories, subject to minimum allotment, as per InvIT regulations.
- In case of under-subscription in any investor category, the unsubscribed portion may be allotted to applicants in the other categories.

Public communications, publicity materials, advertisements and research materials

- Public communication shall not contain any matter extraneous to the offer document, and shall be truthful and fair.

Other conditions

- No InvIT can make a public issue of units if it or any of its sponsors, investment managers, or trustees is debarred from accessing the capital market by SEBI, or is on the list of wilful defaulters published by the Reserve Bank of India.
- Investment managers have to appoint a compliance officer for monitoring compliance of securities laws and for redressal of investor grievances.

GUIDELINES FOR PREFERENTIAL ISSUE OF UNITS BY INVITs

Regulation 2 (1) (zo) of SEBI (Infrastructure Investment Trusts) Regulations, 2014 defines a preferential issue. Regulation 14(4) (b) read with Regulations 2(1) (zo) provides for any subsequent issue of units after an initial offer in a manner specified by SEBI. Accordingly, the detailed guidelines for preferential issue by an InvIT are provided herein.

A listed InvIT may make preferential issue of units to an institutional investor as defined in the InvIT regulations, if it satisfies the following conditions:

(a) A resolution of the unitholders of the InvIT approving the preferential issue has been passed.

(b) The InvIT is in compliance with the conditions for continuous listing and disclosure obligations under these regulations and circulars issued thereunder.

(c) The InvIT is in compliance with the minimum public unitholding requirements as stipulated under the InvIT Regulations.

(d) No preferential issue of units by the InvIT has been made in the six months preceding the relevant date.

- Preferential issue pursuant to the unitholders resolution referred above shall be completed within a period of twelve months from the date of passing of the resolution.
- Allotment pursuant to preferential issue shall be completed within 12 days.
- The units shall be issued only in dematerialized form.
- The units to be issued in preferential issue shall be of same class or kind as the units issued in the initial offer by the InvIT.

  Further, such units have been listed on a recognised stock exchange, having nationwide trading terminal for a period of at least six months prior to the date of issuance of notice to its unitholders for convening the meeting to approve the preferential issue.

- The minimum subscription and trading lot for the units to be issued in preferential issue shall be same as that for units issued in the initial offer by the InvIT.
- The units in a preferential issue shall be offered and allotted to a minimum of two investors and maximum of 1000 investors in a financial year.

Relevant date for the purpose of preferential issue shall mean the date of the meeting in which the board of directors of the investment manager of the InvIT or the committee of directors duly authorised by the board of directors of the investment manager of the InvIT decides to open the proposed issue.

Placement Document

- The InvIT may appoint one or more SEBI registered intermediaries to carry out the obligations relating to the issue.
- The preferential issue of units by an InvIT shall be done on the basis of a placement document, which shall contain disclosures as specified in the InvIT Regulations.
- The placement document shall be serially numbered and copies shall be circulated only to select investors subject to compliance with above mentioned clause.
- The InvIT shall, while seeking in-principle approval from the recognised stock exchange, furnish a copy of the placement document, a certificate issued by its merchant banker or statutory auditor confirming compliance with the provisions of these guidelines along with any other documents required by the stock exchange.
- The placement document shall also be placed on the website of the concerned stock exchange and the InvIT with a disclaimer to the effect that it is in connection with a preferential issue and that no offer is being made to the public or to any other investor.

Pricing

- The preferential issue shall be made at a price not less than the average of the weekly high and low of the closing prices of the units quoted on the stock exchange during the two weeks preceding the relevant date.

  Explanation: For the purpose of this clause, the term “stock exchange” means any of the recognised stock exchanges on which the units of the InvIT are listed and on which the highest trading volume in such units has been recorded during the two weeks immediately preceding the relevant date.
- The InvIT shall not allot partly paid-up units.
- The prices determined for preferential issue shall be subject to appropriate adjustments, if the InvIT:
  a) makes a rights issue of units;
  b) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

Restriction on allotment

- No allotment shall be made, either directly or indirectly, to any party to the InvIT or their related parties except to the sponsor only to the extent that is required to ensure compliance with regulation 12 (3) of the InvIT Regulations.

Explanation: To determine the "related parties", the term related party as defined under the InvIT Regulations shall be applicable. However, Mutual Funds, Insurance Companies and Pension Funds shall not be treated as related parties.

- The applicants in preferential issue shall not withdraw their bids after the closure of the issue.

Transferability of Units

The units allotted under preferential issue shall not be sold by the allottee for a period of one year from the date of allotment, except on a recognised stock exchange.

LISTING AND TRADING OF UNITS

Mandatory Listing

- It shall be mandatory for units of all InvITs to be listed on a recognized stock exchange having nationwide trading terminals.
- Not applicable if the initial offer does not satisfy the minimum subscription amount or the minimum number of subscribers as prescribed under the SEBI InvIT Regulations.

Listing Permission

- The listing of the units shall be in accordance with the listing agreement entered into between the InvIT and the designated stock exchanges.
- In the event of non-receipt of listing permission from the stock exchange(s) or withdrawal of Observation Letter issued by SEBI the units shall not be eligible for listing and the InvIT shall be liable to refund the subscription monies, to the respective allottees immediately alongwith interest at the rate of fifteen per cent per annum.

Trading

- The units of the InvIT listed in the designated stock exchanges shall be traded, cleared and settled in accordance with the bye-laws of designated stock exchanges and such conditions as may be specified by SEBI.
- Any person other than the sponsor(s) holding units of the InvIT prior to initial offer shall hold the units for a period of not less than one year from the date of listing of the units.
- The units shall remain listed on the designated Stock Exchanges unless delisted under the SEBI InvIT Regulations.

Holding and Redemption

- Any person other than the sponsor(s) holding units of the InvIT prior to initial offer shall hold the units for a period of not less than one year from the date of listing of the units.
- The InvIT shall redeem units only by way of a buyback or at the time of delisting of units.

- It shall be mandatory for units of all InvITs to be listed on a recognized stock exchange having nationwide trading terminals, whether publicly issued or privately placed.

  However, this shall not apply if the initial offer does not satisfy the minimum subscription amount or the minimum number of subscribers as prescribed under the SEBI InvIT Regulations.

- The listing of the units shall be in accordance with the listing agreement entered into between the InvIT and the designated stock exchanges.

- In the event of non-receipt of listing permission from the stock exchange(s) or withdrawal of Observation Letter issued by SEBI, wherever applicable, the units shall not be eligible for listing and the InvIT shall be liable to refund the subscription monies, if any, to the respective allottees immediately alongwith interest at the rate of fifteen percent per annum from the date of allotment.

- The units of the InvIT listed in the designated stock exchanges shall be traded, cleared and settled in accordance with the bye-laws of designated stock exchanges and such conditions as may be specified by SEBI.

- The InvIT shall redeem units only by way of a buyback or at the time of delisting of units.

- The units shall remain listed on the designated Stock Exchanges unless delisted under the SEBI InvIT Regulations.

- The minimum public holding for the units of the InvIT after listing shall be in accordance with the provisions of issue and listing of units, failing which action may be taken as may be specified by SEBI and by the designated stock exchanges including delisting of units under these regulations.

- The minimum number of unit holders in an InvIT other than the sponsor(s), its related parties and its associates,–

  - in case of privately placed InvIT, shall be five;

  - forming part of public shall be twenty;

  at all times post listing of the units, failing which action may be taken as may be specified by SEBI and by the designated stock exchanges including delisting of units under these regulations.

- With respect to listing of privately placed units,–

  - its units shall be mandatorily listed on the designated stock exchange(s) within thirty working days from the date of allotment;

  - trading lot for the purpose of trading of units on the designated stock exchange shall be rupees one crore.

  Apart from the above, if an InvIT invests not less than eighty per cent of the value of the InvIT assets, in completed and revenue generating assets, the trading lot for the purpose of trading of units on the designated stock exchange of such InvIT shall be rupees two crore;

- With respect to listing of publicly offered units,–

  - Its units shall be mandatorily listed on the designated stock exchange(s) within 12 working days from the date of closure of the initial public offer. This shall not apply if the initial public offer does not satisfy the minimum subscription amount or the minimum number of subscribers as prescribed under the SEBI InvIT Regulations.

- Trading lot for the purpose of trading of units on the designated stock exchange shall be 1 unit.

– Any person other than the sponsor(s) holding units of the InvIT prior to initial offer shall hold the units for a period of not less than one year from the date of listing of the units.

– SEBI and designated stock exchanges may specify any other requirements pertaining to listing and trading of units of the InvIT by issuance of guidelines or circulars.

DELISTING OF UNITS

– The investment manager shall apply for delisting of units of the InvIT to SEBI and the designated stock exchanges if ,-

(a) the public holding falls below the specified limit under the InvIT Regulations.

(b) the number of unit holders of the InvIT falls below the limit as prescribed in the InvIT Regulations.

(c) if there are no projects or assets remaining under the InvIT for a period exceeding six months and InvIT does not purpose to invest in any project in future. The period may be extended by further 6 months, with the approval of unit holders.

(d) SEBI or the designated stock exchanges require such delisting for violation of the listing agreement or these regulations or the Act.

(e) the trustee and investment manager requests such delisting and such request has been approved by unit holders in accordance with these regulations.

(f) unit holders apply for such delisting in accordance with these regulations.

(g) SEBI or the designated stock exchanges require such delisting in the interest of the unit holders.

Note:-

- If clause (a) or (b) is breached, the trustee may provide a period of six months to the investment manager to rectify the same, failing which shall apply for such delisting.
- In case of PPP projects, such delisting shall be subject to relevant clauses in the concession agreement.

– SEBI and the designated stock Exchanges may consider such application for delisting for approval or rejection as may be appropriate in the interest of the unit holders.

– SEBI may, instead of delisting of the units, if it deems fit, provide additional time to the InvIT or parties to the InvIT to comply with above mentioned conditions.

– SEBI may reject the application for delisting and take any other action, as it deems fit, under the SEBI InvIT Regulations or the Act for violation of the listing agreement or these regulations or the Act.

- The procedure for delisting of units of InvIT including provision of exit option to the unit holders shall be in accordance with the listing agreement and in accordance with procedure as may be specified by SEBI and by the designated stock exchanges from time to time.
- After delisting of its units, the InvIT shall surrender its certificate of registration to SEBI and shall no longer undertake activity of an InvIT.
- The InvIT and parties to the InvIT shall continue to be liable for all their acts of omissions and commissions with respect to activities of the InvIT notwithstanding surrender of registration to SEBI.

INVESTMENT CONDITIONS AND DISTRIBUTION POLICY

1. The investment by an InvIT shall only be in Holdco and/or SPVs or infrastructure projects or securities in India in accordance with the SEBI InvIT Regulations and the investment strategy as detailed in the offer document or Placement memorandum.
2. In case of PPP projects, the InvIT shall mandatorily invest in the infrastructure projects through Holdco and/or SPV.
3. The InvIT may invest in infrastructure projects through SPVs subject to the following,–
   a. no other shareholder or partner of the SPV shall exercise any rights that prevents the InvIT from complying with the provisions of the SEBI InvIT Regulations and an agreement has been entered into with such shareholders or partners to that effect prior to investment in the SPV;

      However, the shareholders' agreement or partnership agreement shall provide for an appropriate mechanism for resolution of disputes between the InvIT and the other shareholders or partners in the holdco and/or the SPV.

      Further, the provisions of the SEBI InvIT Regulations shall prevail in case of inconsistencies between such agreement(s) and the obligations cast upon an InvIT under the SEBI InvIT Regulations.

   b. in case the SPV is a company/LLP, the investment manager, in consultation with the trustee, shall appoint majority of board of directors or governing board of such SPVs as applicable;
   c. the investment manager shall ensure that the in every meeting including annual general meeting of the SPV, the voting of the InvIT is exercised.
4. The InvIT may invest in infrastructure projects through holdcos subject to the following,-
   a. the ultimate holding interest of the InvIT in the underlying SPV(s) is not less than twenty six per cent;
   b. no other shareholder or partner of the holdco or the SPV(s) shall exercise] any rights that prevent the InvIT, the HoldCo or the SPV(s) from complying with the provisions of the SEBI InvIT Regulations and an agreement has been entered into with such shareholders or partners to that effect prior to investment in the holdco/SPV:

      However, the shareholders' agreement or partnership agreement shall provide for an appropriate mechanism for resolution of disputes between the InvIT and the other shareholders or partners in the holdco and/or the SPV.

      Further, the provisions of the SEBI InvIT Regulations shall prevail in case of inconsistencies between such agreement(s) and the obligations cast upon an InvIT under these regulations.

   c. the investment manager, in consultation with the Trustee, shall appoint the majority of the Board of directors or governing board of the holdco and SPV(s); the investment manager shall ensure that in every meeting including annual general meeting of the Holdco and SPV(s), the voting of the InvIT is exercised;

5. In case of InvIT as specified under the SEBI InvIT Regulations, the InvIT shall invest not less than eighty per cent of the value of the InvIT assets in eligible infrastructure projects either directly or through holdcos or through SPVs. However, un-invested funds may be invested in instruments as provided under below clause.

6. In case of InvITs as specified above :

   a. not less than 80% of the value of InvIT the assets shall be invested, proportionate to the holding of the InvITs, in completed and revenue generating infrastructure projects subject to the following;

      (i) if the investment has been made through a holdco and/or SPV, whether by way of equity or debt or equity linked instruments or partnership interest, only the portion of direct investments in completed and revenue generating projects by such Holdco and/or SPVs shall be considered and the remaining portion shall be included under clause (b) as mentioned below;

      (ii) if any project is implemented in stages, the part of the project which can be categorized as completed and revenue generating project shall be considered and the remaining portion shall be included under clause (b) as mentioned below;

   b. not more than 20% of value of the InvIT assets, shall be invested in,–

      (i) under-construction infrastructure projects, whether directly or through Holdco and/or SPVs. However, investment in such assets shall not exceed 10% of the value of the InvIT assets;

      (ii) listed or unlisted debt of companies or body corporate in infrastructure sector. However, this shall not include any investment made in debt of the Holdco and/or SPV.

      (iii) equity shares of companies listed on a recognized stock exchange in India which derive not less than 80% of their operating income from infrastructure sector as per the audited accounts of the previous financial year;

      (iv) government securities;

      (v) money market instruments, liquid mutual funds or cash equivalents.

   c. if the conditions specified in clauses (a) and (b) are breached, the investment manager shall inform the same to the trustee and ensure that the conditions as specified in these Regulations are satisfied within six months of such breach.

   However, the period may be extended to one year subject to approval from investors in accordance with these regulations.

7. The investment conditions as specified above, shall be complied at the time of Offer document/ placement memorandum and thereafter.

8. With respect to distributions made by the InvIT and the Holdco and/or SPV,-

   a. not less than 90% of net distributable cash flows of the SPV shall be distributed to the InvIT/ holdco in proportion of its holding in the SPV subject to applicable provisions in Companies Act, 2013 or Limited Liability Partnership Act, 2008;

   b. not less than 90 % of net distributable cash flows of the InvIT shall be distributed to the unit holders;

c. with regard to distribution of net distributable cash flows by the holdco to the InvIT, the following conditions shall be complied;

- with respect to cash flows received by the holdco from underlying SPVs, 100% of such cash flows received by the holdco shall be distributed to the InvIT; and
- with respect to the cash flows generated by the holdco on its own, not less than 90% of such net distributable cash flows shall be distributed by the holdco to the InvIT.

d. such distributions shall be declared and made not less than once every six months in every financial year in case of publicly offered InvITs and not less than once every year in case of privately placed InvITs and shall be made not later than 15 days from the date of such declaration.

e. subject to clause (6), such distribution shall be in the manner as mentioned in the offer document or placement memorandum.

f. any amount remaining unclaimed or unpaid out of the distributions declared by a InvIT shall be transferred to the 'Investor Protection and Education Fund' constituted by the SEBI. However, the amount transferred to Investor Protection and Education Funds shall not bear any interest.

9. If any infrastructure asset is sold by the InvIT or Holdco or SPV or if the equity shares or interest in the Holdco or SPV are sold by the InvIT–

- if the InvIT proposes to re-invest the sale proceeds into another infrastructure asset, it shall not be required to distribute any sales proceeds to the InvIT or to the investors;
- If the InvIT proposes not to invest the sales proceeds into any other infrastructure asset within a period of one year, it shall be require to distribute the same.

10. If the distributions are not made within fifteen days of declaration, then the investment manager shall be liable to pay interest to the unit holders at the rate of 15% per annum till the distribution is made and such interest shall be not be recovered in the form of fees or any other form payable to the investment manager by the InvIT.

11. An InvIT shall not invest in units of other InvITs.

12. An InvIT shall not undertake lending to any person other than the holdco/ SPV(s) in which the InvIT has invested in. However, investment in debt securities shall not be considered as lending.

13. An InvIT shall hold an infrastructure asset for a period of not less than three years from the date of purchase of such asset by the InvIT, directly or through Holdco and/or SPV. However, this shall not apply to investment in securities of companies in infrastructure sector other than SPVs.

14. In case of any co-investment with any person(s) in any transaction–

a. the investment by the other person(s) shall not be at terms more favourable than those to the InvIT;

b. the investment shall not provide any rights to the person(s) which shall prevent the InvIT from complying with the provisions of these regulations;

c. the agreement with such person(s) shall include the minimum percentage of distributable cash flows that will be distributed and entitlement of the InvIT to receive not less than pro-rata distributions and mode for resolution of any disputes between the InvIT and the other person(s).

- No schemes shall be launched under the InvIT.
- SEBI may specify any additional conditions for investments by the InvIT as deemed fit.

RIGHTS AND MEETINGS OF THE UNIT HOLDERS

1. The unit holder shall have the rights to receive income or distributions as provided for in the offer document or placement memorandum.

2. With respect to any matter requiring approval of the unit holders-

   - a resolution shall be considered as passed when the votes cast by unit holders, so entitled and voting, in favour of the resolution exceed a certain percentage as specified in these regulations, of votes cast against;
   - the voting may also be done by postal ballot or electronic mode;
   - a notice of not less than twenty one days shall be provided to the unit holders;
   - voting by any person who is a related party in such transaction as well as associates of such person(s) shall not be considered on the specific issue;
   - investment manager shall be responsible for all the activities pertaining to conducting of meeting of the unit holder, subject to overseeing by the trustee.

   However, in issues pertaining to the investment manager such as change in investment manager including removal of the investment manager or change in control of the investment manager, trustee shall convene and handle all activities pertaining to conduct of the meetings.

   Further that in respect of issues pertaining to the trustee including change in the trustee, the trustee shall not be involved in any manner in the conduct of the meeting.

Right of Unit holders in InvITs

- ➢ Right to receive returns through cash distributions made by the trust
- ➢ Rights to vote on matters pertaining to acquisition of new assets or borrowing
- ➢ Right to vote on related party matters
- ➢ Right to vote on matters such as appointment or change of the Investment Manager
- ➢ Right to vote on induction of a Sponsor, with the opportunity to exit for dissenting voters
- ➢ Right to vote on exit of Sponsor
- ➢ Right to receive periodic disclosures like annual report, valuation report, quarterly/ semi-annual financials etc.

3. For an InvITs–

   - an annual meeting of all unit holders shall be held not less than once a year within one hundred twenty days from the end of financial year and the time between two meetings shall not exceed fifteen months;
   - with respect to the annual meeting of unit holders–
     - – any information that is required to be disclosed to the unit holders and any issue that, in the ordinary course of business, may require approval of the unit holders may be taken up in the meeting including,–

       (a) latest annual accounts and performance of the InvIT;

       (b) approval of auditor and fees of such auditor, as may be required;

(c) latest valuation reports;

(d) appointment of valuer, as may be required;

(e) any other issue.

– for any issue taken up in such meetings which require approval from the unit holders other than as specified in point No. (6) under votes cast in favour of the resolution shall be more than the votes cast against the resolution.

4. In case of–

- any approval from unit holders required for investment conditions, related party transactions and valuation of assets;
- any transaction, other than any borrowing, value of which is equal to or greater than twenty five per cent of the InvIT assets;
- any borrowing in terms of limit specified as required under the provision for borrowing and deferred payment as mentioned under the SEBI InvIT Regulations;
- any issue of units after initial public offer by InvIT, in whatever form, other than any issue of units which may be considered by SEBI;
- increasing period for compliance with investment conditions to one year in accordance with these regulations;
- any issue, in the ordinary course of business, which in the opinion of the sponsor(s) or trustee or investment manager, is material and requires approval of the unit holders, if any;
- any issue for which SEBI or the designated stock exchanges requires such approval; approval from unit holders shall be required where votes cast in favour of the resolution shall be more than the votes cast against the resolution.

5. In case of –

- any change in investment manager including removal of the investment manager or change in control of the investment manager;
- any material change in investment strategy or any change in the management fees of the InvIT.
- the trustee or investment manager proposing to seek delisting of units of the InvIT.
- any issue, not in the ordinary course of business, which in the opinion of the sponsor(s) or investment manager or trustee requires approval of the unit holders.
- any issue for which SEBI or the designated stock exchanges requires approval.
- any issue taken up on request of the unit holders including–
  - removal of the investment manager and appointment of another investment manager to the InvIT;
  - removal of the auditor and appointment of another auditor to the InvIT;
  - removal of the valuer and appointment of another valuer to the InvIT;

– delisting of an InvIT, if the unit holders have sufficient reason to believe that such delisting would act in the interest of the unit holders;

– any issue which the unit holders have sufficient reason to believe that is detrimental to the interest of the unit holders;

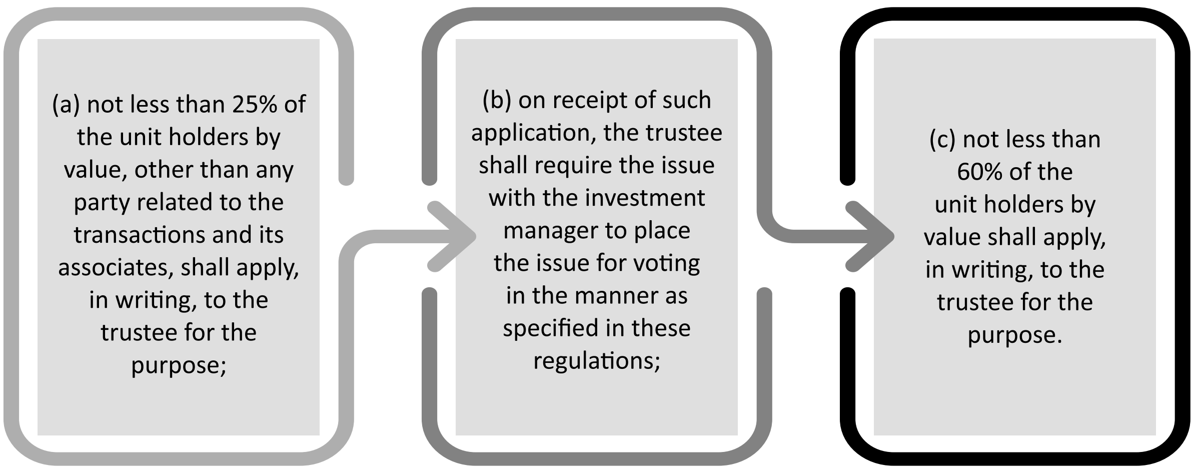
– change in the trustee if the unit holders have sufficient reason to believe that acts of such trustee is detrimental to the interest of the unitholders;

approval from unit holders shall be required where votes cast in favour of the resolution shall not be less than one and half times the votes cast against the resolution.

In case of any borrowing by an InvIT in terms of the limit specified in clause (b) of sub-regulation 3 of regulation 20, the approval from 75% of the unit holders by value shall be obtained.

No person, other than sponsor(s), its related parties and its associates, shall acquire units of an InvIT which taken together with units held by such person and by persons acting in concert with such person in such InvIT, exceeds 75% of the value of outstanding InvIT units unless approval from 75% of the unit holders by value excluding the value of units held by parties related to the transaction, is obtained. However, if the required approval is not received, the person acquiring the units shall provide an exit option to the dissenting unit holders to the extent and in the manner as may be specified by the SEBI.

6. With respect to the right(s) of the unit holders under sub-point (f) of point no.(5)-



7. In case of any change in sponsor or inducted sponsor or change in control of sponsor or inducted sponsor or conversion to self-sponsor investment manager-

a) prior to such change, approval from 75% of the unit holders by value excluding the value of units held by parties related to the transaction has to be obtained;

b) if the required approval is not received,-

i. in case of change of sponsor or inducted sponsor, the proposed inducted sponsor shall provide the dissenting unit holders an option to exit by buying their units in the manner specified by the SEBI;

ii. in case of change in control of the sponsor or inducted sponsor, the said sponsor or inducted sponsor shall provide the dissenting unit holders an option to exit by buying their units in the manner specified by the SEBI.

iii. in case of conversion to Self-Sponsored Investment Manager, the Investment Manager shall provide the dissenting unit holders an option to exit by buying their units in the manner specified by the SEBI.

Explanation: Change in sponsor or inducted sponsor shall mean any change due to entry of a new sponsor with or without exit of an existing sponsor.

8. The existing sponsor(s) proposing to disassociate as sponsor(s) by seeking to convert the Investment Manager to Self-Sponsored Investment Manager shall comply with the following conditions:

(i) the InvIT has been listed for a period of at least five years;

(ii) the InvIT has undertaken not less than twelve distributions on a continuous basis and has complied with the distribution norms as per these Regulations in the preceding five years;

(iii) the InvIT is rated AAA by a registered credit rating agency for a continuous period of five years immediately preceding the exit of the sponsor;

(iv) during the period of preceding five years, the InvIT has not breached, at any time, the maximum leverage thresholds as specified in these regulations;

(v) the Investment Manager is meeting the net worth criteria specified for the sponsor in these regulations;

(vi) the minimum unitholding requirement applicable to sponsor(s) and sponsor group(s) shall be complied with, on or after the date of conversion of the Investment Manager to Self-Sponsored Investment Manager, by the Investment Manager, shareholders of the Investment Manager and/or group entities of Investment Manager;

Explanation: Investment Manager, shareholders of the Investment Manager and/or group entities of Investment Manager may acquire units of the InvIT for the purpose of compliance of above condition.

(vii) the sponsor(s) or its associate(s) do not own or control the Investment Manager of the InvIT on or after the date of conversion of the Investment Manager to Self- Sponsored Investment Manager;

(viii) the sponsor has not transferred / sold assets to the InvIT in the last three years and no assets/projects shall be acquired by the InvIT from the outgoing sponsor(s) for a period of one year from the date of conversion to Self-Sponsored Investment Manager;

(ix) at least one of the sponsor(s) proposing to disassociate should have been a sponsor of the InvIT for a minimum period of five years;

(x) the InvIT shall not have any under-construction assets acquired from the sponsor that have not commenced commercial operations;

(xi) the sponsor(s) or its associate(s) are not the Project Manager and do not own or control the Project Manager on or after the date of conversion of the Investment Manager to Self-Sponsored Investment Manager;

(xii) unitholders approval in terms of sub-regulation (7) of InvIT regulation and consent of the Trustee has been obtained for conversion to Self-Sponsored Investment Manager;

There are no outstanding subordinate units.

(xiii) such other conditions as may be specified by the SEBI.

Maintenance of Records

The investment manager shall maintain records pertaining to the activity of the InvIT, wherever applicable, including–

(a) all investments or divestments of the InvIT and documents supporting the same including rationale for such investments or divestments;

(b) agreements entered into by the InvIT or on behalf of the InvIT;

(c) documents relating to appointment of persons;

(d) insurance policies for infrastructure assets;

(e) investment management agreement;

(f) documents pertaining to issue and listing of units including placement memorandum, draft and final offer document, in-principle approval by designated stock exchanges, listing agreement with the designated stock exchanges, details of subscriptions, allotment of units, etc;

(g) distributions declared and made to the unit holders;

(h) disclosures and periodical reporting made to the trustee, SEBI, unit holders and the designated stock exchanges including annual reports, half yearly reports, etc.;

(i) valuation reports including methodology of valuation;

(j) books of accounts and financial statements;

(k) audit reports;

(l) reports relating to activities of the InvIT placed before the board of directors of the investment manager;

(m) unit holders grievances and actions taken thereon including copies of correspondences made with the unit holder and SEBI, if any;

(n) any other material documents;

The trustee shall maintain records, wherever applicable, pertaining to–

(a) certificate of registration granted by SEBI;

(b) registered trust deed;

(c) documents pertaining to application made to the Board for registration as an InvIT;

(d) titles of the infrastructure assets.

However, where the original title documents are deposited with the lender or any other person in respect of any loan or debt, the trustee shall maintain copies of such title documents;

(e) notices and agenda send to unit holders for meetings held;

(f) minutes of meetings and resolutions passed therein;

(g) periodical reports and disclosures received by the trustee from the investment manager;

(h) disclosures, periodically or otherwise, made to SEBI, unit holders and the designated stock exchanges;

(i) any other material documents.

The aforesaid records may be maintained in physical or electronic form. However, where records are required to be duly signed and are maintained in the electronic form, such records shall be digitally signed.

GOVERNANCE NORMS FOR INVITs

Applicability of SEBI (LODR) Regulations, 2015

The corporate governance norms applicable for listed companies shall be applicable to REITs as specified in Regulation 26G of SEBI InvITs Regulations.

For the purposes of this regulation, the interpretation of certain expression as mentioned in SEBI (LODR) Regulations, 2015 shall be read as under while reading with REITs Regulations:

Expression in SEBI (LODR) Regulations, 2015	***To be read as, while reading with InvITs Regulations***
promoters	parties to the REIT
listed entity	InvIT or investment manager of InvIT, as may be applicable
company secretary	compliance officer
executive director	non-independent director
non-executive director	independent director
Boar d of Directors of the listed entity	Board of Directors of Investment Manager
subsidiary of listed entity	HoldCo and/or SPV of InvIT as applicable

Additional Requirements

(1) The Board of Directors of the Investment Manager shall comprise of not less than six directors and have not less than one woman independent director.

(2) The quorum for every meeting of the Board of Directors of the Investment Manager shall be one-third of its total strength or three directors, whichever is higher, including at least one independent director.

Explanation - The participation of the directors by video conferencing or by other audio-visual means shall be counted for the purpose of quorum and shall be recorded by the Investment Manager.

(3) The Board of Directors of the Investment Manager shall review compliance reports every quarter pertaining to all laws applicable to the InvIT as well as steps taken to rectify instances of non-compliances.

(4) The minimum information as specified in SEBI InvITs Regulations shall be placed before the Board of Directors of the Investment Manager.

(5) The Chief Executive Officer, the Chief Financial Officer and the Compliance Officer, shall provide the compliance certificate to the Board of Directors as specified in SEBI InvITs Regulations.

(6) The Board of Directors of the Investment Manager shall set forth clearly the recommendation of the Manager in the notice to the unit holders for each item as mentioned in point no. 5 under Rights and meetings of Unit holders.

Vigil Mechanism

(1) The Investment Manager shall formulate a vigil mechanism, including a whistle blower policy for directors and employees to report genuine concerns.

(2) The vigil mechanism shall provide for adequate safeguards against victimization of Director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

(3) An independent service provider may be engaged by the Investment Manager for providing or operating the vigil mechanism who shall report to the audit committee.

(4) The audit committee shall review the functioning of the vigil mechanism.

Secretarial Compliance Report

(1) The Investment Manager shall submit a secretarial compliance report given by a **practicing company secretary** to the stock exchanges, in such form as specified, within sixty days from end of each financial year.

(2) The secretarial compliance report shall be annexed with the annual report of the REIT.

Quarterly Compliance Report on Corporate Governance

(1) The Investment Manager shall submit a quarterly compliance report on governance in the format as may be specified by the SEBI to the recognized stock exchange(s) within twenty-one days from the end of each quarter.

(2) The quarterly compliance report shall be signed either by the compliance officer or the chief executive officer of the Investment Manager.

MINIMUM INFORMATION TO BE PLACED BEFORE BOARD OF DIRECTORS OF THE INVESTMENT MANAGER

The following minimum information to be placed before Board of Directors of the investment manager:

(a) Annual operating plans and budgets and any updates.

(b) Capital budgets and any updates

(c) Quarterly results for the investment manager and its operating divisions or business segments

(d) Minutes of meetings of audit committee and other committees of the Board of Directors.

(e) The information on recruitment and remuneration of senior officers just below the level of Board of Directors, including appointment or removal of Chief Financial Officer and the Compliance Officer.

(f) Show cause, demand, prosecution notices and penalty notices, which are materially important.

(g) Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.

(h) Any material default in financial obligations to and by the InvIT, HoldCo. and/or SPV.

(i) Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the investment manager or taken an adverse view regarding another enterprise that may have negative implications on the investment manager.

(j) Details of any joint venture or collaboration agreement.

(k) Significant labour problems and their proposed solutions, any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.

(l) Sale of investments, HoldCo. and/or SPV, assets which are material in nature and not in normal course of business.

(m) Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.

(n) Non-compliance of any regulatory, statutory or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

(o) Reports of tabletop exercises or workshops for identifying risks and vulnerabilities, and specifying risk mitigations and processes for addressing vulnerabilities

POWER TO RELAX STRICT ENFORCEMENT OF THE REGULATIONS

The SEBI may, exempt any person or class of persons from the operation of all or any of the provisions of these regulations for a period as may be specified but not exceeding twelve months, for furthering innovation in technological aspects relating to testing new products, processes, services, business models, etc. in live environment of regulatory sandbox in the securities markets.

Any exemption granted by the SEBI under sub-regulation (1) shall be subject to the applicant satisfying such conditions as may be specified including conditions to be complied with on a continuous basis.

"regulatory sandbox" means a live testing environment where new products, processes, services, business models, etc. may be deployed on a limited set of eligible customes for a specified period of time, for furthering innovation in the securities market, subject to such conditions as may be specified by the SEBI.

For details about Regulatory Sandbox, click on the link: *https://www.icsi.edu/media/webmodules/Framework_for_Regulatory_Sandbox.pdf*

LESSON ROUND-UP

- An Infrastructure Investment Trust (InvITs) is like a mutual fund, which enables direct investment of small amounts of money from possible individual/institutional investors in infrastructure to earn a small portion of the income as return.
- SEBI notified the SEBI (Infrastructure Investment Trusts) Regulations, 2014 on September 26, 2014, providing for registration and regulation of InvITs in India. The objective of InvITs is to facilitate investment in the infrastructure sector.
- The key laws applicable to InvITs include the InvITs Regulations, 2014, the InvIT Guidelines, the Trusts Act, the Registration Act, the FEMA, Income Tax Act, 1961 and SEBI (International Financial Services Centre) Guidelines, 2015.
- SEBI (Infrastructure Investment Trusts) Regulations, 2014 comprises of Nine chapters and seven schedules.
- SEBI has issued the Guidelines for Public Issue & for Preferential Issue of InvITs in pursuance to SEBI (Infrastructure Investment Trusts), Regulations, 2014.

- The InvITs can raise capital from both domestic and foreign investors. Raising capital from foreign investor pursuant to initial offer of units or follow-on offer can be made.
- The offer document or placement memorandum of the InvIT shall contain material, true, correct and adequate disclosures to enable the investors to make an informed decision.
- The advertisements shall be in accordance with the offer document and any circulars or guidelines as may be specified by SEBI in this regard.
- The Investment Manager shall submit valuation reports received to the designated stock exchanges within fifteen days from the receipt of such valuation reports.
- The records may be maintained in physical or electronic from. However, if records are maintained in electronic from it shall be digitally signed.

GLOSSARY

Bidder: Any prospective investor, other than an Anchor Investor who makes a Bid in the issue.

Concession Agreement: An agreement entered into by a person with a concessioning authority for the purpose of implementation of the project as provided in the agreement.

IMA: Investment Management Agreement is an agreement between the trustee and the investment manager which lays down the roles and responsibilities of the manager towards the InvIT.

Net Worth: In relation to a company or a body corporate shall have the meaning assigned to it under sub-section (57) of section 2 of the Companies Act, 2013.

Unit: It means beneficial interest of the InvIT.

TEST YOURSELF

(*These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.*)

1. Elucidate the provisions with respect to the issue and listing of units under SEBI (Infrastructure Investment Trusts), Regulations, 2014.
2. What are the guidelines issued for Public issue of units of InvITs by SEBI?
3. Whether the units of InvITs can be issued on preferential basis? If yes, explain the guidelines issued by SEBI with respect to issue of units on preferential basis?
4. What are the investment conditions for an InvIT under the SEBI (Infrastructure Investment Trusts) Regulations, 2014?
5. Who can invest in units of an InvIT?
6. Explain the provision relating to maintenance of records by an investment manager under the SEBI InvITs Regulations.
7. Distinguish between REITs and InvITs.
8. What is the structure of an InvIT? What is the registration process?
9. Enumerate the rules for distribution of cash flows by InvITs.

LIST OF FURTHER READINGS

- Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014
- SEBI Annual Report 2019-20
- SEBI Monthly e-bulletins.
- ICSI Publication on FAQs on SEBI (InvIT) Regulations, 2014.

OTHER REFERENCES

- De'construct'ing InvITs and REITs by Cyril amarchand mangaldas; https://www.cyrilshroff.com/wp-content/uploads/2017/01/De_construct_ing-InvITs-and-REITs-.pdf

Raising of Funds – Private Funding

Lesson 11

KEY CONCEPTS

■ Alternative Investment Funds ■ Angel Fund ■ Angel Investor ■ Seed Financing ■ Venture Capital ■ Private Equity ■ Placement Memorandum ■ Social Impact Fund ■ Corporate Debt Market Development Fund

Learning Objectives

To understand:

- Meaning of Alternative Investment Fund (AIF) and its Categories
- Regulatory prescriptions on Registration of AIFs, Placement Memorandum, Schemes, Tenure and Listing
- Investment Strategy and Conditions for AIFs
- Angel Fund and investment by Angel Fund
- The concept of Special Situation Fund
- Meaning of Seed Funding, Private Equity and Venture Capital
- Foreign Venture Capital Investors (FVCI) and Investment Conditions
- Process and Documentation required for listing and trading of Alternative Investment Fund on Stock Exchange

Lesson Outline

REGULATORY FRAMEWORK

- SEBI (Alternative Investment Funds) Regulations, 2012
- Securities and Exchange Board of India (Foreign Venture Capital Investor) Regulations, 2000
- Master Circular for Alternative Investment Funds (AIFs)
- Companies Act, 2013

INTRODUCTION

Indian entrepreneurs need private equity and debt products to meet the capital needs of their growth, restructuring, turn around or start-up plans. The main providers of this form of capital are private equity and venture capital funds which are channelled through Alternative Investment Funds (AIFs). Given that such capital is in short supply in India, a favourable policy and regulatory environment is essential. AIFs in India are regulated by the Securities and Exchange Board of India (SEBI). Other government agencies which play an important role are the Ministry of Finance and sector regulators in the pension and insurance areas as well as the Reserve Bank of India.

BACKGROUND

SEBI had earlier framed the SEBI (Venture Capital Funds) Regulations, 1996 (“VCF Regulations”) to encourage investments into start-ups and mid-size companies. Since the introduction of the VCF Regulations, it was observed by SEBI that the venture capital route was being used by several other categories of funds such as private equity funds, real estate funds etc. Further, since registration as a Venture Capital Fund (“VCF”) was not mandatory under the VCF Regulations, not all private equity or other categories of funds were registering with the SEBI.

While these funds did not enjoy certain exemptions that were available to VCFs, they were not subjected to any investment restrictions. SEBI noted the need for comprehensive regulations to deal with investments that are sourced from diverse parts of the private pool of capital. Accordingly, SEBI notified the Alternative Investment Fund (AIF) Regulations to govern unregulated entities and create a level playing ground for existing venture capital investors.

The Securities and Exchange Board of India (“SEBI”) has notified the SEBI (Alternative Investment Funds) Regulations, 2012 (‘AIF Regulations’) on 21 May, 2012 - a comprehensive regulatory framework for regulating private pools of capital or Alternative Investment Funds, thus bringing various funds investing in Indian securities under a unified regulatory umbrella.

What is an Alternate Investment Fund (“AIF”)?

Alternative Investment Fund or AIF means any fund established or incorporated in India which is a privately pooled investment vehicle which collects funds from sophisticated investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors.

The AIF Regulations aim to regulate funds involved in the pooling or raising of private capital from Institutional Investors or High Networth Investors (“HNI”) with a view to invest such funds in accordance with a defined investment policy for benefit of the investors and the manager of such fund, irrespective of their legal domicile. These regulations provide that an entity, seeking to pool and manage such private pool of capital for investing in securities or acting as an Alternative Investment Fund (“AIF”), should be registered with the SEBI under these regulations.

Question: Is an AIF permitted to make an invitation to the public to subscribe to its securities?

Answer: No. AIFs are privately pooled investment vehicles. AIFs shall raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called. As an eligibility criterion for registration as an AIF, the applicant is required to be prohibited by its memorandum and articles of association/ trust deed/ partnership deed from making an invitation or solicitation to the public to subscribe to its securities.

SEBI (ALTERNATIVE INVESTMENT FUNDS) REGULATIONS, 2012

Important Definitions

"Accreditation Agency" means a subsidiary of a recognized stock exchange or a subsidiary of a depository or any other entity as may be specified by the SEBI from time to time.

Explanation: For the purpose of this clause, the Board may recognize an accreditation agency subject to such conditions as may be specified.

"Accredited Investor" means any person who is granted a certificate of accreditation by an accreditation agency who,

(i) in case of an individual, Hindu Undivided Family, family trust or sole proprietorship has:

a. annual income of at least two crore rupees; or

b. net worth of at least seven crore fifty lakh rupees, out of which not less than three crores seventy-five lakh rupees is in the form of financial assets; or

c. annual income of at least one crore rupees and minimum net worth of five crore rupees, out of which not less than two crore fifty lakh rupees is in the form of financial assets.

(ii) in case of a body corporate, has net worth of at least fifty crore rupees;

(iii) in case of a trust other than family trust, has net worth of at least fifty crore rupees;

(iv) in case of a partnership firm set up under the Indian Partnership Act, 1932, each partner independently meets the eligibility criteria for accreditation.

However, Central Government and the State Governments, developmental agencies set up under the aegis of the Central Government or the State Governments, funds set up by the Central Government or the State Governments, qualified institutional buyers as defined under the Securities and Exchange Board of India(Issue of Capital and Disclosure Requirements) Regulations, 2018, Category I foreign portfolio investors, sovereign wealth funds and multilateral agencies and any other entity as may be specified by the Board from time to time, shall deemed to be an accredited investor and may not be required to obtain a certificate of accreditation.

"Alternative Investment Fund" means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which-

(i) is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and

(ii) is not covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of the SEBI to regulate fund management activities.

However, the following shall not be considered as Alternative Investment Fund for the purpose of these regulations-

(i) family trusts set up for the benefit of 'relatives' as defined under Companies Act, 2013;

(ii) ESOP Trusts set up under the SEBI (Share Based Employee Benefits) Regulations or as permitted under Companies Act, 2013;

(iii) employee welfare trusts or gratuity trusts set up for the benefit of employees;

(iv) holding companies' as defined under sub-section 46 of section 2 of Companies Act, 2013;

(v) other special purpose vehicles not established by fund managers, including securitization trusts, regulated under a specific regulatory framework;

(vi) funds managed by securitisation company or reconstruction company which is registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; and

(vii) any such pool of funds which is directly regulated by any other regulator in India.

"Debt Fund" means an Alternative Investment Fund which invests primarily in debt or debt securities of listed or unlisted investee companies or in securitized debt instruments as per stated objectives of the Fund.

"Corpus" means the total amount of funds committed by investors to the Alternative Investment Fund by way of a written contract or any such document as on a particular date.

"Hedge Fund" means an Alternative Investment Fund which employs diverse or complex trading strategies and invests and trades in securities having diverse risks or complex products including listed and unlisted derivatives.

"Infrastructure Fund" means an Alternative Investment Fund which invests primarily in unlisted securities or partnership interest or listed debt or securitized debt instruments of investee companies or special purpose vehicles engaged in or formed for the purpose of operating, developing or holding infrastructure projects. "Infrastructure" shall be as defined by the Government of India from time to time.

"Invesitable Funds" means corpus of the Scheme of Alternative Investment Fund net of expenditure for administration and management of the fund estimated for the tenure of the funds.

Explanation.– For the purpose of this clause, the expression "tenure" means the duration of scheme from the date of first close till last date of the term as specified in the fund documents.

"Large Value Fund for Accredited Investors" means an Alternative Investment Fund or scheme of an Alternative Investment Fund in which each investor (other than the Manager, Sponsor, employees or directors of the Alternative Investment Fund or employees or directors of the Manager) is an accredited investor and invests not less than seventy crore rupees.

"Private Equity Fund" means an Alternative Investment Fund which invests primarily in equity or equity linked instruments or partnership interests of investee companies according to the stated objective of the fund.

"SME" means Small and Medium Enterprise and shall have the same meaning as assigned to it under the Micro, Small and Medium Enterprises Development Act, 2006 as amended from time to time.

"SME Fund" means an Alternative Investment Fund which invests primarily in unlisted securities of investee companies which are SMEs or securities of those SMEs which are listed or proposed to be listed on a SME exchange or SME segment of an exchange.

"***Social Enterprise***" shall have the same meaning as assigned to it in clause (h) of regulation 292A of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

In terms of regulation 292A(h) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, "Social Enterprise" means either a Not for Profit Organization or a For Profit Social Enterprise that meets the eligibility criteria specified in Chapter X-A.

"***Social Impact Fund***" means an Alternative Investment Fund which invests primarily in securities, units or partnership interest of social ventures or securities of social enterprises and which satisfies the social performance norms laid down by the fund.

"***Social Stock Exchange***" shall have the same meaning as assigned to it in clause (i) of regulation 292A of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

In terms of regulation 292A(i) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 "Social Stock Exchange" means a separate segment of a recognized stock exchange having nationwide trading terminals permitted to register Not for Profit Organizations and / or list the securities issued by Not for Profit Organizations in accordance with provisions of these regulations.

"***Social Units***" means units issued by a social impact fund or schemes of a social impact fund to investors who have agreed to receive only social returns or benefits and no financial returns against their contribution.

"Social Venture" means a trust, society or company or venture capital undertaking or limited liability partnership formed with the purpose of promoting social welfare or solving social problems or providing social benefits and includes–

(i) public charitable trusts registered with Charity Commissioner;

(ii) societies registered for charitable purposes or for promotion of science, literature, or fine arts;

(iii) company registered under Section 8 of the Companies Act, 2013;

(iv) micro finance institutions.

"Sponsor" means any person or persons who set up the Alternative Investment Fund and includes promoter in case of a company and designated partner in case of a limited liability partnership.

"Startup" means a private limited company or a limited liability partnership which fulfills the criteria for startup as specified by the Department of Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India, vide notification no. G.S.R. 127(E) dated February 19, 2019 or such other policy of the Central Government issued in this regard from time to time.

"Venture Capital Fund" means an Alternative Investment Fund which invests primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property right based activities or a new business model and shall include an angel fund as defined under Chapter III-A of the SEBI (AIF) Regulations, 2012.

"Venture Capital Undertaking" means a domestic company which is not listed on a recognised stock exchange at the time of making investments.

Question: In which legal forms can an AIF be set up?

Answer: An AIF under the SEBI (Alternative Investment Funds) Regulations, 2012 can be established or incorporated in the form of a trust or a company or a limited liability partnership or a body corporate. Most of the AIFs registered with SEBI are in trust form.

Categories of AIFs

AIF shall seek registration in one of the categories mentioned in the AIF Regulations. There are three categories of Alternative Investments Funds and they are :

(i) **Category I Alternative Investment Fund** are those which invest in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and shall include venture capital funds, SME Funds, social impact funds, infrastructure funds, special situation funds and such other Alternative Investment Funds as may be specified.

Alternative Investment Funds which are generally perceived to have a positive spillover effect on the economy and for which SEBI or Government of India or other regulators in India might consider providing incentives or concessions shall be included and such funds which are formed as trusts or companies shall be construed as venture capital company or venture capital fund as specified under sub-section (23FB) of Section 10 of the Income Tax Act, 1961.

(ii) **Category II Alternative Investment Fund** are those which does not fall in Category I and III and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements and as permitted in the AIF Regulations. Alternative Investment Funds such as private equity funds or debt funds for which no specific incentives or concessions are given by the government or any other Regulator shall be included under this category.

(iii) **Category III Alternative Investment Fund** which employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. Alternative Investment Funds such as hedge funds or funds which trade with a view to make short term returns or such other funds which are open ended and for which no specific incentives or concessions are given by the government or any other Regulator shall be included in this category.

(iv) **Specified Alternative Investment Fund under Regulation 19 of SEBI AIF Regulations.**

Regulations 19 prescribed that SEBI may lay down framework for AIFs other than the funds falling in the categories specified in SEBI AIF Regulations

Registration of AIFs

All AIFs are required to be mandatorily registered under any of the III categories as mentioned above with SEBI. Entity or person shall not act as an Alternative Investment Fund unless it has obtained a certificate of registration from the SEBI. Any entity who fails to make an application for grant of a certificate within the period specified therein shall cease to carry on any activity as an Alternative Investment Fund.

The AIF Regulations permit AIF to launch multiple schemes under one AIF subject to filing of the placement memorandum with SEBI and the Certificate of Registration shall be valid until the AIF is wound up or the certificate is cancelled by SEBI. An AIF which has been granted registration under a particular category cannot change its category subsequent to registration, except with the approval of SEBI.

Question: Can an AIF change its category pursuant to registration?

Answer: Yes. As per Circular No. CIR/IMD/DF/12/2013 dated 07th August, 2013, only AIFs who have not made any investments under the category in which they were registered earlier shall be allowed to make application for change in category.

Online Filing System for Alternative Investment Funds

In a constant endeavor to facilitate ease of operations in terms of applying for registration, reporting and various compliances under 'AIF Regulations', SEBI has introduced an online system for filings related to (AIF). The online system can be used for application for registration, reporting and filing in terms of the provisions of AIF Regulations and circulars issued thereunder.

All applicants desirous of seeking registration as an AIF are now required to submit their applications online only, through SEBI Intermediary Portal at *https://siportal.sebi.gov.in*.

Furthermore, all SEBI registered AIFs are now required to file their compliance reports and submit applications for any request under the provisions of AIF Regulations and circulars issued thereunder, through the online system only.

Investment Strategy

All AIFs must state its investment strategy, investment purpose and its investment methodology in its placement memorandum to the investors. In case the AIF decides to alter the fund strategy, it shall be made only with the consent of atleast 2/3rd of the unit holders by value of their investment in the AIF.

Investment in AIFs

The AIF, in all categories, may raise funds from any investor whether Indian, foreign or non-resident Indians only by way of issue of units.

A social impact fund or schemes of social impact fund may also issue social units. The AIF shall issue units in dematerilaised form subject to the conditions specified by the SEBI from time to time.

- Each scheme of the AIF shall have corpus of atleast twenty crore rupees and the AIF shall not accept from an investor, an investment of value less than one crore rupees.
- In case the investors are employees or directors of the AIF Fund or employees or directors of the Manager, the minimum value of investment shall be twenty five lakh rupees. However, this clause shall no apply to an accredited investor.

- The Manager or Sponsor shall have a continuing interest in the AIF Fund of not less than two and half percent of the corpus or five crore rupees, whichever is lower, in the form of investment in the Alternative Investment Fund and such interest shall not be through the waiver of management fees. However, In the case of Category III AIF, the continuing interest shall be not less than five percent of the corpus or ten crore rupees, whichever is lower.

- The Manager or Sponsor shall disclose their investment in the Alternative Investment Fund to the investors of the Alternative Investment Fund.

- No scheme of the Alternative Investment Fund shall have more than 1000 investors. Provided that the provisions of the Companies Act, 2013 shall apply to the Alternative Investment Fund, if it is formed as a company.

- The AIF shall collect funds only by way of private placement.

- A social impact fund or schemes of a social impact fund may also issue social units. Social impact fund shall have a corpus of at least five crore rupees and in case of a social impact fund which invests only in securities of not for profit organizations registered or listed on a social stock exchange, the minimum value of investment by an individual investor shall be two lakh rupees.

In case the corpus of an open-ended scheme falls below rupees twenty crores:

i. The AIF shall intimate to SEBI within 2 days of receiving request for redemption from the client.

ii. The AIF shall take necessary action to bring back the scheme size to twenty crores within 3 months from the date of such breach.

iii. In case the AIF fails to bring back the corpus within the prescribed period, it shall redeem entire units of all investors and wind up the scheme.

iv. In case of repeated violations by the AIF, SEBI may take action against the AIF, as may be appropriate.

Foreign investment in Alternative Investment Funds (AIFs)

In terms of Regulation 10(a) of SEBI (Alternative Investment Funds) Regulations, 2012, AIFs may raise funds from any investor whether Indian, foreign or non-resident Indians, by way of issue of units. At the time of on-boarding investors, the manager of an AIF shall ensure the following:

- Foreign investor of the AIF is a resident of the country whose securities market regulator is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding or a signatory to the bilateral Memorandum of Understanding with SEBI.

  For the purpose of the aforesaid clause, "Bilateral Memorandum of Understanding with SEBI" shall mean a bilateral Memorandum of Understanding between SEBI and any authority outside India that provides for information sharing arrangement as specified under clause (ib) of sub-section (2) of Section 11 of the SEBI Act, 1992.

  The investor, or its underlying investors contributing 25% or more in the corpus of the investor or identified on the basis of control, is not the person(s) mentioned in the Sanctions List notified from time to time by the United Nations Security Council and is not a resident in the country identified in the public statement of Financial Action Task Force as

  (i) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

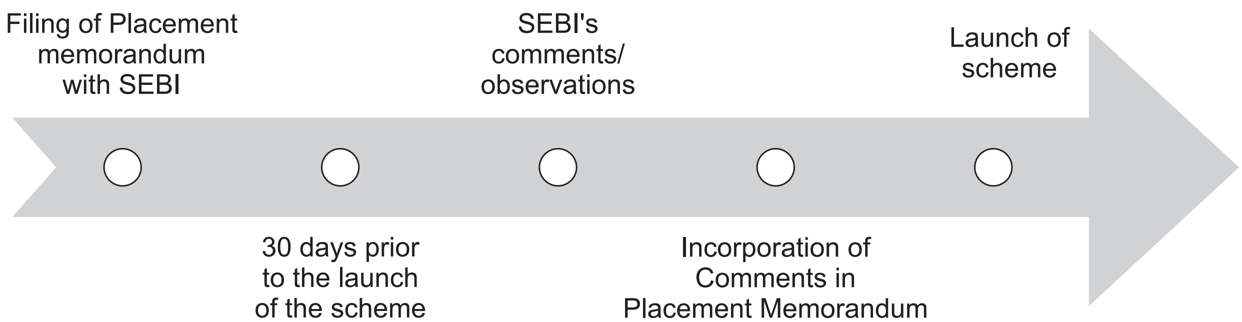
  (ii) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

Placement Memorandum

AIF shall raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called. This document shall contain all material information about the AIF and the Manager, background of key investment team of the Manager, targeted investors, fees and all other expenses proposed to be charged, tenure of the Alternative Investment Fund or scheme, conditions or limits on redemption, investment strategy, risk management tools and parameters employed, key service providers, terms of reference of the committee constituted for approving the decisions of the Alternative Investment Fund, conflict of interest and procedures to identify and address them, disciplinary history, the terms and conditions on which the Manager offers investment services, its affiliations with other intermediaries, manner of winding up of the AIF or the scheme and such other information as may be necessary for the investor to take an informed decision on whether to invest in the Alternative Investment Fund.

Schemes

The AIF Fund may launch schemes after filing of its placement memorandum with SEBI. Placement memorandum shall be filed with SEBI through a merchant banker atleast 30 days prior to the launch of the scheme along with the prescribed fees. The SEBI may communicate its comments, if any, to the merchant banker prior to launch of the scheme and the merchant banker shall ensure that the comments are incorporated in the placement memorandum prior to launch of the scheme. However, these requirements shall not apply to large value fund for accredited investors.



Question: Can an AIF launch schemes?

Ans: Yes. An AIF may launch schemes subject to filing of placement memorandum with SEBI. Further, it may be noted that prior to launch of scheme, an AIF is required to pay Rs. 1 lakh as scheme fees to SEBI while filing the placement memorandum. Such fee shall be paid atleast 30 days prior to launch of scheme. However, payment of scheme fees shall not apply in case of launch of first scheme by the AIF other than angel fund.

Modalities for filing of placement memorandum through a Merchant Banker

AIFs shall launch scheme subject to filing of placement memorandum with SEBI through a SEBI registered Merchant Banker. In this context, the following is specified:

(a) The Merchant Banker shall independently exercise due diligence of all the disclosures in the placement memorandum, satisfy itself with respect to veracity and adequacy of the disclosures and provide a due diligence certificate in the prescribed format.

(b) While filing draft placement memorandum at the time of registration or prior to launch of new scheme on the SEBI intermediary portal, the due diligence certificate provided by the Merchant Banker shall also be submitted, along with other necessary documents.

(c) The details of the Merchant Banker shall be disclosed in the placement memorandum.

(d) The Merchant Banker appointed for filing of placement memorandum shall not be an associate of the AIF, its sponsor, manager or trustee.

Tenure

Category I & II AIF

- Minimum tenure of 3 years
- Close ended fund*
- The tenure of close ended fund may be extended for a further period of 2 years only with the approval of two-third of the unit holders by value of their investment.
- Large value funds for accredited investors may be permitted to extend its tenure beyond two years, subject to terms of the contribution agreement, other fund documents and such conditions as may be specified by the SEBI from time to time.

Category III AIF

- Either open ended or close ended fund*
- The tenure of close ended fund may be extended for a further period of 2 years only with the approval of two-third of the unit holders by value of their investment.
- Large value funds for accredited investors may be permitted to extend its tenure beyond two years, subject to terms of the contribution agreement, other fund documents and such conditions as may be specified by the SEBI from time to time.

In the absence of consent of unitholders or upon expiry of the extended tenure, the AIF or the scheme of the AIF shall be wound up.

* The manner of calculating the tenure of close ended scheme of an AIF, including the manner of modification of the tenure may be specified by SEBI from time to time.

Listing

Units of close ended Alternative Investment Fund may be listed on stock exchange subject to a minimum tradable lot of one crore rupees. Listing of Alternative Investment Fund units shall be permitted only after final close of the fund or scheme.

General Investment Conditions

Investments by all categories of Alternative Investment Funds shall be subject to the following conditions:-

(a) Alternative Investment Fund may invest in securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and the SEBI from time to time;

In this regard, SEBI stated that AIFs may invest in equity and equity linked instruments only of offshore venture capital undertakings, subject to overall limit of USD 1500 million (combined limit for AIFs and Venture Capital Funds registered under the SEBI).

(b) The terms of Co-investment in an investee company by a Manager or Sponsor or co-investor, shall not be more favourable than the terms of investment of the Alternative Investment Fund. However, the terms of exit from the Co-investment in an investee company including the timing of exit shall be identical to the terms applicable to that of exit of the Alternative Investment Fund.

(c) Category I and II Alternative Investment Funds shall invest not more than twenty five percent of the investable funds in an Investee Company directly or through investment in the units of other Alternative Investment Funds.

However, large value funds for accredited investors of Category I and II may invest upto 50% of investable funds in an investee company directly or through investment in the units of other AIFs.

(d) Category III Alternative Investment Funds shall invest not more than ten per cent of the investable funds in an Investee Company, directly or through investment in units of other Alternative Investment Funds and the large value funds for accredited investors of Category III Alternative Investment Funds may invest up to twenty per cent of the investable funds in an Investee Company, directly or through investment in units of other Alternative Investment Funds.

However, for investment in listed equity of an Investee Company, Category III Alternative Investment Funds may calculate the investment limit of ten per cent of either the investable funds or the net asset value of the scheme and large value funds for accredited investors of Category III Alternative Investment Funds may calculate the investment limit of twenty per cent of either the investable funds or the net asset value of the scheme, subject to the conditions specified by the SEBI from time to time.

(e) Alternative Investment Funds which are authorised under the fund documents to invest in units of Alternative Investment Funds shall not offer their units for subscription to other Alternative Investment Funds.

(f) Alternative Investment Fund shall not invest except with the approval of seventy five percent of investors by value of their investment in the Alternative Investment Fund in -

i. associates;

ii. units of Alternative Investment Funds managed or sponsored by its Manager, Sponsor or associates of its Manager or Sponsor.

(g) Except with the approval of seventy five percent of the investors by value of their investment in the scheme of Alternative Investment Fund and subject to the conditions specified by the Board, a scheme of an Alternative Investment Fund shall not buy or sell investments, from or to –

(a) associates; or

(b) schemes of Alternative Investment Funds managed or sponsored by its Manager, Sponsor or associates of its Manager or Sponsor; or

(c) an investor who has committed to invest at least fifty percent of the corpus of the scheme of Alternative Investment Fund.

While obtaining approval of the investors, the investor specified under sub-clause (c) who has committed to invest at least fifty percent of the corpus of the scheme of Alternative Investment Fund and is buying or selling the investment, from or to, the Alternative Investment Fund, shall be excluded from the voting process.

(h) Un-invested portion of the investable funds and divestment proceeds pending distribution to investors may be invested in liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury bills, Triparty Repo Dealing and Settlement, Commercial Papers, Certificates of Deposits, etc. till the deployment of funds as per the investment objective or the distribution of the funds to investors as per the terms of the fund documents, as applicable.

(i) Alternative Investment Fund may act as Nominated Investor, as specified in regulation 106N(1)(b) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. Nominated investor means a qualified institutional buyer or private equity fund, who enters into an agreement with the merchant banker to subscribe to the issue in case of under-subscription or to receive or deliver the specified securities in the market-making process in case of SME IPOs.

(j) Investment by Category I and Category II Alternative Investment Funds in the shares of entities listed on institutional trading platform after the commencement of SEBI (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2015 shall be deemed to be investment in unlisted securities for the purpose of the AIF Regulations.

(k) Alternative Investment Funds shall hold their investments in dematerialised form, subject to such conditions as may be specified by the SEBI from time to time. However, this shall not apply to:

(a) investments by Alternative Investment Funds in such type of instruments which are not eligible for dematerialisation,

(b) investments held by a liquidation scheme of the Alternative Investment Funds that are not available in the dematerialised form, and

(c) such other investments by Alternative Investment Funds and such other schemes of Alternative Investment Funds as may be specified by the Board from time to time.

Guidelines for Overseas Investment by Alternative Investment Funds (AIFs) / Venture Capital Funds (VCFs)

In terms of Regulation 15(1)(a) of SEBI (Alternative Investment Funds) Regulations, 2012, AIFs/VCFs may invest in securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and SEBI from time to time. In this regard, the following is specified –

1. AIFs may invest in equity and equity linked instruments only of off-shore venture capital undertakings, subject to overall limit of USD 1500 million (combined limit for AIFs and Venture Capital Funds registered under the erstwhile Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996).
2. For the purpose of such investment, it is clarified that "Offshore Venture Capital Undertakings" means a foreign company whose shares are not listed on any of the recognized stock exchange in India or abroad.
3. Such investments shall not exceed 25% of the investable funds of the scheme of the AIF.
4. AIFs shall invest in an overseas investee company, which is incorporated in a country whose securities market regulator is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to the bilateral Memorandum of Understanding with SEBI.
5. AIFs shall not invest in an overseas investee company, which is incorporated in a country identified in the public statement of Financial Action Task Force (FATF) as:
   i. a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
   ii. a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with FATF to address the deficiencies.
6. These investments would be subject to Foreign Exchange Management (Overseas Investment) Regulations, 2022, including amendments thereof and related directions issued by RBI from time to time.
7. AIFs shall not invest in Joint venture/Wholly Owned Subsidiary while making overseas investments.
8. AIFs shall adhere to FEMA, 1999, its Rules, Regulations and Directions issued by the Government/ RBI from time to time.

9. AIFs shall comply with all requirements under RBI guidelines on opening of branches/subsidiaries/Joint Venture /undertaking investment abroad by NBFCs, where more than 50% of the funds of the AIF has been contributed by a single NBFC.

10. AIFs shall transfer/sell the investment in overseas investee company only to the entities eligible to make overseas investments, as per the extant guidelines issued under the FEMA, 1999.

Conditions for Category I AIFs

The following investment conditions shall apply to all Category I Alternative Investment Funds:-

(a) Category I Alternative Investment Fund shall invest in investee companies, venture capital undertakings, special purpose vehicles, limited liability partnerships, in units of other Category I Alternative Investment Funds of the same sub category or in units of Category II Alternative Investment Funds as specified in AIF regulation.

(b) Category I Alternative Investment Funds may engage in hedging, including credit default swaps in terms of the conditions as may be specified by SEBI from time to time.

(c) Category I AIF shall not borrow funds directly or indirectly or engage in any leverage except for meeting temporary funding requirements for not more than thirty days, on not more than four occasions in a year and not more than ten percent of the investable funds.

However, Category I Alternative Investment Funds may create encumbrance on equity of investee company, which is in the business of development, operation or management of projects in any of the infrastructure sub-sectors listed in the Harmonised Master List of Infrastructure issued by the Central Government, only for the purpose of borrowing by such investee company and subject to such conditions as may be specified by the Board from time to time

In case the AIF is a **Venture Capital Fund**, the following additional conditions shall apply :-

(a) At least seventy-five percent of the investable funds shall be invested in unlisted equity shares or equity linked instruments of a venture capital undertaking or in companies listed or proposed to be listed on a SME exchange or SME segment of an exchange. However, the investment conditions shall be achieved by the fund by the end of its life cycle.

(b) Such funds may enter into an agreement with merchant banker to subscribe to the unsubscribed portion of the issue or to receive or deliver securities in the process of market making under Chapter IX of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and the provisions of clause (a) of sub-regulation shall not apply in case of acquisition or sale of securities pursuant to such subscription or market making.

(c) Such funds shall be exempt from sub-regulations (1) and (2) of regulation 3 and sub-regulation (1) of regulation 4 of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 in respect of investment in companies listed on the SME exchange or SME segment of an exchange pursuant to due diligence of such companies subject to the following conditions:

   (i) the fund shall disclose any trading in securities pursuant to such due-diligence, within two trading days of such trading, to the stock exchanges where the investee company is listed;

   (ii) such investment shall be locked in for a period of one year from the date of investment.

In case the fund is an **SME Fund**, the following additional conditions shall apply:

(a) Atleast seventy five percent of the investable funds shall be invested in unlisted securities or partnership interest of venture capital undertakings or investee companies which are SMEs or in companies listed or proposed to be listed on SME exchange or SME segment of an exchange or in units of Category II Alternative Investment Funds which invest primarily in such venture capital undertakings or investee companies.

(b) Such funds may enter into an agreement with merchant banker to subscribe to the unsubscribed portion of the issue or to receive or deliver securities in the process of market making under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

However, Category II Alternative Investment Funds may create encumbrance on equity of investee company, which is in the business of development, operation or management of projects in any of the infrastructure sub-sectors listed in the Harmonised Master List of Infrastructure issued by the Central Government, only for the purpose of borrowing by such investee company and subject to such conditions as may be specified by the Board from time to time.

(c) Such funds shall be exempt from sub-regulations (1) and (2) of regulation 3 and sub-regulation (1) of regulation 4 of the SEBI (Prohibition of Insider Trading) Regulations, 2015 in respect of investment in companies listed on the SME exchange or SME segment of an exchange pursuant to due diligence of such companies subject to the following conditions:

(i) the fund shall disclose any trading in securities pursuant to such due-diligence, within two trading days of such trading, to the stock exchanges where the investee company is listed;

(ii) such investment shall be locked in for a period of one year from the date of investment.

In case the fund is a **Social Impact Fund**, the following additional conditions shall apply :

(a) At least seventy-five percent of the investable funds shall be invested in unlisted securities or partnership interest of social ventures or in units of social ventures or in securities of social enterprises. However, an existing social impact fund may invest the remaining investable funds in securities of not for profit organizations registered or listed on a social stock exchange with the prior consent of atleast 75% of the investors by value of their investment.

(b) Such funds may accept grants, provided that such utilization of such grants shall be restricted to investing in unlisted securities or partnership interest of social ventures as mentioned point (a).

However, the amount of grant that may be accepted by the fund from any person shall not be less than ten lakh rupees. Provided further that the minimum amount of grant shall not apply to accredited investors. Further, no profits or gains shall accrue to the provider of such grants.

(c) A social impact fund or schemes of a social impact fund launched exclusively for a not for profit organization registered or listed on a social stock exchange, shall be permitted to deploy or invest hundred percent of the investable funds in the securities of not for profit organizations registered or listed on a social stock exchange.

(d) Such funds may give grants to social ventures or social enterprises, provided that appropriate disclosure is made in the placement memorandum.

In case the fund is an **Infrastructure Fund**, the following additional conditions shall apply:

(a) Atleast seventy five percent of the investable funds shall be invested in unlisted securities or units or partnership interest of venture capital undertaking or investee companies or special purpose vehicles, which are engaged in or formed for the purpose of operating, developing or holding infrastructure projects or in units of Category II Alternative Investment Funds which invest primarily in such venture capital undertakings or investee companies or special purpose vehicles.

(b) Notwithstanding the above, such funds may also invest in listed securitized debt instruments or listed debt securities of investee companies or special purpose vehicles, which are engaged in or formed for the purpose of operating, developing or holding infrastructure projects.

Conditions for Category II AIFs

The following investment conditions shall apply to Category II Alternative Investment Funds:-

(a) Category II AIFs shall invest in investee companies or in the units of Category I or other Category II Alternative Investment Funds as may be disclosed in the placement memorandum.

Category II AIFs shall invest primarily in unlisted companies directly or through investment in units of other Alternative Investment Funds.

(b) Category II Alternative Investment Funds may not borrow funds directly or indirectly and shall not engage in leverage except for meeting temporary funding requirements for not more than thirty days, not more than four occasions in a year and not more than ten percent of the investable funds.

However, Category II Alternative Investment Funds may create encumbrance on equity of investee company, which is in the business of development, operation or management of projects in any of the infrastructure sub-sectors listed in the Harmonised Master List of Infrastructure issued by the Central Government, only for the purpose of borrowing by such investee company and subject to such conditions as may be specified by the Board from time to time

(c) Notwithstanding this restriction, a Category II Alternative Investment Fund may engage in hedging, subject to guidelines as specified by SEBI from time to time.

(d) Category II Alternative Investment Funds may buy or sell credit default swaps in terms of the conditions as may be specified by the SEBI from time to time.

(e) Category II Alternative Investment Funds may enter into an agreement with merchant banker to subscribe to the unsubscribed portion of the issue or to receive or deliver securities in the process of market making under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

(f) Category II Alternative Investment Funds shall be exempt from sub-regulations (1) and (2) of regulation 3 and sub-regulation (1) of regulation 4 of the SEBI (Prohibition of Insider Trading) Regulations, 2015 in respect of investment in companies listed on SME Exchange or SME segment of an exchange pursuant to due diligence of such companies subject to the following conditions:

(i) the fund shall disclose any trading in securities pursuant to such due diligence, within two trading days of such trading, to the stock exchanges where the investee company is listed;

(ii) such investment shall be locked in for a period of one year from the date of investment.

Conditions for Category III AIFs

The following investment conditions shall apply to Category III Alternative Investment Funds:-

(a) Category III Alternative Investment Funds may

- invest in securities of listed or unlisted investee companies or derivatives, units of other Alternative Investment Funds or complex or structured products;
- deal in goods received in delivery against physical settlement of commodity derivatives.
- buy or sell credit default swaps in terms of conditions as may be specified by SEBI from time to time.

(b) Category III Alternative Investment Funds may engage in leverage or borrow, subject to consent from the investors in the fund and subject to a maximum limit, as may be specified by SEBI.

However, such funds shall disclose information regarding the overall level of leverage employed, the level of leverage arising from borrowing of cash, the level of leverage arising from position held in derivatives or in any complex product and the main source of leverage in their fund to the investors and to SEBI periodically, as may be specified by SEBI.

(c) Category III Alternative Investment Funds shall be regulated through issuance of directions regarding areas such as operational standards, conduct of business rules, prudential requirements, restrictions on redemption and conflict of interest as may be specified by SEBI.

ANGEL FUNDS

As per AIF Regulations , Angel Fund means a sub-category of Venture Capital Fund under Category I Alternative Investment Fund that raises funds from angel investors and invests in accordance with the provisions of Chapter III-A of the AIF Regulations.

Angel Investor

Here, 'Angel Investor' means any person who proposes to invest in an angel fund and satisfies one of the following conditions, namely,

(a) an individual investor who has net tangible assets of at least two crore rupees excluding value of his principal residence, and who:

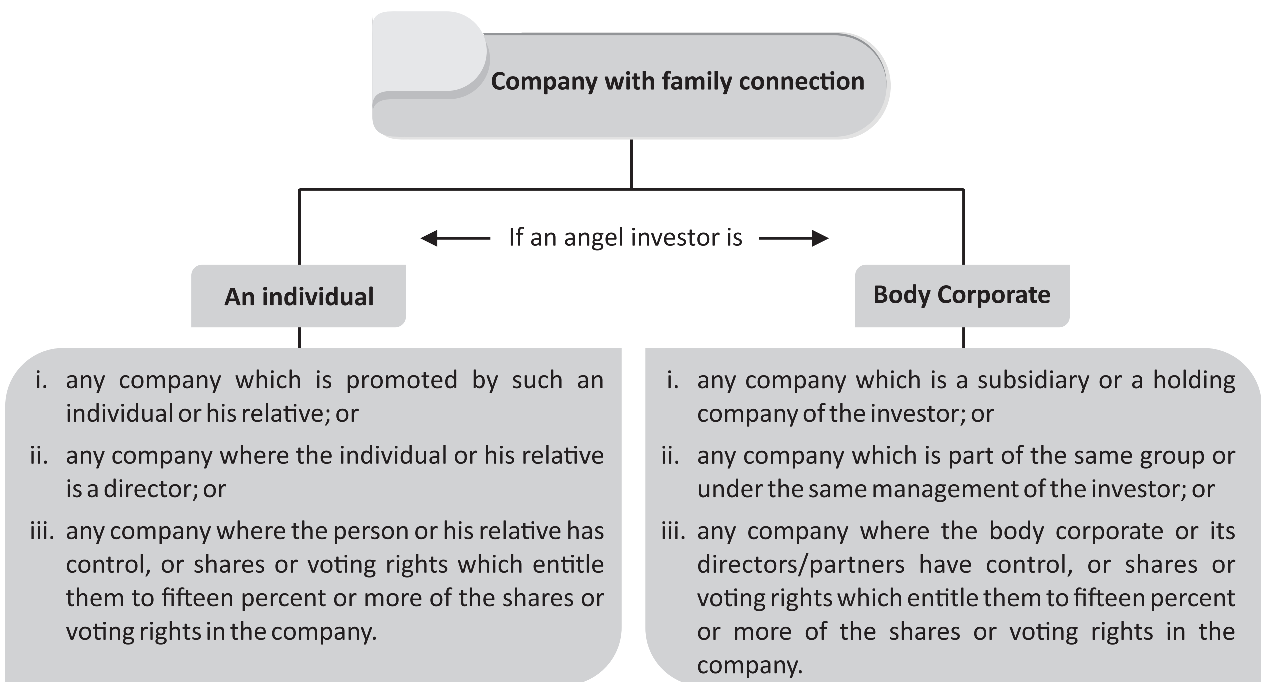
- has early stage investment experience, or
- has experience as a serial entrepreneur, or
- is a senior management professional with at least ten years of experience.

> Early stage investment experience shall mean prior experience in investing in start-up or emerging or early-stage ventures and 'serial entrepreneur' shall mean a person who has promoted or co-promoted more than one start-up venture.

(b) a body corporate with a net worth of at least ten crore rupees; or

(c) an Alternative Investment Fund registered under SEBI AIF Regulations or a Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations, 1996.

Company with family connection



Applicability

The provisions of Chapter III A of the AIF Regulations, 2012 shall apply to angel funds and schemes launched by such angel funds and the other provisions of the AIF Regulations, except clauses (a), (b), (c), (d) and (f) of regulation 10, regulation 12, regulation 14, clauses (a), (c) and (e) of sub-regulation (1) of regulation 15, clause (b) of sub-regulation (1) of regulation 16 and sub-regulation (2) of regulation 16 of the AIF Regulations, and the guidelines and circulars issued under the AIF Regulations unless specifically excluded, shall apply to angel funds and schemes launched by such angel funds, their sponsors and managers and angel investors.

Registration

An applicant may apply for registration as an angel fund in accordance with the registration requirements as specified and an Alternative Investment Fund already registered under the AIF, which has not made any investments, may apply for conversion of its category into an angel fund.

Investment in an Angel Fund

Angel funds shall only raise funds by way of issue of units to angel investors. An angel fund shall have a corpus of at least five crore rupees. Angel funds shall accept, up to a maximum period of five years, an investment of not less than twenty five lakh rupees from an angel investor and such funds shall be raised through private placement by issue of information memorandum or placement memorandum, by whatever name called. However, the provisions of the Companies Act, 2013 shall apply to the Angel Fund, if it is formed as a company.

Schemes

The angel fund may launch schemes subject to filing of a term sheet with SEBI, containing material information regarding the scheme, in the format and time period as may be specified by SEBI.

No scheme of the angel fund shall have more than 200 angel investors.

However, the provisions of the Companies Act, 2013 shall apply to the Angel Fund, if it is formed as a company.

Investment by Angel Funds

(1) Angel funds shall invest in startups which

   a. are not promoted or sponsored by or related to an industrial group whose group turnover exceeds Rs. 300 crore.

   b. for the purpose of this clause, “industrial group” shall include a group of body corporates with the same promoter(s)/promoter group, a parent company and its subsidiaries, a group of body corporates in which the same person/ group of persons exercise control, and a group of body corporates comprised of associates/subsidiaries/holding companies. For the purpose of this clause, “group turnover” shall mean combined total revenue of the industrial group.

   c. are not companies with family connection with any of the angel investors who are investing in the company.

(2) Investment by an angel fund in any venture capital undertaking shall not be less than twenty five lakh rupees and shall not exceed Rs. 10 crore rupees.

(3) Investment by an angel fund in the venture capital undertaking shall be locked-in for a period of one year.

(4) Angel Funds shall not invest in associates.

(5) Angel funds shall not invest more than twenty-five per cent of the total investments under all its schemes in one venture capital undertaking, the compliance of which shall be ensured by the angel fund at the end of its tenure.

(6) An angel fund may also invest in the securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and SEBI from time to time.

Listing

Units of Angel Funds shall not be listed on any recognized stock exchange.

Obligations of Sponsors and Managers of Angel Fund

The manager or sponsor shall have a continuing interest in the angel fund of not less than two and half percent of the corpus or fifty lakh rupees, whichever is lesser, and such interest shall not be through the waiver of management fees.

The manager of the angel fund shall obtain an undertaking from every angel investor proposing to make investment in a venture capital undertaking, confirming his approval for such an investment, prior to making such an investment.

SPECIAL SITUATION FUNDS

"Special situation fund" means a Category 1 Alternative Investment Fund that invests in special situation assets in accordance with its investment objectives and may act as a resolution applicant under the Insolvency and Bankruptcy Code, 2016.

Special situation asset includes,-

(a) stressed loan available for acquisition in terms of Clause 58 of Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 as amended from time to time or as part of a resolution plan approved under the Insolvency and Bankruptcy Code, 2016 or in terms of any other policy of the Reserve Bank of India or Government of India issued in this regard from time to time;

(b) security receipts issued by an Asset Reconstruction Company registered with the Reserve Bank of India;

(c) securities of investee companies,

(i) whose stressed loans are available for acquisition in terms of Clause 58 of the Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 as amended from time to time or as part of a resolution plan approved under the Insolvency and Bankruptcy Code, 2016 or in terms of any other policy of the Reserve Bank of India or Government of India issued in this regard from time to time;

(ii) against whose borrowings, security receipts have been issued by an Asset Reconstruction Company registered with the Reserve Bank of India;

(iii) whose borrowings are subject to corporate insolvency resolution process under Chapter II of the Insolvency and Bankruptcy Code, 2016;

(iv) who have disclosed all the defaults relating to the payment of interest/ repayment of principal amount on loans from banks / financial institutions/ Systemically Important Non-Deposit taking Non-Banking Financial Companies/ Deposit taking Non-Banking Financial Companies and /or listed or unlisted debt securities in terms of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 and such payment default is continuing for a period of at least ninety calendar days after the occurrence of such default.

(d) Any other asset as may be specified by the SEBI from time to time.

Applicability

Chapter III –B of AIF Regulations pertaining to Special Situation Fund shall apply to special situation funds and schemes launched by such special situation funds.

All other provisions of these regulations, except clauses (b) and (c) of regulation 10, clauses (a), (c) and (e) of sub-regulation (1) of regulation 15, clause (a) of sub-regulation (1) of regulation 16 and the guidelines and circulars issued under these regulations, unless the context otherwise requires or is repugnant to the provisions of this Chapter, shall apply to the special situation funds, the schemes of special situation funds and their sponsors and managers.

Registration

An applicant may apply for registration as a special situation fund in accordance with the provisions of Chapter II of these Regulations.

Investment in special situation funds

Each scheme of a special situation fund shall have a corpus as may be specified by the SEBI. The special situation fund shall accept from an investor, an investment of such value as may be specified by the SEBI.

The special situation fund shall not accept investments from any other Alternative Investment Fund other than a special situation fund.

Investment by special situation funds

Special situation funds shall invest only in special situation assets and may act as a resolution applicant under the Insolvency and Bankruptcy Code, 2016. However, the special situation fund shall not invest in,

- its associates; or
- the units of any other Alternative Investment Fund other than the units of a special situation fund; or
- units of special situation funds managed or sponsored by its manager, sponsor or associates of its manager or sponsor.

SEBI, vide its circular dated January 27, 2022, has specified the following with respect to special situation fund:

- Each scheme of SSF shall have a corpus of at least one hundred crore rupees.
- SSF shall accept an investment of value not less than ten crore rupees from an investor. In case of an accredited investor, the SSF shall accept an investment of value not less than five crore rupees. Further, in case of investors who are employees or directors of the SSF or employees or directors of the manager of the SSF, the minimum value of investment shall be twenty-five lakh rupees.
- SSF intending to act as a resolution applicant under the Insolvency and Bankruptcy Code, 2016 shall ensure compliance with the eligibility requirement provided thereunder.

CORPORATE DEBT MARKET DEVELOPMENT FUND

Meaning: Corporate Debt Market Development Fund" means an Alternative Investment Fund set up and making investments in terms of Chapter III-C of these regulations.

Registration: The Corporate Debt Market Development Fund shall apply for registration as an Alternative Investment Fund and constituted in the form of a Trust and the instrument of Trust shall be in the form of a deed duly registered under the provisions of the Indian Registration Act, 1908.

Filing of placement memorandum: The placement memorandum of the Corporate Debt Market Development Fund shall be filed with SEBI and SEBI may communicate its comments, if any, to the Manager prior to the launch of the fund and the Manager shall incorporate the comments in the placement memorandum prior to the launch of the fund.

Tenure: The Corporate Debt Market Development Fund shall be a close ended fund, with a tenure of fifteen years from the date of its first closing. However, the tenure may be extended with the prior approval of the Board.

Winding up: The Corporate Debt Market Development Fund shall be wound up with the prior approval of the Board.

Investment in the Corporate Debt Market Development Fund

The units of the Corporate Debt Market Development Fund shall be offered to the Asset Management Companies as defined under the SEBI (Mutual Funds) Regulations, 1996 and the specified debt-oriented schemes of mutual funds.

The Manager or Sponsor shall have a continuing interest in the Corporate Debt Market Development Fund of not less than five crore rupees in the form of investment in the fund but such continuing interest shall not be through the waiver of management fees.

Investment conditions for the Corporate Debt Market Development Fund

1. During periods of market dislocation, the Corporate Debt Market Development Fund shall purchase corporate debt securities from the specified debt-oriented schemes of mutual funds which meet the following eligibility criteria:

   (a) corporate debt securities shall be listed and have an investment grade rating;

   (b) the residual maturity of such securities shall not exceed five years on the date of purchase;

   (c) securities where there is no material possibility of default or adverse credit news or views.

2. The Corporate Debt Market Development Fund shall purchase corporate debt securities in proportion to the contribution made in it at a mutual fund level and in accordance with detailed guidelines as may be approved by the SEBI.

3. The Corporate Debt Market Development Fund shall hold eligible securities, till maturity or sell the same in the secondary market upon reversal of market dislocation, in the manner as specified by the SEBI from time to time.

4. Other than market dislocation period, the Corporate Debt Market Development Fund shall invest in liquid and low-risk debt instruments and undertake any other activity related to corporate debt market, as may be specified by the SEBI from time to time.

5. The Corporate Debt Market Development Fund shall buy corporate debt securities at fair price adjusted for liquidity risk, interest rate risk and credit risk but not at distress prices.

6. The sharing of loss by the sellers of corporate debt securities to the Corporate Debt Market Development Fund during periods of market dislocation may be higher than their pro rata holding in the Alternative Investment Fund vis-à-vis other unit holders.

7. The Corporate Debt Market Development Fund shall not invest in the securities of companies incorporated outside India.

8. Investment by the Corporate Debt Market Development Fund in any one investee company shall not exceed five percent of its fund capital at the time of investment. However, the combined investment in the corporate debt securities of an issuer group as specified under the SEBI (Mutual Funds) Regulations, 1996 shall not exceed seven and half percent of its fund capital at the time of investment.

9. The Corporate Debt Market Development Fund may borrow funds up to ten times its corpus, subject to such conditions as may be specified by the Board in consultation with the Government of India.

10. The valuation procedure and methodology for valuing assets of the Corporate Debt Market Development Fund shall be governed by the norms applicable to Mutual Fund schemes under the SEBI (Mutual Funds) Regulations, 1996.

11. In-specie distribution of assets of the Corporate Debt Market Development Fund may be made to the unit holders, only at the time of winding up subject to the consent of seventy-five percent of the unit holders by value of their investment in such fund.

12. Any material alteration to the investment strategy of the Corporate Debt Market Development Fund shall be with the prior approval of the SEBI.

Disclosures

The portfolio of the Corporate Debt Market Development Fund shall be disclosed to the unitholders on a fortnightly basis. The Net Asset Value of the Corporate Debt Market Development Fund shall be disclosed to the unitholders on a daily basis.

Governance Mechanism for the Corporate Debt Market Development Fund

- The Corporate Debt Market Development Fund shall appoint a trustee company.
- The Board of directors of trustee company and the Manager of the Corporate Debt Market Development Fund shall be appointed with the prior approval of the SEBI.
- The roles and responsibilities of the trustee company shall be similar to the roles and responsibilities assigned to trustees under the SEBI (Mutual Funds) Regulations, 1996.
- The trustee company of the Corporate Debt Market Development Fund shall not engage in any activity other than acting as a trustee of the Corporate Debt Market Development Fund, except with the prior written consent of the SEBI.
- Two-thirds of the members of the board of directors of the trustee company shall be independent directors and shall not be associated with the Sponsor or the Manager in any manner whatsoever.
- No person shall initially or any time thereafter be appointed as a director of the trustee company of the Corporate Debt Market Development Fund without the prior approval of the Board.
- An audit committee of the trustee company shall be constituted to review compliance with the provisions of placement memorandum as required under these regulations along with other responsibilities as may be specified by the Board from time to time.
- The manager of the Corporate Debt Market Development Fund shall appoint a Governance Committee.

- The Governance Committee shall comprise corporate bond market experts including academicians, fund managers or Chief Investment Officers, risk management professionals and independent market experts.
- The Governance Committee, jointly with the board of the Manager and trustee company, shall approve the policies of the Corporate Debt Market Development Fund.
- The Governance Committee shall supervise the activities of the Corporate Debt Market Development Fund, especially relating to management of conflict of interest, if any.
- The Governance Committee shall have oversight on management of asset liability mismatches during times of market dislocation.

Listing

The units of the Corporate Debt Market Development Fund shall not be listed on any recognised stock exchange.

Grievance Redressal Mechanism

The Manager shall redress investor grievances promptly but not later than twenty-one calendar days from the date of receipt of the grievance and in such manner as may be specified by the SEBI.

SEBI may also recognize a body corporate for handling and monitoring the process of grievance redressal within such time and in such manner as may be specified.

Dispute Resolution

All claims, differences or disputes between investors and the Alternative Investment Fund or the Manager arising out of or in relation to the activities of the Alternative Investment Fund or the Manager in the securities market shall be submitted to a dispute resolution mechanism that includes mediation and/or conciliation and/or arbitration, in accordance with the procedure specified by the SEBI.

If the Alternative Investment Fund has been established as a trust, then no loss or damage or expenses incurred by the Manager or officers of the Manager, including those in relation to resolution of claims or disputes of investors, shall be met out of the trust property.

GENERAL OBLIGATIONS AND RESPONSIBILITIES AND TRANSPARENCY

Reporting of investment activities by AIFs

In accordance with the AIF Regulations, SEBI may at any time call upon the Alternative Investment Fund to file such reports, as the SEBI may desire, with respect to the activities carried on by the Alternative Investment Fund. In this regard, the following reporting requirement is specified:

- All AIFs shall submit report on their activity as an AIF to SEBI on quarterly basis within 10 calendar days from the end of each quarter in the specified formats. Further, Category III AIFs shall also submit report on leverage undertaken, on quarterly basis in the specified formats.
- AIFs shall submit these reports online through SEBI intermediary Portal.

Term Sheet - Angel Funds

Angel funds may launch schemes subject to filing of a Term Sheet in the format as specified.

Such Term Sheet shall contain material information regarding the scheme and shall be filed with the SEBI within 10 days of launching the scheme.

Question: How can the investors redress their complaints against AIFs?

Answer: SEBI has a web based centralized grievance redress system called SEBI Complaint Redress System (SCORES) at http://scores.gov.in where investors can lodge their complaints against AIFs.

Further, in terms of the AIF Regulations, for dispute resolution, the AIF by itself or through the Manager or Sponsor, is required to lay down procedure for resolution of disputes between the investors, AIF, Manager or Sponsor through arbitration or any such mechanism as mutually decided between the investors and the AIF.

Compliance Test Report (CTR)

a. At end of financial year, the manager of an AIF shall prepare a compliance test report on compliance with AIF Regulations and circulars issued thereunder in the specified format.

b. In case the AIF is a trust, the CTR shall be submitted to the trustee and sponsor within 30 days from the end of the financial year. In case of other AIFs, the CTR shall be submitted to the sponsor within 30 days from the end of the financial year.

c. In case of any observations/comments on the CTR, the trustee/sponsor shall intimate the same to the manager within 30 days from the receipt of the CTR. Within 15 days from the date of receipt of such observations/comments, the manager shall make necessary changes in the CTR, as may be required, and submit its reply to the trustee/sponsor.

d. In case any violation of AIF Regulations or circulars issued thereunder is observed by the trustee/sponsor, the same shall be intimated to SEBI as soon as possible.

Maintenance of Records

The Manager or Sponsor shall be required to maintain following records describing :-

(a) the assets under the scheme/fund;

(b) valuation policies and practices;

(c) investment strategies;

(d) particulars of investors and their contribution;

(e) rationale for investments made.

The records shall be maintained for a period of five years after the winding up of the fund.

OPERATIONAL AND PRUDENTIAL NORMS FOR ALTERNATIVE INVESTMENT FUNDS (AIFs)

Risk Management and Compliance: All Category III AIFs which employ leverage shall have a comprehensive risk management framework supported by an independent risk management function and have a strong and independent compliance function, appropriate to the size, complexity and risk profile of the fund. Also Category III AIFs are required to maintain appropriate records of the trades/transactions performed and such information should be available to SEBI, whenever sought and provide full disclosure and transparency about conflicts of interest and how they manage them from time to time to investors in accordance with the AIF Regulations. Such conflicts shall be disclosed to the investors in the placement memorandum and by separate correspondences as and when such conflicts may arise. Such information shall also be disclosed to SEBI as and when required by SEBI.

Redemption norms: These norms shall apply to open ended Category III AIFs for all their existing and new schemes. The Manager of such AIFs shall ensure adequate and sufficient degree of liquidity of the scheme/ fund in order to allow it, in general, to meet redemption obligations and other liabilities. The Manager shall establish, implement and maintain an appropriate liquidity management policy and process to ensure that the liquidity of the various underlying assets is consistent with the overall liquidity profile of the fund/scheme while making any investment.

Prudential requirements: All Category III AIFs which undertake leverage, whether through investment in derivatives or by borrowing or by any other means shall comply with the prudential requirements.

For the purpose of arriving at leverage undertaken by an AIF, leverage shall be calculated as the ratio of the exposure to the Net Asset Value of the AIF. Leverage shall be calculated as under:

$$\text{Leverage} = \frac{\text{Total exposure \{Longs+Shorts (after offsetting as permitted)\}}}{\text{Net Asset Value (NAV)}}$$

The leverage of a Category III AIF shall not exceed 2 times of the NAV of the fund. i.e. If an AIF's NAV is Rs. 100 crore, its exposure (Longs+shorts) after offsetting positions as permitted shall not exceed Rs. 200 crore.

SEED FUNDING

Seed funding, taken from the word "seed" is the capital needed to start/expand your business. It often comes from the company founders' personal assets, from friends and family or other investors. The amount of money is usually relatively small because the business is still in the idea or conceptual stage.

This type of funding is often obtained in exchange for an equity stake in the enterprise, although with less formal contractual overhead than standard equity financing.

Lenders often view seed capital as a risky investment by the promoters of a new venture, which represents a meaningful and tangible commitment on their part to making the business a success.

This would be a type of Venture Capital Funding and hence covered under the provisions of Angel Funding in the AIF Regulations.

PRIVATE EQUITY

Private equity is a type of equity (finance) and one of the asset classes that are not publicly traded on a stock exchange. Private equity is essentially a way to invest in some assets that is not publicly traded, or to invest in a publicly traded asset with the intention of taking it private. Unlike stocks, mutual funds, and bonds, private equity funds usually invest in more illiquid assets, i.e. companies. By purchasing companies, the firms gain access to those assets and revenue sources of the company, which can lead to very high returns on investments. Another feature of private equity transactions is their extensive use of debt in the form of high-yield bonds. By using debt to finance acquisitions, private equity firms can substantially increase their financial returns.

Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet. The major of private equity consists of institutional investors and accredited investors who can commit large sums of money for long periods of time.

Private equity investments often demand long holding periods to allow for a turnaround of a distressed company or a liquidity event such as IPO or sale to a public company. Generally, the private equity fund raise money from investors like Angel investors, Institutions with diversified investment portfolio like – pension funds, insurance companies, banks, funds of funds etc.

Types of Private Equity

Private equity investments can be divided into the following categories:

Leveraged Buyout (LBO): This refers to a strategy of making equity investments as part of a transaction in which a company, business unit or business assets is acquired from the current shareholders typically with the use of financial leverage. The companies involved in these type of transactions that are typically more mature and generate operating cash flows.

Venture Capital: It is a broad sub-category of private equity that refers to equity investments made, typically in less mature companies, for the launch, early development, or expansion of a business.

Growth Capital: This refers to equity investments, mostly minority investments, in the companies that are looking for capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business.

VENTURE CAPITAL

Venture Capital is one of the innovative financing resource for a company in which the promoter has to give up some level of ownership and control of business in exchange for capital for a limited period, say, 3-5 years.

A venture capital company is a group of investors who pool investments focused within certain parameters. The participants in venture capital firms can be institutional investors like pension funds, insurance companies, foundations, corporations or individuals.

Venture Capital is generally equity investments made by venture capital funds, at an early stage in privately held companies, having potential to provide a high rate of return on their investments. It is a resource for supporting innovation, knowledge based ideas and technology and human capital intensive enterprises.

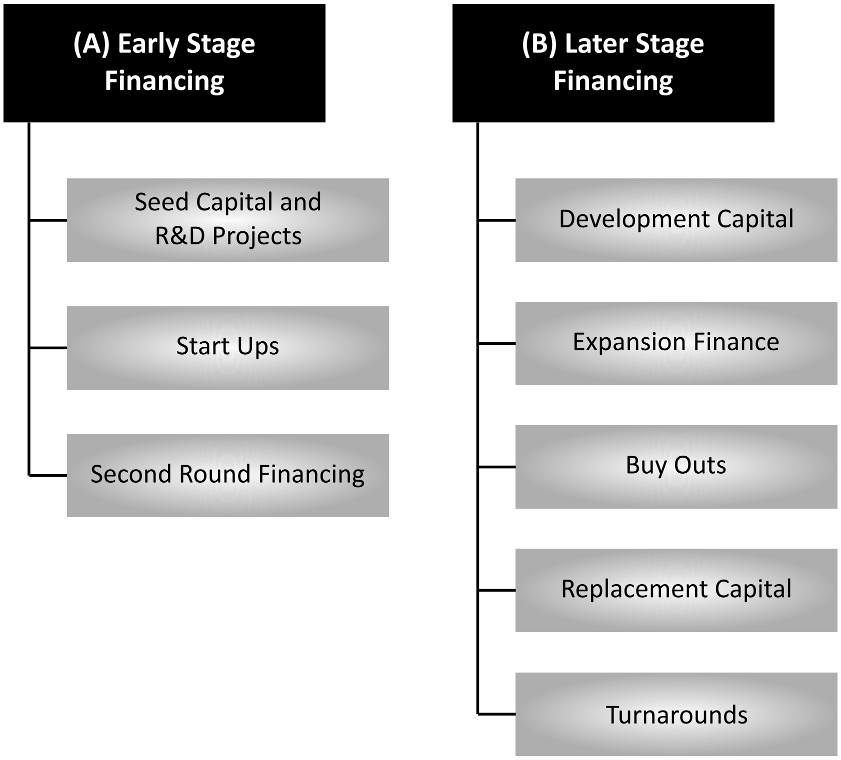
Unlike banks, which seek their return through interest payments, venture firms seek for capital appreciation. Generally, venture capital firms look for a return of five to ten times the original investment.

Areas of Investment

Different venture groups prefer different types of investments. Some specialize in seed capital and early expansion while others focus on exit financing. Biotechnology, medical services, communications, electronic components and software companies seem to be the most likely attraction of may venture firms and receiving the most financing. Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability.

In India, software sector has been attracting a lot of venture finance. Besides media, health and pharmaceuticals, agri-business and retailing are the other areas that are favored by a lot of venture companies.

Stages of Investment Financing



Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability. Venture capital firms usually recognise the following two main stages when the investment could be made in a venture namely:

A. Early Stage Financing

I. ***Seed Capital and R&D Projects:*** Venture capitalists are more often interested in providing seed finance i. e. making provision of very small amounts for finance needed to turn into a business. Research and Development activities are required to be undertaken before a product is to be launched. External finance is often required by the entrepreneur during the development of the product. The financial risk increases progressively as the research phase moves into the development phase, where a sample of the product is tested before it is finally commercialised venture capitalists/firms/funds are always ready to undertake risks and make investments in such R & D projects promising higher returns in future.

II. ***Start Ups:*** The most risky aspect of venture capital is the launch of a new business after the Research and Development activities are over. At this stage, the entrepreneur and his products or services are still not tried and rested in the market forces. The finance required usually falls short of his own resources. Start-ups may include new industries/businesses set up by the experienced persons in the area in which they have knowledge, specialization and proficiency. Others may result from the research bodies or large corporations, where a venture capitalist joins with an industrially experienced or corporate partner.

III. ***Second Round Financing:*** It refers to the stage when product has already been launched in the market but has not earned enough profits to attract new investors. Additional funds are needed at this stage to meet the growing needs of business. Venture Capital Institutions (VCIs) provide larger funds at this stage than at other early stage financing in the form of debt. The time scale of investment is usually three to seven years.

B. Later Stage Financing

Those established businesses which require additional financial support but cannot raise capital through public issue approach venture capital funds for financing expansion, buyouts and turnarounds or for development capital. This is known as later stage financing. It includes the following:

I. ***Development Capital:*** It refers to the financing of an enterprise which has overcome the highly risky stage and have recorded profits but cannot go public, thus needs financial support. Funds are needed for the purchase of new equipment/plant, expansion of marketing and distributing facilities, launching of product into new regions and so on. The time scale of investment is usually one to three years and falls in medium risk category.

II. ***Expansion Finance:*** Venture capitalists perceive low risk in ventures requiring finance for expansion purposes either by growth implying bigger factory, large warehouse, new factories, new products or new markets or through purchase of existing businesses. The time frame of investment is usually from one to three years. It represents the last round of financing before a planned exit.

III. ***Buy Outs:*** It refers to the transfer of management control by creating a separate business by separating it from their existing owners. It may be of two types.

i. **Management Buyouts (MBOs):** In Management Buyouts (MBOs) venture capital institutions provide funds to enable the current operating management/investors to acquire an existing product line/ business. They represent an important part of the activity of VCIs.

ii. **Management Buy-ins (MBIs):** Management Buy-ins are funds provided to enable an outside group of manager(s) to buy an existing company. It involves three parties: a management team, a target company and an investor (i.e. Venture Capital Institution). MBIs are more risky than MBOs and hence are less popular because it is difficult for new management to assess the actual potential of the target company. Usually, MBIs are able to target the weaker or under-performing companies.

IV. ***Replacement Capital:*** VCIs another aspect of financing is to provide funds for the purchase of existing shares of owners. This may be due to a variety of reasons including personal need of finance, conflict in the family, or need for association of a well-known name. The time scale of investment is one to three years and involve low risk.

V. ***Turnarounds:*** Such form of venture capital financing involves medium to high risk on a time scale of three to five years. It involves buying the control of a sick company which requires specialised skills in finance. It may require rescheduling of company's all the borrowings, change in management or even a change in ownership.

An active "hands on" approach is required in the initial crisis period where the venture capitalists may appoint its own chairman or nominate its directors on the board.

FOREIGN VENTURE CAPITAL INVESTORS

Foreign Venture Capital Investor (FVCI) means an investor incorporated and established outside India, which proposes to make investment in venture capital fund(s) or venture capital undertakings in India and is registered under the SEBI (Foreign Venture Capital Investors) Regulations, 2000.

Registration

All FVCIs, must get themselves registered with SEBI.

Investment Conditions

All investments to be made by a FVCI should be subject to the following conditions:

(a) it should disclose to SEBI its investment strategy.

(b) it can invest its total funds committed in one venture capital fund or alternative investment fund.

(c) it shall make investments as enumerated below:

(i) atleast 66.67% of the investible funds should be invested in unlisted equity shares or equity linked instruments of venture capital undertaking or investee company.

(ii) not more than 33.33% of the investible funds may be invested by way of:

(a) subscription to initial public offer of a venture capital undertaking or investee company whose shares are proposed to be listed;

(b) debt or debt instrument of a venture capital undertaking or investee company in which the foreign venture capital investor has already made an investment by way of equity;

(c) preferential allotment of equity shares of a listed company subject to lock in period of one year;

(d) It shall disclose the duration of life cycle of the fund;

(e) Special Purpose Vehicles which are created for the purpose of facilitating or promoting investment in accordance with the FVCI Regulations.

The investment conditions and restrictions stipulated, above shall be achieved by the Foreign Venture Capital Investor by the end of its life cycle.

Maintenance of books and Records

Every Foreign Venture Capital Investor is required to maintain for a period of eight years, books of accounts, records and documents which should give a true and fair picture of the state of affairs of the Foreign Venture Capital Investor. Every Foreign Venture Capital Investor should intimate to SEBI, in writing, the place where the books, records and documents are being maintained.

General Obligations

Foreign Venture Capital Investor or a global custodian acting on behalf of the foreign venture capital investor should enter into an agreement with the domestic custodian to act as a custodian of securities for Foreign Venture Capital Investor.

Foreign Venture Capital Investor should ensure that domestic custodian takes steps for:

- monitoring of investment of Foreign Venture Capital Investors in India;
- furnishing of periodic reports to SEBI; and
- furnishing such information as may be called for by SEBI.

Foreign Venture Capital Investor is required to appoint a branch of a bank approved by Reserve Bank of India as designated bank for opening of foreign currency denominated accounts or special non-resident rupee account.

PROCESS AND DOCUMENTATION REQUIRED FOR LISTING AND TRADING ALTERNATIVE INVESTMENT FUND ON STOCK EXCHANGE

Process

Documentation

A. List of documents to be submitted for seeking In-principle approval for listing units of AIF scheme Certified true copy of the following agreements/documents:

- Draft Information/Placement memorandum. Hard as well as soft copy
- Investment Management Agreement. (In case of 1st Listing)
- Certification of registration of Alternative Investment Fund issued by SEBI. (In case of 1st Listing)
- Custodian Agreement. (In case of 1st Listing)
- R & T Agreement. (In case of 1st Listing)
- Trust Deed (if applicable)
- Memorandum & Articles of Association of the issuer. (in case of 1st listing)
- Resolution passed by trustee in case of AIF is established as trust or board of directors in case AIF is established as Company or by partners in case AIF is established as a Limited Liability partnership at their meeting approving listing of units of close ended AIF on the BSE Ltd.
- An undertaking from the CEO/compliance officer that AIF is in compliance with SEBI (Alternative Investment Funds) Regulations, 2012 as amended and all the other applicable laws.

Note: The Stock Exchange may ask for documents other than those mentioned above.

B. List of documents to be submitted for Listing of units of AIF (Post allotment of units)

Certified true copy of the following agreements/documents:

- Letter of Application for listing of units of Scheme.
- Details of the applicant (In case of 1st Issue/Listing) and Issue Details.
- Certified True Copy of observations/comments received from SEBI on the/placement Memorandum/ Scheme Information Document (SID).
- Certified true copy of the Final Placement Memorandum/Scheme Information Document (SID) (soft copy also required).

- Unit holding pattern of Unit holders of the Scheme.

Scheme Name	Option	Mode of Issue	ISIN	Symbol	Date of allotment	Number of Units	Face Value	Issue Price	Date of Redemption
				Grand Total No. of Units					

- Confirmation from the CEO/Compliance officer regarding allotment of units and the actual no. of units allotted.
- Statement of Collection details.
- Listing Agreement (In case of 1st Listing) as per SEBI LODR Regulations.
- Confirmation from CEO/Compliance officer regarding compliance with the provisions of Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 including subsequent amendments thereof and SEBI circulars issued in this respect.
- Confirmation from NSDL and CDSL (ISIN activation).
- Confirmation from RTA on the final number of units to be allotted with NSDL, to be allotted with CDSL and to be issued under physical form.
- Undertaking from the RTA on the units considered under switches that they have debited the units from the respective schemes and credited the applicable units in this scheme (if applicable).
- Confirmation received from NSDL/CDSL for credit.
- Confirmation from RTA regarding dispatch of Certificates/Account statement/refund order.
- Annual listing fees plus Applicable Taxes.

Note: The Stock Exchange may ask for documents other than those mentioned above.

GUIDELINES ON DISCLOSURES, REPORTING AND CLARIFICATIONS UNDER THE AIF REGULATIONS

SEBI has provided certain clarifications on the AIF Regulations in order to increase transparency to the investors by issuing guidelines on this behalf.

SEBI has prescribed that Category III AIFs should report to the custodian the amount of leverage at the end of the day (based on closing prices) by the end of next working day. SEBI has further clarified that AIFs should include in the placement memorandum detailed disclosures of the fees and charges as applicable to the investors and disciplinary history of the AIFs, sponsors, managers, their directors/partners/promoters and associates etc.

All AIFs shall intimate any changes to the placement memorandum to all investors within 1 month of making such change. Such change shall also be intimated to SEBI.

In case of changes to the placement memorandum which significantly influences the decision of the investor to continue to be invested in the AIF, the following process should be followed by the AIF:

(1) Existing unit holders who do not wish to continue after the change should be provided an exit option.

(2) If the scheme of the AIF is open ended, the exit option can be provided by either of the following:

- – Buying out of units of the dissenting investors by the manger/ someone else arranged by the manager, valuation of which should be based on market price of underlying assets.

- Redemption of units of the investors through sale of underlying assets.

(3) If the scheme of the AIF is close ended, the exit option can be provided as follows :

- Buying out of units of the dissenting investors by the manger/someone else arranged by the manager.
- Prior to buying out of such units, valuation of those units should be undertaken by 2 independent valuers and exit should be at a value at least as large as average of the two valuations.
- The trustee of AIF (in case AIF is a trust) or sponsor (in case of any other AIF) should be responsible for overseeing the process.

Moreover, all guidelines that are issued by SEBI with respect to KYC requirements, Anti-Money laundering and outsourcing of activities should be applicable to AIFs and the manager of the AIF should be responsible for complying with such guidelines.

LESSON ROUND-UP

- SEBI had earlier framed the SEBI (Venture Capital Funds) Regulations, 1996 ("VCF Regulations") to encourage investments into start-ups and mid-size companies.
- SEBI notified the Alternative Investment Fund (AIF) Regulations to govern unregulated entities and create a level playing ground for existing venture capital investors.
- The AIF Regulations has replaced the existing SEBI (Venture Capital Funds) Regulations, 1996 funds registered under the VCF Regulations shall continue to be regulated by the said regulations till the existing fund or scheme is wound up.
- SEBI has classified AIF into three broad categories i.e., Category I, Category II, Category III.
- All AIFs are required to be mandatorily registered under any one of the III categories as specified by SEBI.
- Alternative Investment Fund shall raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called.
- Listing of Alternative Investment Fund units shall be permitted only after final close of the fund or scheme.
- SEBI has notified a separate set of provisions for Angel Funds and Special Situation Funds.
- Units of angel funds shall not be listed on any recognised stock exchange.
- Seed Funding is a type of Venture Capital Funding and hence covered under the provisions of Angel Funding in the AIF Regulations.
- Private equity is essentially a way to invest in some assets that is not publicly traded, or to invest in a publicly traded asset with the intention of taking it private. Unlike stocks, mutual funds, and bonds, private equity funds usually invest in more illiquid assets, i.e. companies.
- Venture Capital is one of the innovative financing resource for a company in which the promoter has to give up some level of ownership and control of business in exchange for capital for a limited period, say, 3-5 years.
- Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability.

- Foreign Venture Capital Investor (FVCI) means an investor incorporated and established outside India, which proposes to make investment in venture capital fund(s) or venture capital undertakings in India and is registered under the SEBI (Foreign Venture Capital Investors) Regulations, 2000.

GLOSSARY

Buyout: A sector of the private equity industry. Also, the purchase of a controlling interest of a company by an outside investor or a management team.

Corpus: It means the total amount of funds committed by investors to the Alternative Investment Fund by way of a written contract or any such document as on a particular date.

Investee Company: It means any company, special purpose vehicle or limited liability partnership or body corporate in which an AIF makes an investment.

Manager: Manager means any person or entity who is appointed by the AIF to manage its investment by whatever name called and may also be same as the sponsor of the fund.

Unit: Unit means beneficial interest of the investors the AIF or a scheme of the AIF and may be fully or partly paid up.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What is an Alternative Investment Fund?
2. Which categories of Alternative Investment Funds (AIF) are available for the investors to make investment? Explain.
3. Explain the provisions relating to "Special Situation Fund (SSF)" in view of requirement with regard to minimum corpus funds for each scheme of SSF and minimum investment required by different types of investors of SSF.
4. What is placement memorandum? Discuss briefly the contents of placement Memorandum.
5. Explain the provisions with regard to an Angel Fund. Whether investment by Angel Funds are restricted by any specific guidelines?
6. What do you understand by private equity? Discuss about different categories of private equity.
7. Discuss the concepts "Seed funding" and "Private Equity".
8. "Venture capital firms, finance both early and later stage investments to maintain a balance between risk and profitability." Explain early stage financing.

LIST OF FURTHER READINGS

- FAQs on SEBI (Alternative Investment Fund) Regulations, 2012 are available at https://www.sebi.gov.in/sebi_data/attachdocs/1471519155273.pdf
- Guidelines on disclosures, reporting and clarifications under AIF Regulations are available at https://www. sebi.gov.in/legal/circulars/jun-2014/guidelines-on-disclosures-reporting-and-clarifications-under-aif- regulations_27118.html

Raising of Funds – Non Fund Based

Lesson 12

KEY CONCEPTS

■ Bonus Issue ■ Employee Stock Option Schemes ■ Employee Stock Purchase Schemes ■ Stock Appreciation Rights Schemes ■ General Employee Benefits Schemes ■ Retirement Benefit Schemes ■ Sweat Equity Shares ■ Relevant Date ■ Intellectual Property Rights

Learning Objectives

To understand:

- Concepts related to bonus shares, sweat equity shares and various share based employee benefit schemes
- Provisions relating to bonus shares, sweat equity shares and various share based employee benefit schemes
- Various compliances required to be fulfilled from time to time by a company with respect to bonus shares, sweat equity shares and share based employee benefit schemes

Lesson Outline

- Bonus Issues
  - Provisions pertaining to Bonus Issue under the Companies Act, 2013, SEBI (ICDR) Regulations, 2018, SEBI (LODR) Regulations, 2015
  - Check Points and Procedure for Issue of Bonus Shares
- SEBI (Shares Based Employee Benefits and Sweat Equity) Regulations, 2021
  - Applicability
  - Non-Applicability
  - Important Definitions
  - Schemes – Implementation and Process
- Administration of Specific Scheme
- Provisions pertaining to ESOP/ESPS under the SEBI (LODR) Regulations, 2015
- ESPS/ESOS/SARS/GEBS/RBS – Pre Issue and Post Issue Formalities
- Procedure for issuing ESOP by a Listed Company
- Issue of Sweat Equity Shares
- Provisions pertaining to Sweat Equity Shares under the Companies, 2013 and SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021
- Check Points and Procedure for Issuance of Sweat Equity Shares
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021
- Relevant Provisions of the Companies Act, 2013
- Relevant Provisions of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
- Relevant Provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

BONUS ISSUE

Factors to the success of any company is its ability to draw investors to be with the company by issuing various incentives like dividends and bonus shares to them. When an issuer makes an issue of shares to its existing shareholders without any consideration based on the number of shares already held by them as on a record date it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium account in a particular ratio to the number of securities held on a record date.

Bonus shares are additional shares issued by a company to its existing shareholders for free, based on a ratio of the shares already owned by them. By issuing bonus shares, the number of shares outstanding increases; but while the distribution is made according to the ratio decided by the company, the individual shareholding stake does not change.

A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. They are given free. The vesting of the rights in the bonus shares takes place when the shares are actually allotted and not from any earlier date.

When a company has accumulated free reserves and is desirous of bridging the gap between the capital and fixed assets, it issues bonus shares to its equity shareholders. Such an issue would not place any fresh funds in the hands of the company. On the contrary, after a bonus issue it would become necessary for the company to earn more to effectively service the increased capital. The shareholder will, however, be benefitted by way of increased return on investment and increased number of shares in their hands.

Advantages of Issuing Bonus Shares

1. Fund flow is not affected adversely.
2. Market value of the Company's shares comes down to their nominal value by issue of bonus shares.
3. Market value of the members' shareholdings increases with the increase in number of shares in the company.
4. Bonus shares is not an income. Hence, it is not a taxable income.
5. Paid-up share capital increases with the issue of bonus shares.

A. Provisions pertaining to Bonus Issue under the Companies Act, 2013

According to section 63(1), a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of —

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account.

Bonus shares shall not be made by capitalizing reserves created by the revaluation of assets.

Conditions for issue of Bonus Shares

In terms of section 63(2) of the Companies Act, 2013, company shall not capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless-

(a) It is authorised by its articles;

(b) It has been authorized by the shareholders in a general meeting of the company, on the recommendation of the Board of Directors;

(c) It has not defaulted in the payment of interest or principal in respect of fixed deposits or debt securities, if any issued by it;

(d) It has not defaulted in respect of the payment of statutory dues of the employees, such as contribution to provident fund, gratuity and bonus;

(e) The partly paid up shares, if any outstanding on the date of allotment have been made fully paid up.

No Bonus shares in lieu of dividend [Section 63(3)]

The bonus shares shall not be issued in lieu of dividend.

According to Rule 14 of the Companies (Share Capital and Debentures) Rules, 2014, the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

B. Provisions pertaining to Bonus Issue under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018

SEBI has issued regulations for Bonus Issue which are contained in Chapter XI of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 with regard to bonus issues by listed companies.

1. Eligibility [Regulation 293]

Subject to the provisions of the Companies Act, 2013 or any other applicable law, a listed issuer shall be eligible to announce its bonus issue and issue bonus shares to its members if:

- It is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc. However, if there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve.
- It has received approval from the stock exchanges for listing and trading of all securities. excluding options granted to employees pursuant to an employee stock option scheme and convertible securities issued by the issuer prior to the issuance of bonus shares.
- It has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
- It has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus.
- Any outstanding partly paid shares on the date of the allotment of the bonus shares, are made fully paid-up.
- Any of its promoters or directors is not a fugitive economic offender.

2. Rights of Fully or Partly Compulsorily Convertible Debt Instruments Holders

An issuer shall make a bonus issue of equity shares only if it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments if any, in proportion to the convertible part thereof i.e. the proposed bonus issue should not dilute the value or rights of the fully or partly convertible debentures.

The equity shares so reserved for the holders of fully or partly compulsorily convertible debt instruments, shall be issued to the holder of such convertible debt instruments or warrants at the time of conversion of such convertible debt instruments, optionally convertible instruments, warrants, as the case may be, on the same terms or same proportion at which the bonus shares were issued.

3. Bonus out of Free Reserves

Bonus issue shall be made only out of free reserves, securities premium account or capital redemption reserve account and built out of the genuine profits or securities premium collected in cash and reserves created by revaluation of fixed assets shall not be capitalised for this purpose.

4. Bonus issues not to be in lieu of Dividend

The bonus share shall not be issued in lieu of dividend.

If an issuer has issued SR equity shares to its promoters or founders, any bonus issue on the SR equity shares shall carry the same ratio of voting rights compared to ordinary shares and the SR equity shares issued in a bonus issue shall also be converted to equity shares having voting rights same as that of ordinary equity shares along with existing SR equity shares.

5. Bonus issue in Dematerialised Forms

The allotment of shares in a bonus issue shall be made only in the dematerialised form.

6. Implementation of Proposal

An issuer, announcing a bonus issue after approval by its board of directors and not requiring shareholders' approval for capitalization of profits or reserves for making the bonus issue, shall implement the bonus issue within 15 days from the date of approval of the issue by its Board of Directors.

However, where the issuer is required to seek shareholders' approval for capitalization of profits or reserves for making the bonus issue, the bonus issue shall be implemented within 2 months from the date of the meeting of its Board of Directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

> It may be noted that SEBI has prescribed per day fine if the bonus issue is not completed within the above- mentioned timeline of fifteen days / two months.

Explanation : For the purpose of a bonus issue by a listed entity to be considered as 'implemented' the date of commencement of trading shall be considered.

A bonus issue, once announced, shall not be withdrawn.

Examples:

1. Mr. X holds 300 shares of ABC Ltd. which declares 1:1 bonus that is for every one share, he gets 1 share for free. That is total 300 shares for free and his total holding will increase to 600 shares.
2. Mr. X holds 300 shares of ABC Ltd. which declares 4:1 bonus that is for every one share, he gets 4 shares for free. That is total 1200 shares for free and his total holding will increase to 1500 shares.
3. Mr. X holds 400 shares of ABC Ltd. which declares 1:4 bonus that is for every four shares, he gets 1 share for free. That is total 100 shares for free and his total holding will increase to 500 shares.

C. Provisions pertaining to Bonus Issue under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

Prior Intimation: As per Regulation 29 of the SEBI (LODR) Regulations, 2015, the listed entity shall give prior intimation to stock exchange about the meeting of the Board of Directors in which the proposal for declaration of bonus securities is due to be considered. The said intimation is required to be given at least two working days in advance, excluding the date of the intimation and date of the meeting.

Record Date: As per Regulation 42 of the SEBI (LODR), 2015, the listed entity shall intimate the record date for issue of bonus shares to all the stock exchange(s) where it is listed or where stock derivatives are available on the stock of the listed entity or where listed entity's stock form part of an index on which derivatives are available.

Disclosure of events or information: As per Regulation 30 of the SEBI (LODR), 2015, the listed entity shall disclose to the Exchange(s), within 30 minutes of the closure of the meeting, held to consider the increase in capital by issue of bonus shares through capitalization including the date on which such bonus shares shall be credited/dispatched.

CHECK POINTS FOR ISSUANCE OF BONUS SHARE

Before issuance of Bonus Shares, followings points must be ensured:

1. Check, if there is a provision in the Articles of Associations (AoA) permitting issue of bonus shares by capitalization of reserves, etc. If there is no such provision, alter the AoA to permit the issuance of bonus shares. Passing a resolution at the company's general body meeting making provisions in the AoA for capitalization of reserve.
2. Check and ensure that the expanded capital after the issue is within the authorised share capital of the company. Otherwise, complete the proceedings by increasing the Authorised Capital suitably.
3. Check that it has received approval from the stock exchange for listing.
4. Check that there is no default in payment of interest or principal in respect of: (i) fixed deposits or (ii) debt securities issued by company.
5. Check and ensure that there is no default in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.
6. In case the share capital of the company consists of any partly paid-up shares, to make it fully paid-up before issue of bonus shares.
7. Ensure that none of the directors or promoters of the company is a fugitive economic offender.
8. Ensure that the Bonus issue is made out of free reserve built out of the genuine profits or share premium collected in cash only.
9. Ensure that reserves created by revaluation of fixed assets are not capitalised and that bonus shares are not issued in lieu of dividend.
10. Ensure that in case the company makes a bonus issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making the bonus issue, the company has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.

11. Ensure that the Company must implement the bonus issue within 15 days from the date of approval of the issue by Board of Directors if the company announcing a bonus issue after the approval of Board of Directors and does not require shareholders' approval for capitalization of profits or reserves for making the bonus issue.
12. Ensure that the bonus issue must be implemented within 2 months from the date of the meeting of Board of Directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval if the company is required to seek shareholders' approval for capitalization of profits or reserves for making the bonus issue.
13. Once the decision to make a bonus issue is announced, the issue cannot be withdrawn.

PROCEDURE FOR ISSUE OF BONUS SHARES

1. Send Notice of Board Meeting at least before 7 days before the date of Board Meeting.
2. In the case of listed entity, inform the Stock Exchange atleast 2 working days prior to the date of Board Meeting of the proposal to consider the Bonus Issue.
3. Convene a Board Meeting to consider the issue of bonus shares and for taking necessary steps in that regard, including fixing the date of closure of books and to fix up the date, time, place and agenda for holding a General Meeting to pass a Special Resolution.
4. Submit the Outcome of Board Meeting within 30 minutes of the conclusion of the Board Meeting.
5. Issue a notice of General Meeting to the shareholders, Directors and Auditors at least 21 clear days. before the date of General Meeting.
6. Conduct a general meeting to consider and pass Special resolution .
7. File form MGT-14 within 30 days of passing special resolution.
8. Permission of RBI, if any, required under FEMA, 1999 should be obtained to allot bonus shares to Non-Resident Indians if such issue do not fall under the automatic route.
9. Obtain necessary listing and trading approval from the stock exchange.
10. To hold a Board Meeting and complete proceeding regarding allotment of the bonus shares in the proportion and in the manner as mentioned in the resolution, and as approved by the Stock Exchange.
11. File the return of allotment with the ROC in PAS—3 after paying the requisite fee within 30 days of the allotment of shares.
12. Submit an application to the Stock Exchange(s) concerned for listing the bonus shares allotted.
13. Obtain necessary approval from the NSDL and CDSL for issuing shares in demat mode.
14. In case of physical, issue the share certificates within 60 days from the date of issue.

Documents required for granting in-principle approval for listing under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, for the companies proposing Bonus Issue

1. Certified copy of the resolution passed by the Board of Directors of the Company approving the bonus issue.
2. Certified true copy of the notice convening the AGM/EGM of shareholders along with the explanatory statement annexed thereto where the proposal for issue is to be put for approval.

3. Certified copy of the resolution passed by the shareholders at the AGM/EGM approving the Bonus issue; and/or Increase in the authorised share capital, if applicable.
4. Certificate from Statutory Auditors / Practicing Chartered Accountant / Practicing Company Secretary confirming that the proposed bonus issue is being made in accordance with the requirements of Chapter XI of SEBI (Issue of Capital & Disclosure Requirement) Regulations, 2018.
5. Statement of total bonus entitlement as per the existing capital, bonus shares to be allotted and shares kept in abeyance, if any to be given by the Company Secretary.
6. Certified true copy of the amended copy of the Memorandum and Articles of Association of the Company. In case the Memorandum and Articles of Association is not amended, confirmation from the company regarding the same.
7. Confirmation by the Managing Director/ Company Secretary.
8. Processing fee.
9. Copy of the latest audited annual report.
10. Name & Designation of the Contact Person of the Company. Telephone Nos. (landline & mobile) Email address.

Documents required for listing approval for Bonus equity shares issued by the Companies

1. Letter of Application (i.e. by Listed companies applying for listing of further issue) duly completed.
2. Certified true copy of the Board resolution in which the equity shares were allotted.
3. Brief particular of the new securities issued.
4. Shareholding Pattern as per the format prescribed under Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 giving details pre and post allotment of bonus shares.
5. Certificate from Statutory Auditors / Practicing Chartered Accountant / Practicing Company Secretary to the effect that the SEBI (ICDR) Regulations, 2018 for bonus issue has been complied with.
6. The details such as date of Board of Directors meeting approving Bonus issue, date of approval of shareholders, last date by which the bonus issue was to be completed as per Regulation295 and delay in number of days, to be provided if Bonus issue has not been implemented within the time prescribed under Regulation 295 of SEBI (ICDR) Regulations, 2018.
7. Confirmation by the Managing Director/ Company Secretary.
8. Details of further listing /processing fee remitted.

SEBI (SHARE BASED EMPLOYEE BENEFITS AND SWEAT EQUITY) REGULATIONS, 2021

Introduction

A company always wants to retain the top talent in the company those already working within the company for the future success of the organization. One of the ways in which companies attract and retain key employees is by rewarding them with equity shares, traditionally, which are called Sweat Equity Shares and through various employee benefits schemes like ESOP. The aim of ESOP or sweat equity is to retain the best employees by offering a good enough carrot.

SEBI (Issue of Sweat Equity) Regulations, 2002 (“Sweat Equity Regulations”) and SEBI (Share Based Employee Benefits) Regulations, 2014 (“SBEB Regulations”) were notified on September 24, 2002 and October 28, 2014 respectively. The Sweat Equity regulations provided framework for issuance of Sweat Equity shares by listed companies and the SBEB Regulations provided framework to regulate Employee Stock Option Scheme, Employee Stock Purchase Scheme and other share based employee benefits.

Further, to improve ease of doing business from a regulatory perspective, it was observed that, both the SBEB Regulations and the Sweat Equity Regulations regulate employee benefits arising out of and relating with the equity shares of listed companies, thus the possibility of merging both such regulations may be explored.

Accordingly, the SEBI constituted the Expert Group to analyze the above proposals, and to provide its recommendations on the following:

- Revisiting the framework of SBEB regulations and suggesting policy change thereto.
- Revisiting the framework of SEBI Sweat equity regulations *vis-à-vis* the Companies Act, 2013 and suggesting policy changes thereto.
- Suggesting, whether it is advisable to combine both the regulations and if so, providing a draft of combined regulations.

The changes in the two regulations and their merger into a single regulation were approved by SEBI in its Board Meeting held on August 06, 2021. **Thereafter, the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 (herein referred as "New Regulations") have been notified and become effective on August 13, 2021.**

Pursuant to this, the SEBI (Share Based Employee Benefits) Regulations, 2014 and SEBI (Issue of Sweat Equity) Regulations, 2002 (herein referred as "Erstwhile Regulations") stand repealed.

Applicability

The provisions of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 shall apply to the following: -

(i) employee stock option schemes;

(ii) employee stock purchase schemes;

(iii) stock appreciation rights schemes;

(iv) general employee benefits schemes;

(v) retirement benefit schemes; and

(vi) sweat equity shares.

Companies Covered

The provisions of these regulations shall apply to any company whose equity shares are listed on a recognised stock in India and who seeks to issue sweat equity shares or has a scheme:-

(i) for direct or indirect benefit of employees;

(ii) involving dealing in or subscribing to or purchasing securities of the company, directly or indirectly; and

(iii) satisfying, directly or indirectly, any one of the following conditions:

(a) the scheme is set up by the company or any other company in its group;

(b) the scheme is funded or guaranteed by the company or any other company in its group;

(c) the scheme is controlled or managed by the company or any other company in its group.

Non- Applicability

The provisions pertaining to preferential issue as specified in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 shall not be applicable in case of a company issuing new shares in pursuance and compliance of these regulations except wherever specifically provided for in these regulations.

Important Definitions

- **"Employee"**, except in relation to issue of sweat equity shares, means, —
  - (i) an employee as designated by the company, who is exclusively working in India or outside India; or
  - (ii) a director of the company, whether a whole time director or not, including a non-executive director who is not a promoter or member of the promoter group, but excluding an independent director; or
  - (iii) an employee as defined in sub-clauses (i) or (ii), of a group company including subsidiary or its associate company, in India or outside India, or of a holding company of the company, but does not include—
    - (a) an employee who is a promoter or a person belonging to the promoter group; or
    - (b) a director who, either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten per cent of the outstanding equity shares of the company.

> **Question: What does the phrase "exclusively working in India or outside India" mean with respect to the definition of "employee" under Regulation 2(1)(i) of SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021**
>
> **Answer:** The phrase "exclusively working in India or outside India" means any employee who is exclusively working with such company, irrespective of whether such person is employed either in India or outside India.

> **Question: Whether contractual employees are eligible to receive benefits under Share Based Employee Benefits schemes?**
>
> **Answer:** Yes, contractual employees are also eligible to receive benefits under the Share Based Employee Benefits schemes provided they are designated as employees by their employers and are exclusively working with such company or its group company including subsidiary or its associate company or its holding company.

- **"Scheme"** means a scheme of a company proposing to provide share based benefits to its employees under Chapters III of these regulations, which may be implemented and administered directly by such company or through a trust, in accordance with these regulations.
- "**Secretarial auditor"** means a **company secretary in practice** appointed by a company under rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014 to conduct secretarial audit pursuant to regulation 24A of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- "**Employee stock option scheme or ESOS**" means a scheme under which a company grants employee stock options to employees directly or through a trust.

- "**Employee stock purchase scheme or ESPS**" means a scheme under which a company offers shares to employees, as part of public issue or otherwise, or through a trust where the trust may undertake secondary acquisition for the purposes of the scheme.

- "**General employee benefits scheme or GEBS"** means any scheme of a company framed in accordance with these regulations, dealing in shares of the company or the shares of its listed holding company, for the purpose of employee welfare including healthcare benefits, hospital care or benefits, or benefits in the event of sickness, accident, disability, death or scholarship funds, or such other benefit as specified by such company.

Question: Whether any scheme established with the objective of employee welfare with no share-based benefits, but are holding/dealing shares of the listed company or shares of listed holding company, covered under the scope of SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021?

Answer: General Employee Benefits scheme or GEBS has been defined as any scheme of a company framed in accordance with these regulations, dealing in shares of the company or the shares of its listed holding company, for the purpose of employee welfare including healthcare benefits, hospital care or benefits, or benefits in the event of sickness, accident, disability, death or scholarship funds, or such other benefit as specified by such company. Therefore, any employee welfare scheme holding / dealing in shares of the company or the shares of its listed holding company is covered under the scope of SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021, including the timelines prescribed thereunder.

- "**Retirement benefit scheme or RBS"** means a scheme of a company framed in accordance with these regulations, dealing in shares of the company or the shares of its listed holding company, for providing retirement benefits to the employees subject to compliance with existing rules and regulations as applicable under laws relevant to retirement benefits in India.

- "**Sweat equity shares**" means sweat equity shares as defined in sub-section (88) of section 2 of the Companies Act, 2013.

- "**Appreciation**" means the difference between the market price of the share of a company on the date of exercise of SAR or the date of vesting of SAR, as the case may be, and the SAR price.

- "**Exercise**" means making of an application by an employee to the company or to the trust for issue of shares or appreciation in form of cash, as the case may be, against vested options or vested SARs in pursuance of the schemes covered under Part A or Part C of Chapter III of these regulations, as the case may be.

- "**Exercise period**" means the time period after vesting within which an employee can exercise his/her right to apply for shares against the vested option or appreciation against vested SAR in pursuance of the schemes covered under Part A or Part C of Chapter III of these regulations, as the case may be.

- **"Exercise price"** means the price, if any, payable by an employee for exercising the option or SAR granted to such an employee in pursuance of the schemes covered under Part A or Part C of Chapter III of these regulations, as the case may be.

- **"Grant"** means the process by which the company issues options, SARs, shares or any other benefits under any of the schemes.

- **"Grant date"** means the date on which the compensation committee approves the grant.

  Explanation,—For accounting purposes, the grant date will be determined in accordance with applicable accounting standards.

- **“Option”** means the option given to an employee which gives such an employee a right to purchase or subscribe at a future date, the shares offered by the company, directly or indirectly, at a pre-determined price.
- “**Option grantee**” means an employee having a right but not an obligation to exercise an option in pursuance of an ESOS.
- “**Relevant date**” means,-
  - (i) in the case of grant, the date of the meeting of the compensation committee on which the grant is made; or
  - (ii) in the case of exercise, the date on which the notice of exercise is given to the company or to the trust by the employee.
- “**Stock appreciation right or SAR”** means a right given to a SAR grantee entitling him to receive appreciation for a specified number of shares of the company where the settlement of such appreciation may be made by way of cash payment or shares of the company.

  Explanation 1,—A SAR settled by way of shares of the company shall be referred to as equity settled SAR.

  Explanation 2,—For the purpose of these regulations, any reference to stock appreciation right or SAR shall mean equity settled SARs and does not include any scheme which does not, directly or indirectly, involve dealing in or subscribing to or purchasing, securities of the company.
- “**Stock appreciation right scheme or SAR scheme**” means a scheme under which a company grants SAR to employees.
- **“SAR grantee**” means an employee to whom a SAR is granted.
- “**SAR price**” means the base price defined on the grant date of SAR for the purpose of computing appreciation.
- “**Trust**” means a trust established under the provisions of the Indian Trusts Act, 1882 including any statutory modification or re-enactment thereof, for implementing any of the schemes covered by these regulations.
- “**Vesting**” means the process by which the employee becomes entitled to receive the benefit of a grant made to him/her under any of the schemes.
- “**Vesting period**” means the period during which the vesting of option, SAR or a benefit granted under any of the schemes takes place.

SCHEMES—IMPLEMENTATION AND PROCESS

Implementation of Schemes through Trust

1. A company may implement a scheme(s) either directly or by setting up an irrevocable trust(s). If the scheme is to be implemented through a trust, the same has to be decided upfront at the time of taking approval of the shareholders for setting up the scheme(s).

   However, if prevailing circumstances so warrant, the company may change the mode of implementation of the scheme subject to the condition that a fresh approval of the shareholders by a special resolution is obtained prior to implementing such a change and that such a change is not prejudicial to the interests of the employees.

   Further it is provided that if the scheme(s) involves secondary acquisition or gift or both, then it shall be mandatory for the company to implement such scheme(s) through a trust(s).

2. A company may implement several schemes as permitted under these regulations through a single trust.

   However, such single trust shall keep and maintain-

   – proper books of account;

   – records and documents;

   for each such scheme so as to explain its transactions and to disclose at any point of time the financial position of each scheme and in particular give a true and fair view of the state of affairs of each scheme.

3. The trust deed, under which the trust is formed, shall contain provisions as specified in Part A of Schedule – I of these regulations and such trust deed and any modifications thereto shall be mandatorily filed with the recognised stock exchange(s) in India where the shares of the company are listed.

   According to Part A on "Minimum Provisions in Trust Deed" under Schedule I the trust deed shall, inter alia, cover the following:

   - Details of the trust, include the Name of the trust; Object of the trust; Details of settlor; Details of scheme(s) administered; Source(s) of funds; Description of the manner in which the trust funds shall be used for meeting the objects of the trust; Description of the classes of beneficiaries along with their rights and obligations; Details of trustee(s).

   - Powers and duties of trustee(s), including:

     – To frame rules for administration of the scheme(s) in compliance with the scheme documents, object(s) of the trust and these regulations;

     – To maintain books of account of the trust as required under law including these regulations.

   - Provisions for dissolution of the trust.

   - Trust deed shall provide that it would be the duty of the trustees to act in the interest of employees who are beneficiaries of the trust and subject to provisions of these regulations, it shall not act in any manner or include any provision in the trust deed that would be detrimental to the interests of the beneficiaries.

   - Such other clauses which are necessary for safeguarding the interests of the beneficiaries.

4. Any person can be appointed as a trustee of the trust, except in cases where such person—

   i. is a director, key managerial personnel or promoter of the company or its group company including its holding, subsidiary or associate company or any relative of such director, key managerial personnel or promoter; or

   ii. beneficially holds ten percent or more of the paid-up share capital or the voting rights of the company.

   However, where individual(s) or "one person company" as defined under the Companies Act, 2013 is appointed as trustee(s), there shall be a minimum of two such trustees, and in case a corporate entity is appointed as a trustee, then it may be the sole trustee.

5. The trustees of a trust, which is governed under these regulations, shall not vote in respect of the shares held by such trust, so as to avoid any misuse arising out of exercising such voting rights.

6. The trustee should ensure that the requisite approval from the shareholders has been obtained by the company in order to enable the trust to implement the scheme(s) and undertake secondary acquisition for the purposes of the scheme(s).

7. The trust shall not deal in derivatives and shall undertake only delivery-based transactions for the purposes of secondary acquisition as permitted by these regulations.

8. Subject to the requirements of the Companies Act, 2013 read with Companies (Share Capital and Debenture) Rules, 2014, as amended from time to time, as may be applicable, the company may lend monies to the trust on appropriate terms and conditions to acquire the shares either through new issue or secondary acquisition, for the purpose of implementation of the scheme(s).

9. For the purpose of disclosures to the recognised stock exchange, the shareholding of the trust shall be shown as "non-promoter and non-public" shareholding.

   Explanation,—The shares held by the trust shall not form part of the public shareholding which needs to be maintained at a minimum of twenty five per cent as prescribed under the Securities Contracts (Regulation) Rules, 1957.

10. Secondary acquisition in a financial year by the trust shall not exceed two per cent of the paid up equity capital of the company as at the end of the previous financial year.

11. The total number of shares under secondary acquisition held by the trust shall at no point of time exceed the below mentioned limits as a percentage of the paid up equity capital of the company as at the end of the financial year immediately prior to the year in which the shareholders' approval is obtained for such secondary acquisition:

Sl. No.	***Particulars***	***Limit***
A	For the schemes enumerated in Part A (ESOS), Part B (ESPS) or Part C (SAR) of Chapter III of these regulations	5%
B	For the schemes enumerated in Part D (GEBS), or Part E (RBS) of Chapter III of these regulations	2%
C	For all the schemes in aggregate	5%

12. The unappropriated inventory of shares which are not backed by grants, acquired through secondary acquisition by the trust under Part A, Part B or Part C of Chapter III of these regulations, shall be appropriated within a reasonable period which shall not extend beyond the end of the subsequent financial year, or the second subsequent financial year subject to approval of the compensation committee/nomination and remuneration committee for such extension to the second subsequent financial year.

13. The trust shall be required to hold the shares acquired through secondary acquisition for a minimum period of six months except where they are required to be transferred in the circumstances enumerated in these regulations, whether off-market or on the platform of recognised stock exchange.

14. The trust shall be permitted to undertake off-market transfer of shares only under the following circumstances: -

    (a) transfer to the employees pursuant to scheme(s);

    (b) while participating in an open offer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or while participating in a buy-back, delisting or any other exit offered by the company generally to its shareholders.

15. The trust shall not become a mechanism for trading in shares and hence shall not sell the shares in secondary market except under the following circumstances:

    (a) to enable the employee to fund the payment of the exercise price, the amount necessary to meet his/her tax obligations and other related expenses pursuant to exercise of options granted under the ESOS;

(b) on vesting or exercise, as the case may be, of SAR under the scheme covered by Part C of Chapter III of these regulations;

(c) in case of emergency for implementing the schemes covered under Part D and Part E of Chapter III of these regulations, and for this purpose –

(i) the trustee(s) shall record the reasons for such sale; and

(ii) money so realised on sale of shares shall be utilised within a definite time period as stipulated under the scheme or trust deed.

(d) participation in buy-back or open offers or delisting offers or any other exit offered by the company generally to its shareholders, if required;

(e) for repaying the loan, if the unappropriated inventory of shares held by the trust is not appropriated within the timeline as provided above;

(f) winding up of the scheme(s); and

(g) based on approval granted by the Board to an applicant, for the reasons recorded in writing in respect of the schemes covered by Part A or Part B or Part C of Chapter III of these regulations, upon payment of a non-refundable fee of rupees one lakh to the Board along with the application by way of direct credit in the bank account through NEFT/RTGS/IMPS or any other mode allowed by the Reserve Bank of India.

16. The trust shall be required to make disclosures and comply with the other requirements applicable to insiders or promoters under the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 or any modification or re-enactment thereto.

Eligibility Criteria

An employee shall be eligible to participate in the schemes of the company as determined by the compensation committee.

Explanation – Where such employee is a director nominated by an institution as its representative on the Board of Directors of the company –

(i) the contract or agreement entered into between the institution nominating its employee as the director of a company and the director so appointed shall, inter alia, specify the following:-

a. whether the grants by the company under its scheme(s) can be accepted by the said employee in his capacity as director of the company;

b. that grant if made to the director, shall not be renounced in favour of the nominating institution; and

c. the conditions subject to which fees, commissions, other incentives, etc. can be accepted by the director from the company.

(ii) the institution nominating its employee as a director of the company shall file a copy of the contract or agreement with the said company, which shall, in turn file the copy with all the recognised stock exchanges on which its shares are listed.

(iii) the director so appointed shall furnish a copy of the contract or agreement at the first board meeting of the company attended by him after his nomination.

Compensation Committee

(1) A company shall constitute a compensation committee for administration and superintendence of the schemes. Where the scheme is being implemented through a trust the compensation committee shall delegate the administration of such scheme(s) to the trust.

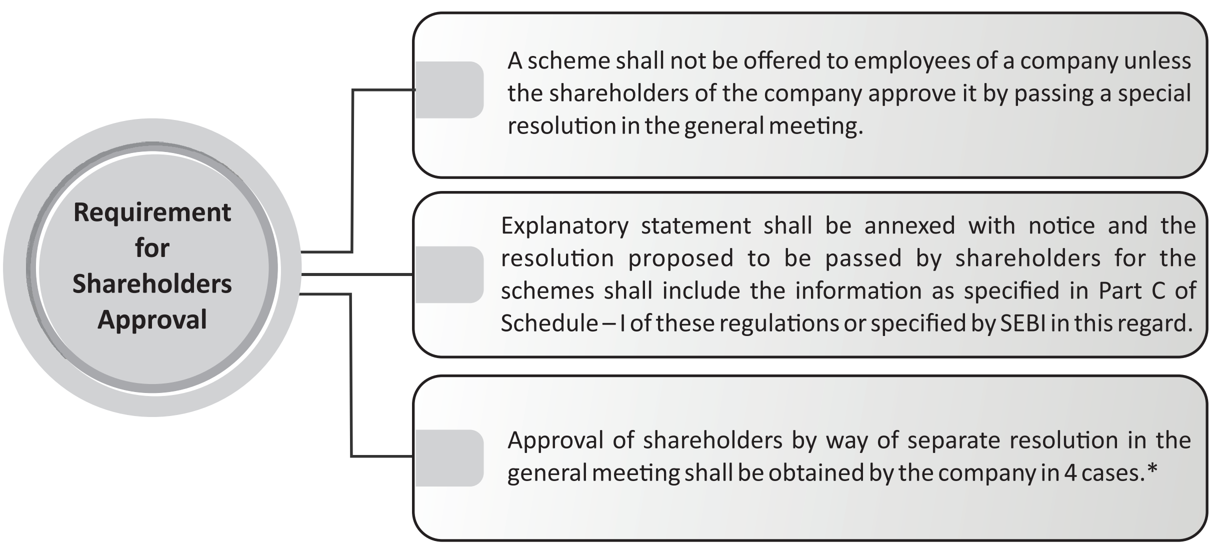
(2) The compensation committee shall be a committee of such members of the Board of Directors of the company as provided under regulation 19 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended from time to time. Provided that a company may also opt to designate its nomination and remuneration committee as the compensation committee for the purposes of these regulations.

(3) The compensation committee shall, inter alia, formulate the detailed terms and conditions of the schemes which shall include the provisions as specified in Part B of Schedule – I of these regulations.

According to Part B of Schedule – I of these regulations the detailed terms and conditions of the schemes which shall, inter alia, include the provisions such as the quantum of options, SARs, shares or benefits as the case may be, per employee and in aggregate under a scheme; the kind of benefits to be granted under a scheme; the conditions under which options, SARs, shares or other benefits as the case may be, may vest in employees and may lapse in case of termination of employment for misconduct; the exercise period within which the employee can exercise the options or SARs and that options or SARs would lapse on failure to exercise the same within the exercise period etc.

(4) The compensation committee shall frame suitable policies and procedures to ensure that there is no violation of securities laws including the SEBI (Prohibition of Insider Trading) Regulations, 2015 and the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 2003, as amended from time to time, by the trust, the company and its employees, as may be applicable.

Shareholders Approval



*Approval of shareholders by way of separate resolution in the general meeting shall be obtained by the company in case of:

a) Secondary acquisition for implementation of the schemes. Such approval shall mention the percentage of secondary acquisition (subject to limits specified under these regulations) that could be undertaken;

b) Secondary acquisition by the trust in case the share capital expands due to capital expansion undertaken by the company including preferential allotment of shares or qualified institutions placement, to maintain the five percent cap as prescribed in these regulations of such increased capital of the company;

c) Grant of option, SAR, shares or other benefits, as the case may be, to employees of subsidiary or holding company;

d) Grant of option, SAR, shares or benefits, as the case may be, to identified employees, during any one year, equal to or exceeding one per cent. of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option, SAR, shares or incentive, as the case may be.

According to Part C of Schedule – I of these regulations, the explanatory statement to the notice and the resolution proposed to be passed for the schemes in general meeting shall, inter alia, contain the information such as brief description of the scheme(s); the total number of options, SARs, shares or benefits, as the case may be, to be offered and granted; identification of classes of employees entitled to participate and be beneficiaries in the scheme(s); requirements of vesting and period of vesting; maximum period within which the options / SARs / benefits shall be vested; exercise price, SAR price, purchase price or pricing formula etc.

Question: What is the process to grant benefits to employees of group company including subsidiary or its associate companies, joint ventures or holding company? Are shareholders required to approve the grant of option, SAR, shares or other benefits, as the case may be, to employees of such companies?

Answer: Yes, as per Regulation 6(3)(c) of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 regulations, shareholders are required to approve the grant of option, SAR, shares or other benefits, as the case may be, to employees of group company including subsidiary or its associate companies, joint ventures or holding company.

Variation of Terms of the Schemes

(1) A company may by special resolution of its shareholders vary the terms of the schemes offered pursuant to an earlier resolution of the general body but not yet exercised by the employees, if such variation is not prejudicial to the interests of the employees.

(2) A company shall be entitled to vary the terms of the schemes to meet any regulatory requirement without seeking shareholders' approval by special resolution.

(3) The provisions of regulation 6 (Shareholders' Approval) of these regulations shall apply to such variation of terms as they apply to the original grant of option, SAR, shares or other benefits, as the case may be.

(4) The notice for passing a special resolution for variation of terms of the schemes shall disclose full details of the variation, the rationale therefor, and the details of the employees who are beneficiaries of such variation.

(5) A company may reprice the options, SAR or shares, as the case may be, which are not exercised, whether or not they have been vested, if the schemes were rendered unattractive due to fall in the price of the shares in the stock market. However, the company ensures that such repricing is not detrimental to the interests of the employees and approval of the shareholders by a special resolution has been obtained for such repricing.

Winding Up of the Schemes

In case of winding up of the schemes being implemented by a company, the excess monies or shares remaining with the trust after meeting all the obligations, if any, shall be utilised for repayment of loan or by way of distribution to employees or subject to approval of the shareholders, be transferred to another scheme under these regulations, as recommended by the compensation committee.

Non-Transferability

- Option, SAR or any other benefit granted to an employee under the regulations shall not be transferable to any person.
- No person, other than the employee to whom the option, SAR or other benefit is granted, shall be entitled to the benefit arising out of such option, SAR or other benefit. However, in case of ESOS or SAR, subject to applicable laws, the company or the trustee may fund or permit the empanelled stock brokers to make suitable arrangements to fund the employee for payment of exercise price, the amount necessary to meet his/her tax obligations and other related expenses pursuant to exercise of options granted under the ESOS or SAR and such amount shall be adjusted against the sale proceeds of some or all the shares of such employee.
- The option, SAR, or any other benefit granted to the employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.
- In the event of death of the employee while in employment, all the options, SAR or any other benefit granted under a scheme to him/her till his/her death shall vest, with effect from the date of his/her death, in the legal heirs or nominees of the deceased employee, as the case may be.
- In case the employee suffers a permanent incapacity while in employment, all the options, SAR or any other benefit granted to him/her under a scheme as on the date of permanent incapacitation, shall vest in him/her on that day.
- In the event of resignation or termination of an employee, all the options, SAR or any other benefit which are granted and yet not vested as on that day, shall expire. However, an employee shall, subject to the terms and conditions formulated by the compensation committee, be entitled to retain all the vested options, SAR or any other benefit covered by these regulations.
- In the event that an employee, who has been granted benefits under a scheme, is transferred or deputed to an associate company prior to vesting or exercise, the vesting and exercise as per the terms of grant shall continue in case of such transferred or deputed employee even after the transfer or deputation.
- In the event that an employee who has been granted benefits under a scheme, is transferred pursuant to scheme of arrangement, amalgamation, merger or demerger or continued in the existing company, prior to the vesting or exercise, the treatment of options in such case shall be specified in such scheme of arrangement, amalgamation, merger or demerger provided that such treatment shall not be prejudicial to the interest of the employee.

Listing

In case a new issue of shares is made under any scheme, shares so issued shall be listed immediately on all recognised stock exchange(s) where the existing shares are listed, subject to the following conditions:

(a) The scheme is in compliance with these regulations;

(b) A statement, as specified by SEBI in this regard, is filed and the company obtains an in-principle approval from the recognised stock exchange(s);

(c) As and when an exercise is made, the company notifies the concerned recognised stock exchange(s) as per the statement as specified by SEBI in this regard.

Schemes implemented by unlisted companies

The shares arising after the IPO of an unlisted company, out of options or SAR granted under any scheme prior to its IPO to the employees, shall be listed immediately upon exercise on all the recognised stock exchanges where the shares of the company are listed subject to compliance with the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and wherever applicable, sub-regulation (1) of regulation 12 of these regulations.

Compliances and conditions

Company shall not make any fresh grant which involves allotment or transfer of shares to its employees under any scheme formulated prior to its IPO and prior to the listing of its equity shares ('pre-IPO scheme') unless:

(i) Such pre-IPO scheme is in conformity with these regulations; and

(ii) Such pre-IPO scheme is ratified by its shareholders subsequent to the IPO. Provided that the ratification under clause (ii) may be done any time prior to grant of new options or shares or SAR under such pre-IPO scheme.

Change shall not be made in the terms of options or shares or SAR issued under such pre-IPO schemes, whether by repricing, change in vesting period or maturity or otherwise unless prior approval of the shareholders, by way of special resolutions, is taken for such a change, except for any adjustments for corporate actions made in accordance with these regulations. For listing of shares issued pursuant to ESOS, ESPS or SAR, the company shall obtain the in-principle approval of the recognized stock exchanges where it proposes to list the said shares prior to the grant of options or SARs.

When the holding company issues option, share, SAR or benefits to the employees of its subsidiary, the cost incurred by the holding company for issuing such option, share, SAR or benefits shall be disclosed in the 'notes to accounts' of the financial statements of the subsidiary company. If the subsidiary reimburses the cost incurred by the holding company in granting option, share, SAR or benefits to the employees of the subsidiary, both the subsidiary as well as the holding company shall disclose the payment or receipt, as the case may be, in the 'notes to accounts' to their financial statements.

The company shall appoint a merchant banker for the implementation of schemes covered by these regulations till the stage of obtaining in-principle approval from the recognized stock exchanges.

Certificate from Auditors

In the case of every company which has passed a resolution for the scheme(s) under these regulations, the Board of Directors shall at each annual general meeting place before the shareholders a certificate from the **secretarial auditors** of the company that the scheme(s) has been implemented in accordance with these regulations and in accordance with the resolution of the company in the general meeting.

Disclosures

In addition to the information that a company is required to disclose in relation to employee benefits under the Companies Act, 2013, the Board of Directors of such a company shall also disclose the details of the scheme(s) being implemented, as specified in part F of Schedule-I of these regulations.

Accounting policies

Any company implementing any of the share based schemes shall follow the requirements including the disclosure requirements of the Accounting Standards prescribed by the Central Government in terms of section 133 of the Companies Act, 2013 including any 'Guidance Note on Accounting for employee share-based Payments' issued in that regard from time to time.

ADMINISTRATION OF SPECIFIC SCHEMES

Employee Stock Option Scheme (ESOS)

Administration and Implementation	• An ESOS shall contain the details of the manner in which the scheme will be implemented and operated. ESOS shall not be offered unless the disclosures, as specified by SEBI in this regard, are made by the company to the prospective option grantees.
Pricing	• The company granting options to its employees pursuant to an ESOS shall be free to determine the exercise price subject to conforming to the accounting policies specified in these regulation.
Vesting Period*	• There shall be a minimum vesting period of one year in case of ESOS. • The company may specify the lock-in period for the shares issued pursuant to exercise of option.
Rights of the option holder	• An employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him/her, till shares are issued upon exercise of option.
Consequence of failure to exercise option	• The amount paid by the employee, if any, at the time of grant, vesting or exercise of option, - ▪ may be forfeited by the company if the option is not exercised by the employee within the exercise period; or ▪ may be refunded to the employee if the options are not vested due to non- fulfilment of conditions relating to vesting of option as per the ESOS.

Note :

*In regard to Vesting period, -

- Where options are granted by a company under an ESOS in lieu of options held by an employee under an ESOS in another company which has merged, demerged, arranged or amalgamated with the first mentioned company, the period during which the options granted by the transferor company were held by such employee shall be adjusted against the minimum vesting period.
- In the event of death or permanent incapacity of an employee, the minimum vesting period of one year shall not be applicable and in such instances, the options shall vest in terms of sub-regulation (4) of regulation 9 of these regulations, on the date of the death or permanent incapacity.

Employee Stock Purchase Scheme (ESPS)

Administration and Implementation	Pricing and Lock-in
• An ESPS scheme shall contain the details of the manner in which the scheme will be implemented and operated.	• A company may determine the price of shares to be issued under an ESPS, provided they conform to the provisions of accounting policies under these regulation. • Shares issued under an ESPS shall be locked-in for a minimum period of one year from the date of allotment.* • If ESPS is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees pursuant to ESPS shall not be subject to lock-in.

**Note* :

In regard to lock-in-

- Where shares are allotted by a company under an ESPS in lieu of shares acquired by the employee under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in period.
- In the event of death or permanent incapacity of an employee, the requirement of lock-in shall not be applicable from the date of death or permanent incapacity.

Stock Appreciation Rights Scheme (SAR Scheme)

Administration and Implementation

- A SAR scheme shall contain the details of the manner in which the scheme will be implemented and operated;
- A company shall have the freedom to implement cash settled or equity settled SAR scheme;
- No SAR shall be offered unless the disclosures, as specified by SEBI in this regard, are made by the company to the prospective SAR grantees.

Vesting

- There shall be a minimum vesting period of one year in case of SAR scheme.

Rights of the SAR holder

- The employee shall not have right to receive dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of SAR granted to him/her.

Note :

With regard to Administration and implementation-

- In case of equity settled SAR scheme, if the settlement results in fractional shares, then the consideration for fractional shares should be settled in cash.

With regard to Vesting-

- In a case where SAR is granted by a company under a SAR scheme in lieu of SAR held by the employee under a SAR scheme in another company which has merged or amalgamated with the first mentioned company, the period during which the SAR granted by the transferor company were held by the employee shall be adjusted against the minimum vesting period.
- In the event of death or permanent incapacity, the minimum vesting period of one year shall not be applicable and in such instances, the options shall vest on the date of death or permanent incapacity.

General Employee Benefits Scheme (GEBS)

Administration and Implementation

(1) GEBS shall contain the details of the scheme and the manner in which the scheme shall be implemented and operated.

(2) The shares of the company or shares of its listed holding company shall not exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet (whether audited or limited reviewed) for the purposes of GEBS.

(3) The secretarial auditor of the company shall certify the above mentioned point (2) compliance at the time of adoption of such balance sheet by the company.

Retirement Benefit Scheme (RBS)

Administration and Implementation

(1) Retirement benefit scheme may be implemented by a company subject to compliance with these regulations and provisions of any other law in force in relation to retirement benefits.

(2) The retirement benefit scheme shall contain the details of the benefits under the scheme and the manner in which the scheme shall be implemented and operated.

(3) The shares of the company or shares of its listed holding company shall not exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet (whether audited or limited reviewed) for the purposes of RBS.

(4) The secretarial auditor of the company shall certify compliance with above mentioned point (3) at the time of adoption of such balance sheet by the company.

Question: What is the treatment to the options, SAR or other benefits which are granted and not vested to the directors who have vacated the office due to retirement?

Answer: Subject to the terms of the company's policies, all grants, SARs or other benefits would continue to vest in accordance with the respective vesting schedules even after the cessation of directorship due to retirement.

PROVISIONS PERTAINING TO ESOP/ESPS UNDER THE SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

Regulation 17(6) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 provides that the board of directors shall recommend all fees or compensation, if any, paid to non-executive directors, including independent directors and shall require approval of shareholders in general meeting. Further provided that the approval of shareholders mentioned above, shall specify the limits for the maximum number of stock options that may be granted to non-executive directors, in any financial year and in aggregate.

Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 prescribed that every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material. Events specified in Para A of Part A of Schedule III are deemed to be material events and listed entity shall make disclosure of such events.

However, the listed entity shall make disclosure of events specified in Para B of Part A of Schedule III, based on application of the guidelines for materiality. Events specified in Para B of Part A of Schedule III inter alia cover the option to purchase securities including ESOP/ESPS scheme.

Options to purchase securities including any ESOP/ESPS Scheme shall be disclosed to the stock exchange upon application of the guidelines for materiality.

In terms of the SEBI circular dated September 09, 2015, the details which a listed entity need to disclose for events on which the listed entity may apply materiality in terms of Para B of Part A of Schedule III of Listing Regulations are:

a) brief details of options granted;

b) whether the scheme is in terms of SEBI (SBEB) Regulations, 2014 (if applicable);

c) total number of shares covered by these options;

d) pricing formula;

e) options vested;

f) time within which option may be exercised;

g) options exercised;

h) money realized by exercise of options;

i) the total number of shares arising as a result of exercise of option;

j) options lapsed;

k) variation of terms of options;

l) brief details of significant terms;

m) subsequent changes or cancellation or exercise of such options;

n) diluted earnings per share pursuant to issue of equity shares on exercise of options.

The listed entity shall first disclose to stock exchange of all events or information which are material, as soon as reasonably possible and not later than 30 minutes from the closure of the meeting of the board of directors in which the decision pertaining to the event has been taken.

ESPS/ESOS/SARS/GEBS/RBS – PRE ISSUE AND POST ISSUE FORMALITIES

Pre-Issue Formalities

Checklist - Prior In-principle under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 for ESPS/ESOS/SARS/GEBS/RBS:

1. Certified copy of Stock Option/Stock Purchase Scheme/ Stock Appreciation Rights Scheme/ General Employee Benefits Scheme/ Retirement Benefit Schemes, certified by the Company Secretary.
2. Certified copy of statement to be filed with the Stock Exchange as required under Regulation 10(b) of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
3. Certified true copy of the notice of AGM/EGM for approving the Scheme/for amending the Scheme/ for approving grants under Regulation 6 of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021, certified by the Company Secretary.
4. Certified true copy of special resolution along with the explanatory statement passed by the shareholders of the Company approving/ amending the Scheme.
5. Certificate of Secretarial Auditors on compliance with SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
6. Certificate of Merchant Banker on compliance with SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
7. List of Promoters as defined under the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
8. Details of employee (wherever applicable) -
   a) Who have been granted options/issued shares in excess of 5% of option/shares issued in one year.
   b) Who have been granted options/issued shares equal to or exceeding 1% of issued capital during any one year.
9. Copy of latest Annual Report.
10. Specimen copy of Share certificate (where shares are issued in physical form).
11. Confirmation from the Company.
12. Undertakings as required by SEBI.
13. Reconciliation statement.
14. Certified true copy of irrevocable trust deed.
15. Certified true copy of Disclosure document (applicable only for ESOS and SARS).
16. Processing fees.

Post-Issue Formalities

Documents required for listing of equity shares issued pursuant to exercise of options granted under ESPS/ ESOS/ SARS/GEBS/RBS:

1. Letter of application and listing application.
2. Certified true copy of Statement as per the format prescribed under Regulation 10(c) of SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
3. Applicable Additional Listing Fees.
4. A certified copy of the resolution passed by the Board of Directors in which the company has allotted these shares.
5. Certificate for receipt of money from the Statutory Auditors/Practicing Company Secretary/ Practicing Chartered Accountant specifically certifying that the company has received the application/allotment monies from the applicants of these shares. For other than ESPS, in case the company opt to submit the above certificate on a quarterly basis the same should be mentioned in the application. Further, the company should ensure submission of quarterly certificate from the Statutory Auditors/Practicing Company Secretary/ Practicing Chartered Accountant specifically certifying that the company has received the application/allotment monies from the applicants of these shares.
6. List of allottees specifying the name of the allottee, number of shares allotted.
7. NSDL/CDSL credit and/or dispatch of physical certificate confirmation by the R & T agent.
8. Certificate from statutory auditors that the issue is in compliance with SEBI (SBEB) Regulations, 2021 and the shares are under lock-in as per the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
9. Statement of reconciliation from the Company Secretary/Compliance Officer/Authorised signatory showing number of shares for which the in-principle approval was taken and no. of shares allotted, date of allotment and the balance outstanding.
10. Undertaking from the Company Secretary/Compliance Officer/ Managing Director of the issuer as per the following:
    1. The Company has complied with the provisions of SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 as amended from time to time and also with SEBI circulars issued thereunder.
    2. The company has complied with all the legal and statutory formalities and no statutory authority has restrained the company from issuing and allotting the above referred shares.
    3. The Company has received the share application money (against exercise of options granted under the <Name of the Scheme under which such options were granted> of the Company.
    4. The company or its promoters or whole-time directors are not in violation of the provisions of Regulation 34 of the SEBI Delisting Regulations, 2021.
    5. We hereby confirm that the company, its promoters, its directors are not in violation of the restrictions imposed by SEBI under SEBI circular no. SEBI/HO/ MRD/DSA/CIR/P/2017/92 dated August 01, 2017.

PROCEDURE FOR ISSUING ESOP BY A LISTED COMPANY

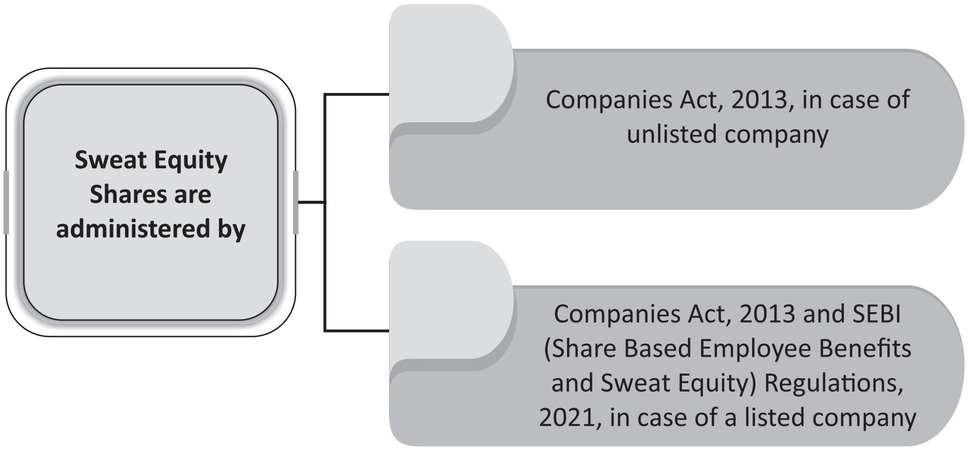
- Prepare the draft ESOP plan in accordance with the Companies Act, 2013 and Rules and SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021;
- Send notice of Board Meeting to all the directors atleast 7 days before the date of Board Meeting;
- Hold Board Meeting to pass the resolution for the issuance of shares through ESOP, appoint the Merchant Banker and approve the notice of the General Meeting for shareholders' approval;
- File the MGT-14 form with the Registrar of Companies within 30 days of passing the board resolution;
- Send a notice of General Meeting to the shareholders, Directors and Auditors at least 21 clear days before the date of General Meeting;
- Hold General Meeting for approval of shareholders and pass the special resolution for the issuance of shares under the ESOP to the employees;
- File the MGT-14 form with the Registrar of Companies within 30 days of passing the special resolution;
- Make an application to the stock exchange for obtaining in-principal approval of the stock exchange;
- Issue of letter of grant of option to the eligible employees along with the letter of acceptance of option;
- On receipt of letter of acceptance of option along with upfront payment (if any), from the employee issue the option certificates;
- After expiry of vesting period, not less than one year, the options shall vest in the employee;
- At that time, the Company shall issue a letter of vesting along with the letter of exercise of options;
- Receipt to letter of exercise from the employee;
- Send notice of Board Meeting to all the directors atleast 7 days before the date of Board Meeting;
- Hold a Board Meeting at the suitable interval during the exercise period for allotment of shares;
- Dispatch of letter of allotment along with the share certificates or credit the shares so allotted with the Depositories;
- Make an application to the stock exchange for listing of the shares so allotted; and
- Receipt of Listing of the shares from the stock exchange.

ISSUE OF SWEAT EQUITY SHARES

'Sweat equity shares' are such equity shares, which are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Sweat equity shares refers to equity shares given to the company's employees on favourable terms, in recognition of their work.

> Sweat equity shares refers to equity shares given to the company's employees on favourable terms, in recognition of their work. Sweat equity shares is one of the modes of making share based payments to employees of the company. The issue of sweat equity shares allows the company to retain the employees by rewarding them for their services. Sweat equity shares rewards the beneficiaries by giving them incentives in lieu of their contribution towards the development of the company.



Which companies can issue sweat equity shares?

Any company can issue sweat equity shares like:

- One person Company
- Private Company
- Public Company
- Section 8 Company
- Listed/Unlisted Company

Difference between ESOP and Sweat Equity

Under ESOP, an employee has the right to exercise the option to receive allotment of shares of the Company by paying exercise price upon vesting of an option which cannot take place earlier than one year from the date of grant of the options. Under Sweat Equity, the employee receives immediate allotment of shares without any vesting requirement.

While ESOP is a deferred form of compensation, sweat equity shares provide immediate entitlement of the benefit extended.

A. Provisions pertaining to Sweat Equity Shares under the Companies Act, 2013

Section 2 (88) of the Companies Act, 2013 defines "sweat equity shares" means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

According to Section 54 of the Companies Act, 2013, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled:

(a) The issue is authorized by a special resolution passed by the company in the General Meeting.

(b) The resolution specifies the number of shares, current market price, consideration, if any and the class or classes of directors or employees to whom such equity shares are to be issued.

(c) The sweat equity shares of a company whose equity shares are listed on a recognized stock exchange are issued in accordance with the Regulations made by SEBI in this regard and if they are not listed the sweat equity shares are to be issued in accordance with Rule 8 of the Companies (Share Capital and Debenture) Rules, 2014.

(d) The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

The expressions "Employee" means-

(a) a permanent employee of the company who has been working in India or outside India; or

(b) a director of the company, whether a whole time director or not; or

(c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company.

Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014 provides that a company other than a listed company, which is not required to comply with the SEBI Regulations on sweat equity, shall not issue sweat equity shares to its directors or employees at a discount or for consideration other than cash, for their providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called, unless the issue is authorised by a special resolution passed by the company in general meeting.

The Companies (Share Capital and Debentures) Rules, 2014 have defined 'value additions' to mean actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Whether Issue of sweat equity shares can be in the form of preferential Issue?

Issue of Sweat Equity Shares is not a 'preferential issue'. As per regulation 2(1)(nn) of SEBI (ICDR) Regulations, 2018 which gives the meaning of a preferential issue excludes an issue of sweat equity shares there from, which means issue of sweat equity shares is not a preferential issue within the meaning of preferential issue. Further, Rule 8 (13) of the Companies (Share Capital and Debentures) Rules, 2014, clearly excludes issue of sweat equity shares from the definition of preferential offer.

B. Provisions pertaining to Sweat Equity Shares under the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021

Applicability

The Chapter IV of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 which deal with 'Issue of Sweat Equity by a Listed Company' shall not apply to an unlisted company. However, an unlisted company coming out with initial public offer and seeking listing of its securities on the recognized stock exchange, pursuant to issue of sweat equity shares, shall comply with the SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2018.

Definition of employee in relation to issue of sweat equity shares

The term 'employee' means,

(i) an employee of the company working in India or abroad; or

(ii) a director of the company whether a whole time director or not.

Issue of sweat equity shares to employees

A company whose equity shares are listed on a recognised stock exchange may issue sweat equity shares in accordance with section 54 of the Companies Act, 2013 and these regulations to its employees for their providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Maximum quantum of sweat equity shares

A company shall not issue sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year. However, the issuance of sweat equity shares in the company shall not exceed twenty five percent of the paid up equity share capital of the company at any time.

Further, a company listed on Innovators Growth Platform shall be permitted to issue not more than fifteen percent of the paid up equity share capital in a financial year subject to overall limit not exceeding fifty percent of the paid up equity share capital of the company, up to ten years from the date of its incorporation or registration.

Special Resolution

(1) For the purposes of passing a special resolution under Section 54(1)(a) of the Companies Act, 2013, the explanatory statement to be annexed to the notice for the general meeting pursuant to section 102 of the Companies Act, 2013 shall contain disclosures as specified in the Schedule – II of these regulations.

Schedule II provides that the explanatory statement to the notice and the resolution proposed to be passed in the general meeting for approving the issuance of sweat equity shall, inter alia, contain the following information:

a) The total number of shares to be issued as sweat equity.

b) The current market price of the shares of the company.

c) The valuation of know-how or intellectual property rights or value addition to be received from the employee or director along with the valuation report / basis of valuation.

d) The names of the employees or directors or promoters to whom the sweat equity shares shall be issued and their relationship with the company.

e) The consideration to be paid for the sweat equity.

f) The price at which the sweat equity shares shall be issued.

g) Ceiling on managerial remuneration, if any, which will be affected by issuance of such sweat equity.

h) A statement to the effect that the company shall conform to the accounting policies as specified by the Board.

i) Diluted Earnings Per Share pursuant to the issue of securities to be calculated in accordance with Accounting Standards specified by the Central Government.

(2) The issue of sweat equity shares to employees who belong to promoter or promoter group shall be approved by way of a resolution passed by a simple majority of the shareholders in general meeting.

However, for passing such a resolution, voting through postal ballot and/or e-voting as specified under Companies (Management and Administration) Rules, 2014 shall also be adopted.

Further, provided that the promoters/promoter group shall not participate in such resolution.

(3) Each issue of sweat equity shares shall be voted by a separate resolution.

(4) The resolution for issue of sweat equity shares shall be valid for a period of not more than twelve months from the date of passing of the resolution.

Pricing of sweat equity shares

The price of sweat equity shares shall be determined in accordance with the pricing requirements stipulated for a preferential issue to a person other than a qualified institutional buyer under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Valuation

(1) The valuation of the know-how or intellectual property rights or value addition shall be carried out by a merchant banker.

(2) The merchant banker may consult such experts and valuers, as it may deem fit, having regard to the nature of the industry and the nature of the valuation of know-how or intellectual property rights or value addition.

(3) The merchant banker shall obtain a certificate from an independent chartered accountant certifying that the valuation of the know-how or intellectual property rights or value addition is in accordance with the relevant accounting standards.

Accounting Treatment

Where the sweat equity shares are issued for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company:-

(a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the relevant accounting standards; or

(b) where clause (a) is not applicable, it shall be expensed as provided in the relevant accounting standards.

Placing of auditor's certificate before annual general meeting

In the general meeting subsequent to the issue of sweat equity shares, the Board of Directors shall place before the shareholders, a certificate from the secretarial auditor of the company that the issue of sweat equity shares has been made in accordance with these regulations and in accordance with the resolution passed by the company authorizing the issue of such sweat equity shares.

Ceiling on managerial remuneration

The amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purpose of sections 196, 197 and other applicable provisions of the Companies Act, 2013, if the following conditions are fulfilled:

(i) the sweat equity shares are issued to any director or manager; and

(ii) the sweat equity shares are issued for non-cash consideration, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the relevant accounting standards.

Lock-in of sweat equity shares

(1) The sweat equity shares shall be locked in for such period of time as specified in relation to a preferential issue under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, as amended from time to time.

(2) The provisions of the SEBI (Issue of Capital and Disclosures Requirements) Regulations, 2018 in respect of public issue in terms of lock-in and computation of promoters' contribution shall apply if a company makes a public issue after it has issued sweat equity shares.

Listing

The sweat equity shares issued by a listed company shall be eligible for listing subject to their issuance being in accordance with these regulations.

Applicability of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

Any acquisition of sweat equity shares shall be subject to the provisions of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

General Obligations of the Company

The company shall ensure that –

(a) the explanatory statement to the notice for general meeting contains the disclosures specified under section 54(1)(b) of the Companies Act, 2013 and regulation 32(1) of these regulations.

(b) the secretarial auditor's certificate required under regulation 36 is placed in the general meeting of the shareholders.

(c) the company, within seven days of the issue of sweat equity shares, sends a statement to the recognised stock exchange, disclosing:

- (i) number of sweat equity shares issued;
- (ii) price at which the sweat equity shares are issued;
- (iii) total amount received towards sweat equity shares;
- (iv) details of the persons to whom sweat equity shares have been issued; and
- (v) the consequent changes in the capital structure and the shareholding pattern before and after the issue of sweat equity shares.

CHECK POINTS FOR ISSUANCE OF SWEAT EQUITY SHARES

Before issuance of Sweat Equity Shares, followings points must be ensured:

1. Ensure that the issuance of Sweat Equity Shares is authorized by a special resolution passed by the company in general meeting. The special resolution is valid for making the allotment with in a period of not more than 12 months from the date of passing the special resolution.
2. It should be noted that the company shall not issue sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year or shares of issue value of Rs. 5 crore, whichever is higher. However, the issuance of sweat equity shares in the company shall not exceed twenty five percent of the paid up equity share capital of the company at any time. However if the Company is a startup Company, as defined in notification number GSR 127(E) dated 19.02.2019 issued by the Department for Promotion of Industrial and Internal Trade, Ministry of Commerce and Industry, Government of India, it may issue sweat equity shares not exceeding fifty percent of its paid up capital up to 10 years from the date of its incorporation or registration.

3. The sweat equity shares to be issued to the directors and employees shall be locked in/non transferable for a period of 3 years from the date of allotment.

4. The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification of such valuation. The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued shall be carried out by a registered valuer who shall provide a proper report addressed to the Board of Directors with justification for such valuation. A copy of the gist along with critical elements of the valuation report obtained under Clause 6 and Clause 7 of Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014 shall be sent to the shareholders with the notice of the general meeting.

PROCEDURE FOR THE ISSUANCE OF SWEAT EQUITY SHARES

1. Decide before convening a Board Meeting, the number of shares, their current market price and consideration, if any, and the class or classes of directors or employees to whom such of sweat equity shares are proposed to be issued.
2. Send notice of Board Meeting to all the directors atleast 7 days before the date of Board Meeting.
3. Convene a Board Meeting to consider the proposal of issue of sweat equity shares and to fix up the date, time, place and agenda for the General Meeting.
4. File e-form MGT-14 with a copy of board resolution within a period of 30 days of passing of board resolution.
5. Send a notice of General Meeting to the shareholders, Directors and Auditors at least 21 clear days before the date of General Meeting.
6. Hold the General Meeting and pass the Special Resolution by three fourths majority and file a copy of the Special Resolution with the ROC in e-Form MGT-14.
7. Convene Board meeting within 12 months of passing of special resolution to the resolution for allotment of sweat equity shares.
8. File return of allotment in e-form PAS-3 with the ROC within 30 days of the allotment.
9. In case of a listed company, to apply to the stock exchange and obtain necessary listing and trading approval for the shares so allotted.
10. In the General Meeting subsequent to the issue of sweat equity, the Board of Directors shall place before the shareholders, a certificate from the secretarial auditor of the Company that the issue of sweat equity shares has been made in accordance with the regulations and in accordance with the resolution passed by the Company authorizing the issue of such sweat equity shares.

LESSON ROUND-UP

- When a company has accumulated free reserves and is desirous of bridging the gap between the capital and fixed assets, it issues bonus shares to its equity shareholders.

- No issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.
- As per Section 63(3) of the Companies Act, 2013, the bonus shares shall not be issued in lieu of dividend.
- Rule 14 of Companies (Share Capital and Debentures) Rules, 2014 states that the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.
- SEBI has issued regulations for Bonus Issue which are contained in Chapter XI of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 by listed companies.
- As per Section 62(1) (b) of Companies Act 2013, the Company can offer shares through employee stock option to their employees through special resolution subject to the conditions specified under Rule 12 of Companies (Share Capital and Debentures) Rules, 2014.
- Issue of Employee Stock option by a listed entity is regulated by SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
- SEBI has, on 13th August, 2021 notified SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 for regulation of all schemes by companies for the benefit of their employees involving dealing in shares, directly or indirectly, with a view to facilitate smooth operation of such schemes while preventing any possible manipulation and matters connected therewith or incidental thereto.
- A company may implement the various schemes as prescribed under SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 either:
    - directly; or
    - by setting up an irrevocable trust(s).
- An employee shall be eligible to participate in the schemes of the company as determined by the compensation committee.
- In case of winding up of the schemes being implemented by a company, the excess monies or shares remaining with the trust after meeting all the obligations, if any, shall be utilised for repayment of loan or by way of distribution to employees as recommended by the compensation committee.
- Section 2 (88) of the Companies Act, 2013 defines "sweat equity shares" means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.
- Where the equity shares of the company are listed on a recognized stock exchange, sweat equity shares should be issued in accordance with SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
- In case of issue of sweat equity shares, the same shall also be approved by special resolution passed by the company in General Meeting.

GLOSSARY

Exercising the option: The act of buying or selling the underlying asset via the option contract.

Intellectual Property: It is a category of property that includes intangible creations of the human intellect and primarily encompasses copyrights, patents and trademarks. It also includes other types of rights, such as trade secret, publicity rights, moral rights and rights against unfair competition.

Voting Rights: The entitlement of a shareholder to exercise vote in the General Meeting of a company.

Vesting: The process by which the employee becomes entitled to receive the benefit of a grant made to him/her under any of the schemes.

Market Price: The latest available closing price on a recognised stock exchange on which the shares of the company are listed on the date immediately prior to the relevant date.

Secondary Acquisition: Acquisition of existing shares of the company by the trust on the platform of a recognised stock exchange for cash consideration.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Briefly discuss the procedure for issuing bonus shares by listed company.
2. What are applicability and non-applicability of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021?
3. "In a growing company, ESOP are being used to retain talent." Discuss.
4. Explain the implementation of ESOP Schemes through Trust in accordance with SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.
5. What are the documents required to be prepared by the company secretary for listing approval for Bonus Shares issued by the company for documentation purpose ?
6. Explain the provisions of the Companies Act, 2013 for Issue of Sweat Equity Shares. To what extent the Sweat Equity Shares can be issued to an Independent Director ?
7. The Board of Directors of Prakash Limited are planning to introduce an Employee Stock Option Scheme (ESOS) for select category of employees. The Board has requested the Company Secretary to prepare the required documentation for obtaining in-principle approval from Stock Exchanges. Advise.

LIST OF FURTHER READINGS

- SEBI Circulars/Notifications/FAQs
- Companies Act and Rules made thereunder

OTHER REFERENCES

- https://www.mca.gov.in/content/mca/global/en/home.html
- https://www.sebi.gov.in/

An Overview on Listing and Issuance of Securities in International Financial Services Centre

Lesson 13

KEY CONCEPTS

■ International Financial Services Centre (IFSC) ■ International Financial Services Centres Authority (IFSCA) ■ Specified Securities ■ Debt Securities ■ ESG Debt Securities ■ Depository Receipts ■ Market Infrastructure Institution ■ Special Purpose Acquisition Company (SPAC) ■ Foreign Jurisdiction

Learning Objectives

To understand:

- Listing and Trading of Securities in IFSC and the Regulatory Framework
- Applicability and Key Definitions under IFSCA (Issuance and Listing of Securities) Regulations, 2021
- Eligibility criteria and issue process for making IPO and FPO
- Eligibility to list specified securities on a recognized stock exchange by a start-up company, with or without making a public offer
- The concept of Special Purpose Acquisition Company (SPAC) and regulatory framework for listing of SPACs
- The eligibility criteria and process for issuance of Depository Receipts
- Regulatory prescriptions for listing of debt securities on the recognized stock exchanges in IFSC
- Framework on listing of ESG Debt Securities
- Listing Obligations and Disclosure Requirements under IFSCA (Issuance and Listing of Securities) Regulations, 2021.

Lesson Outline

- Listing and Trading of Securities in IFSC
- Background on the Regulatory Framework in IFSC
- IFSCA (Issuance and Listing of Securities) Regulations, 2021
- Important Definitions
- Applicability
- Salient Features of IFSCA (Issuance and Listing of Securities) Regulations, 2021
- Initial Public Offer
- Further Public Offer
- Rights Issues or Preferential Issues
- Start-ups and Small and Medium Enterprises (SMEs)
- Special Purpose Acquisition Company (SPAC)
- Regulatory Framework for Listing of SPACs
- Secondary Listing of Specified Securities
- Depository Receipts
- Initial Public Offer of Depository Receipts
- Listing of Debt Securities
- Environment, Social and Governance (ESG) Debt Securities
- Listing Obligations and Disclosure Requirements
- Sustainable Finance at IFSC
- IFSCA (Fund Management) Regulations, 2022 – An Overview
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021
- International Financial Services Centres Authority Act, 2019
- SEBI (International Financial Services Centres) Guidelines, 2015
- IFSCA (Fund Management) Regulations, 2022

LISTING AND TRADING OF SECURITIES IN IFSC

In Globalized world, international capital acts as an important driver of economic growth and development. The setting up of the IFSC in India is aimed at tapping global capital flows to meet India's development needs and simultaneously provide international issuers a globally competitive financial platform for the full range of international financial services.

Section 23 (3) of the Companies Act, 2013 has been notified on September 28, 2020, enabling listing of equity shares of public Indian companies in permissible foreign jurisdictions, including IFSC. Prior to the establishment of International Financial Services Centres Authority (IFSCA or Authority), the listing of equity in IFSC by companies incorporated in India and foreign jurisdiction was regulated by a combination of SEBI (IFSC) Guidelines, 2015, relevant provisions of SEBI (Issue of Capital and Disclosure requirements) Regulations, 2018, Companies Act, 2013 and Foreign currency depository receipt scheme and circulars issued thereunder.

Post the establishment of IFSCA, the Authority in its endeavor to develop a comprehensive and consistent regulatory framework based on global best practices with a special focus on ease of doing business, enacted an all-encompassing framework {International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021} to facilitate issuers to access world's capital markets. Through a cross-border listing, a company can reach beyond its home jurisdiction to identify a foreign stock exchange that meets its particular corporate financing needs. In order to provide an ecosystem for Fintech companies, IFSCA enabled the listing of startups in IFSC. Further, considering the recent innovative methods for raising of capital by companies in some jurisdictions, such as by Special Purpose Acquisition Companies (SPACs), the IFSCA enabled the listing of SPAC on the recognised stock exchanges, in order to facilitate sponsors, raise capital to undertake an acquisition of a company or assets.

The countries worldwide are investing into Environment, Social, Governance (ESG) projects, pursuant to the Paris Agreement and Sustainable Development Goals. The financial sector has been identified as being instrumental in advancing the zero-carbon energy transition. Considering the importance of Environment, Social and Governance issues and the ESG targets, there is a need for the regulators to provide an ecosystem for sustainable financing. IFSCA aims to move towards becoming a prominent international centre for sustainable finance, supporting the needs for ESG financing. Towards this direction, IFSCA has enabled the listing of green bonds, social bonds, sustainable bonds and sustainability linked bonds.

However, to leverage the advantage of vast global potential of capital requirement a dedicated Market Infrastructure Institutions (MII's) are important. Presently in GIFT-IFSC the following MII's are there: -

Market Infrastructure Institutions

Stock Exchange	• India International Exchange • NSE IFSC Limited
Clearing Corporation	• India International Clearing Corporation (IFSC) Limited • NSE IFSC Clearing Corporation Limited
Depositories	• CDSL • NSDL

BACKGROUND ON THE REGULATORY FRAMEWORK IN IFSC

The development of capital markets in IFSC has been a priority area of the IFSCA and towards this end, it has issued a robust regulatory framework in respect of issuance and listing of securities in IFSC. The IFSCA (Issuance and Listing of Securities) Regulations, 2021 ("Listing Regulations") were notified and published in the Gazette of India on July 16, 2021. These regulations have been formulated with the dual objectives of ensuring ease of doing business and protecting the interests of investors in the capital market ecosystem. The Listing regulations provide the unified regulatory framework for issuance and listing of specified securities and debt securities by companies incorporated in IFSC, India and foreign jurisdictions.

It is to be noted that, Ministry of Corporate Affairs has issued notification on August 05, 2021, under section 393A of the Companies Act, 2013 exempting foreign companies/ companies incorporated outside India from the provisions of sections 387 to 392 of the Companies Act, 2013 in so far as they relate to the offering for subscription in the securities, requirements related to the prospectus, and all matters incidental thereto in the IFSCs. Thus, the said notification facilitated listing of Foreign Companies.

Additionally, in order to ensure that capital markets in IFSCs support the financing of innovative business models especially those in the areas of fintech, corporate restructurings, etc., the framework provides for dedicated chapters relating to issuance and listing of securities by Start-ups, Small and Medium Enterprises (SMEs) and Special Purpose Acquisition Companies (SPACs).

The Listing Regulations have a dedicated chapter on ESG debt securities. This would help in bridging the gap between investors and issuers of green bonds, social bonds, sustainable bonds and sustainability linked bonds. It would also help in achieving the objective of making IFSC a prominent centre for sustainable finance.

INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY (ISSUANCE AND LISTING OF SECURITIES) REGULATIONS, 2021

Important Definitions

"Business Combination" means a merger or amalgamation or acquisition of shares or assets of one or more companies having business operations.

"Debt Securities" means non-convertible debt securities which create or acknowledge indebtedness and includes debentures and bonds.

"Depository Receipt" means a negotiable financial instrument representing underlying securities of a company listed in another jurisdiction.

"Foreign Jurisdiction" means a country, other than India, whose securities market regulator is a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding (IOSCO's MMOU) (Appendix A signatories) or a signatory to bilateral Memorandum of Understanding with the IFSCA, and which is not identified in the public statement of Financial Action Task Force as:

i. a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

ii. a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

"Key Managerial Personnel" means the officers or personnel of the issuer who are members of its core management team (excluding board of directors) and includes members of the management one level below the executive directors of the issuer, functional heads and includes 'key managerial personnel' as defined under the Companies Act, 2013 or any other person whom the issuer may declare as key managerial personnel.

"Listed Company" means a company whose specified securities or depository receipts are listed on a recognised stock exchange(s) in IFSC.

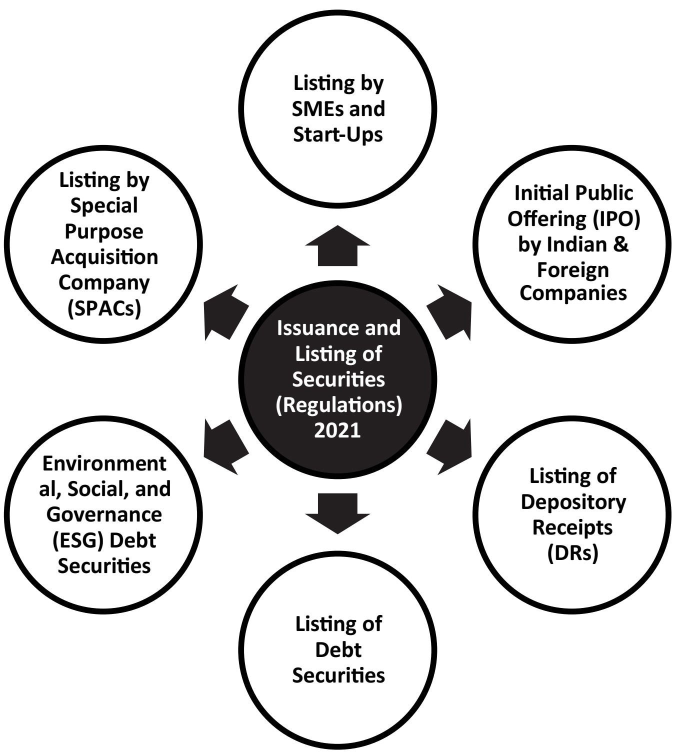
"Special Purpose Acquisition Company"* or *"SPAC" means a company which does not have any operating business and has been formed with the primary objective to affect a business combination.

"Specified Securities" means equity shares and convertible securities.

"SR Equity Shares" means the equity shares of an issuer having superior voting rights compared to all other equity shares issued by that issuer.

Applicability

IFSCA (Issuance and Listing of Securities) Regulations, 2021



These regulations shall apply to:

(a) an initial public offer of specified securities by an unlisted issuer;

(b) a follow-on public offer of specified securities by a listed issuer;

(c) listing of specified securities by a start-up company or an SME company;

(d) secondary listing of specified securities;

(e) an initial public offer of specified securities by a Special Purpose Acquisition Company;

(f) rights issue and/or preferential issues by a listed issuer;

(g) listing of depository receipts;

(h) listing of debt securities;

(i) listing of ESG debt securities; and

(j) issuance and/or listing of any other securities as may be specified by the Authority from time to time.

SALIENT FEATURES OF IFSCA (ISSUANCE AND LISTING OF SECURITIES) REGULATIONS, 2021

Initial Public Offer

IPO

- **Eligibility**
  - Average Pre-tax profit, based on consolidated audited accounts, of at least USD 1 million during the preceding three financial years

    OR
  - Operating revenue of at least USD 20 million in the preceding financial year
- **Offer size -** Not less than USD 15 million
- **Minimum Subscription:**
  - ✓ 75% of the offer size
  - ✓ 200 subscribers

Eligibility

(1) An issuer shall be eligible to make an initial public offer only if:

(i) the issuer has an operating revenue of at least USD 20 million in the preceding financial year; or

(ii) the issuer has an average pre-tax profit, based on consolidated audited accounts, of at least USD 1 million during the preceding three financial years, or any other eligibility criteria that may be specified by the Authority;

(iii) Further, the issuer shall have commenced business at least three years prior to the date of filing of prospectus.

(2) The following entities shall also be eligible in respect of listing of debt securities on a recognised stock exchange, -

(i) an issuer incorporated in IFSC;

(ii) an issuer incorporated in India or a Foreign Jurisdiction in any currency other than INR;

(iii) any supranational, multilateral or statutory organisation/ institution/agency provided such organization/institution/agency is permitted to issue securities as per its constitution:

Provided that the entity is registered or headquartered in India, IFSC or a Foreign Jurisdiction;

(iv) any municipality or any statutory body or board or corporation, authority, trust or agency established or notified by any Central or State Act or any special purpose vehicle notified by the State Government or Central Government including for the purpose of raising fund by the issuer to develop infrastructure or SMART city; and

(v) An entity whose securities are irrevocably guaranteed by a Sovereign (India or a Foreign Jurisdiction);

(vi) Masala bonds;

(vii) Any other debt securities as may be permitted by IFSCA from time to time.

(3) An issuer shall be eligible to list its securities under the IFSCA (Issuance and Listing of Securities) Regulations, 2021 in IFSC only if,

(i) the issuer is duly incorporated or established according to the relevant laws of its place of incorporation or establishment;

(ii) the issuer is operating in conformity with its constitution; and

(iii) the listing of securities in IFSC is in accordance with the applicable laws of the jurisdiction of incorporation.

(4) An issuer shall not be eligible to list securities under IFSCA (Issuance and Listing of Securities) Regulations, 2021, if the issuer or any of its promoters, promoter group, controlling shareholders or directors or selling shareholders is -

(i) debarred from accessing the capital market; or

(ii) a wilful defaulter; or

(iii) a fugitive economic offender.

The securities proposed to be listed on a recognised stock exchange should be freely transferable and held in dematerialised form.

Offer size

The issue shall be of size not less than USD 15 million.

Minimum subscription

For the offer to be successful, the minimum subscription received in the issue shall be at least seventy-five per cent of the issue size and the minimum number of subscribers shall be 200.

FURTHER PUBLIC OFFER

Applicability

An issuer listed on a recognised stock exchange may make a follow-on public offer of specified securities in the manner provided in these regulations.

Offer for Sale

In case of an offer for sale, the securities need to be held by the sellers for at least one year prior to their filing of the draft offer documents.

However, for the purpose of calculation of one year period as aforesaid, in cases where the equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities, including depository receipts, as well as that of resultant equity shares together will be considered together.

Further, the requirement of holding equity shares for a period of one year shall not be applicable in the following cases:

a) If the equity shares offered for sale were acquired pursuant to any scheme of merger or amalgamation in lieu of business and invested capital which had been in existence for a period of more than one year prior to approval of such scheme; or

b) If the equity shares offered for sale were issued under a bonus issue on securities held for a period of at least one year prior to the filing of the draft offer document with IFSCA and when the following conditions are met:

    (i) such specified securities being issued out of free reserves and share premium existing in the books of account as at the end of the financial year preceding the financial year in which the draft offer document is filed with IFSCA; and

    (ii) such equity shares not being issued by utilisation of revaluation reserves or unrealized profits of the issuer.

Lead Manager

It is mandatory to appoint one or more merchant bankers as lead manager(s) and also other intermediaries in consultation with such lead manager(s).

Fast Track Follow-on Public Offer

An issuer may make follow-on public offer through the fast-track route, if the conditions mentioned below are fulfilled:

(i) issuer has listed his equity shares on a recognized stock exchange(s) for a period of at least 18 months;

(ii) issuer is in compliance with all the regulatory requirements specified by IFSCA and the recognised stock exchange(s) in the preceding three years;

(iii) no show-cause notice has been issued by IFSCA and pending against the issuer or its promoters or controlling shareholders or whole-time directors;

(iv) there is no adverse opinion, disclaimer of opinion, qualified opinion by the auditors on the financial statements of the issuer, or any of the issuer's subsidiaries or associated companies (having a material impact on the issuer's consolidated accounts), in the preceding three years;

(v) there has not been any disclosure relating to irregularities in the issuer, having a material impact on the issuer, by any director, key managerial personnel or compliance officer.

Note: If the issuer's securities are listed for a period of less than three years then the date of listing for the purpose of clauses (b) and (d) above, shall be considered from the date of listing.

Initial Disclosures

The offer document shall contain all material disclosures which are true, correct and adequate to enable the investors to take an informed investment decision. The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosures in the offer document.

The offer document shall contain disclosures such as Offer Document Summary, Risk factors, Introduction, General information, Capital Structure etc.

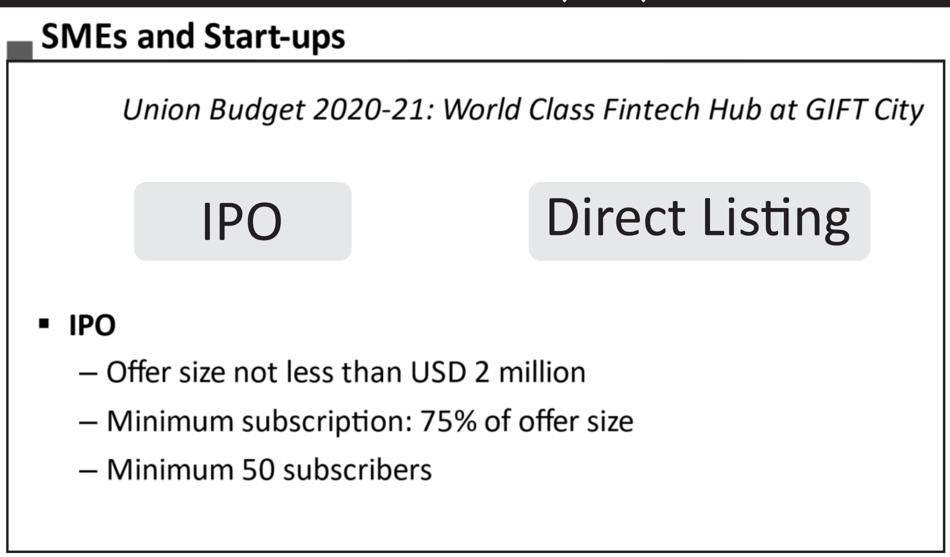
Issue Process

The provisions relating to offer timing, issue size, pricing, offer period, minimum subscription, underwriting, allotment, listing, post-issue report, other responsibilities of lead manager and prohibition on payment of incentives provided for Initial Public Offers shall mutatis mutandis apply to follow on public offer by a listed issuer.

RIGHTS ISSUES OR PREFERENTIAL ISSUES

A company listed on a recognised stock exchange can issue rights issues or preferential issues of specified securities, if such company fulfils the requirements that may be specified by the recognised stock exchange(s) and the Authority from time to time.

START-UPS AND SMALL AND MEDIUM ENTERPRISES (SMEs)



Eligibility

(a) A start-up company is eligible to list its specified securities on a recognized stock exchange(s), **with or without making a public offer**, if it fulfils the below mentioned conditions:

(i) The offer document of the company should be filed within a period of ten years from the date of incorporation/ registration;

(ii) The annual turnover of the company for any of the financial years since incorporation/ registration should not be more than USD 20 million; and

(iii) The start-up is working towards innovation, development or improvement of products or processes or services, or its business model has a high potential of employment generation or wealth creation.

(b) An SME company is eligible to list its specified securities on a recognized stock exchange(s), with or without making a public offer, if the annual turnover of the company for any of the financial years since incorporation/ registration is not more than USD 50 million.

In-Principle approval from Recognised Stock Exchange(s)

(1) The company shall file an application with the recognised stock exchange(s) seeking in-principle approval: Provided that where the application is made to more than one recognised stock exchange, the issuer shall choose one of them as the designated stock exchange.

(2) The stock exchange(s) shall grant an in-principle approval or reject the application for the in-principle approval within thirty days from the date of receipt of complete information from the issuer.

Listing without public offer

(1) The company shall file the information document along with fee as may be specified by IFSCA.

(2) The lead manager(s) shall submit a due diligence certificate along with the information document.

(3) The issuer shall simultaneously file the information document with the recognised stock exchange(s).

Issue Size

a) The issue shall be of size USD two million or more but less than USD fifteen million, or any other amount as may be specified by IFSCA.

b) The issuer may make reservations on a competitive basis out of the issue size in favour of the following categories of persons and the same shall be suitably disclosed in the offer document:

(i) employees;

(ii) directors; and

(iii) shareholders (other than promoters and promoter group) of listed subsidiaries or listed promoter companies.

c) The reservations referred in clause (b) shall not exceed twenty per cent. of the issue size.

Minimum Subscription

For the offer to be successful, the following conditions shall be satisfied:

a) The minimum subscription received in the issue shall be at least seventy-five percent of the offer size; and

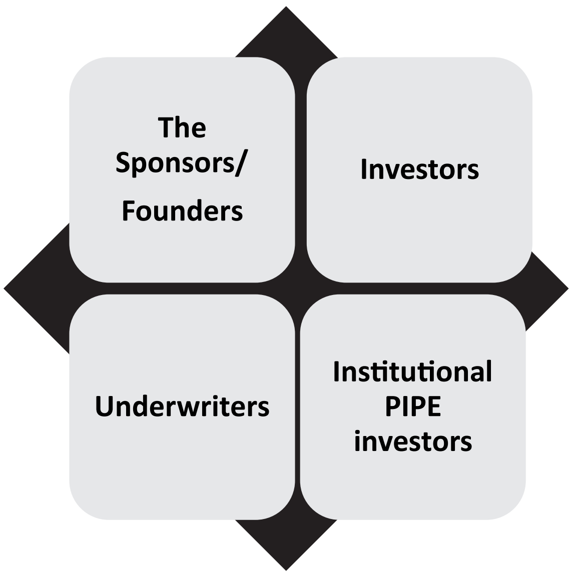
b) The minimum number of subscribers shall be 50 or as may be satisfied by the Authority.

SPECIAL PURPOSE ACQUISITION COMPANY (SPAC)

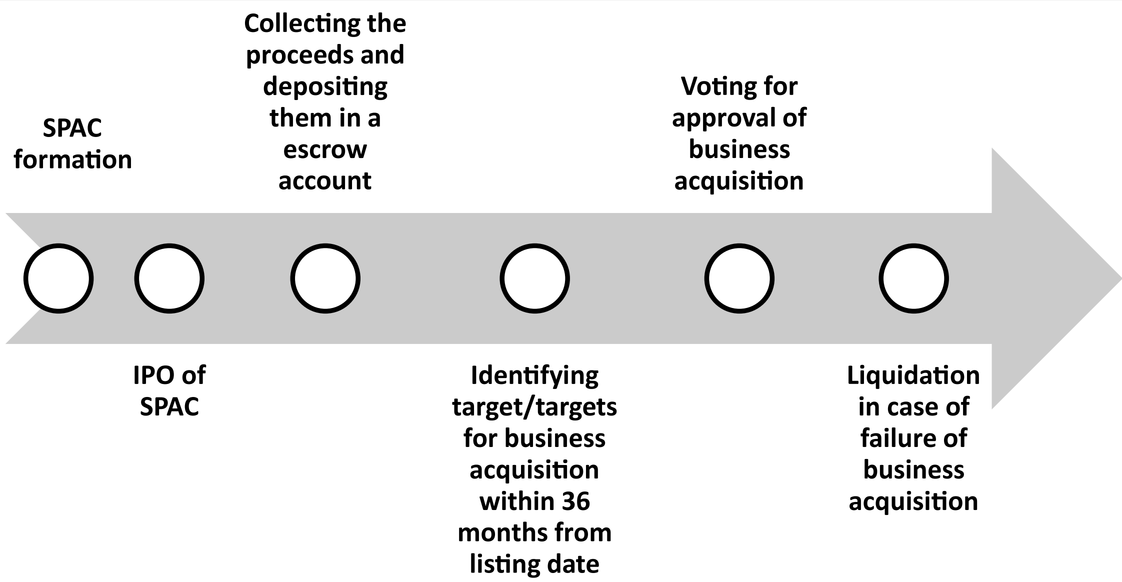
SPAC is a company which does not have any operating business and has been formed with the primary objective to affect a business combination. The SPACs have witnessed a surge in recent years in some of the jurisdictions (particularly USA) and are seen as an alternative to traditional IPOs for many companies to raise funds.

The IFSCA has specified the regulatory framework for listing of SPACs based on global best practices. The Authority's listing framework gives scope for innovation and at the same time has the necessary checks and balances to protect the interests of investors. The framework on SPACs is aimed at facilitating the start-up ecosystem by providing access to global capital.

The entities involved in SPAC



Process flow of SPAC



REGULATORY FRAMEWORK FOR LISTING OF SPACs

Eligibility Criteria

(a) A SPAC incorporated in IFSC, India or foreign jurisdiction is eligible to list its specified securities in IFSC.

(b) A SPAC issuer shall be eligible to raise capital through IPO of specified securities on the recognized stock exchange(s) in IFSC, only if:

   (i) The target business combination has not been identified prior to the IPO; and

   (ii) The SPAC has the provisions for redemption and liquidation in line with the Listing Regulations.

(c) A sponsor of the SPAC issuer shall have a good track record in SPAC transactions or business combinations or fund management or merchant banking activities, and the same shall be disclosed in the offer document.

Initial Disclosures in the Offer Document

The offer document shall contain all material disclosures which are true, correct and adequate to enable the investors to take an informed investment decision.

Issue size

(a) The issue shall be of size not less than USD 50 million.

(b) The sponsors shall hold at least fifteen per cent and not more than twenty per cent of the post issue paid up capital. The sponsors shall also have aggregate subscription (all securities) in terms of amount in the SPAC company prior to or simultaneous to the IPO, amounting to at least 2.5 per cent of the issue size or USD 10 million, whichever is lower.

■ **SPAC**

- **Underwriting** May be underwritten with disclosures in the offer document
- **IPO size and other requirements:**
  - $ 50 million;
  - Minimum application size: $ 100,000
- **Acquisition:** Aggregate fair market value equal to at least 80% of the aggregate amount deposited in the escrow account
- **Time period for business acquisition:** The SPAC Issuer shall complete the business combination within the timeline disclosed in the other document, not exceeding 36 months from the date of listing on the recognised stock exchange.
- **Liquidation:** Sponsors shall not participate in liquidation
- **Lock-up:** Locked up for a period of 1 year from date of closing of business acquisition.

Underwriting for SPAC IPO

(a) May be underwritten and in such case adequate disclosure regarding underwriting arrangements shall be disclosed in the offer document.

(b) At least fifty per cent of the underwriting commission shall be deferred until successful completion of the business combination and shall be deposited in the escrow account.

(c) In case of liquidation, the underwriter shall waive their rights on the deferred commission deposited in the escrow account.

Application size and allotment requirements

(a) Minimum application size: USD 100,000.

(b) For the offer to be successful, at least seventy-five per cent of the issue size shall be subscribed and the minimum number of subscribers shall be at least 50.

(c) No single application shall be allotted more than 10% of the post issue capital and the allotment to investors shall be on proportionate basis or discretionary basis, as disclosed in the offer document.

(d) The minimum number of subscribers shall be 50 or as may be specified by the Authority.

Protection to investors of SPAC IPO through escrow account

(a) The SPAC issuer shall ensure that the entire proceeds of the IPO are kept in an interest-bearing escrow account controlled by an independent custodian until consummation of the SPAC 's business combination.

(b) The escrow funds shall be invested only in instruments disclosed in the offer document and shall include only short-term investment grade liquid instruments.

(c) The interest and other income derived from the amount placed in the escrow account may be withdrawn by the SPAC issuer for the following purposes:

  (i) Payment of taxes; and

  (ii) General working capital expenses, subject to prior approval by way of special resolution of the shareholders other than sponsors.

Prospectus regarding proposed business combination

The SPAC shall file a detailed prospectus with the recognised stock exchange(s) containing all relevant disclosures regarding the proposed business combination, while seeking shareholders' approval.

Shareholders' approval

The SPAC shall seek prior approval by way of majority of shareholders other than sponsors, for the proposed business combination.

Redemption rights of shareholder

(a) If a shareholder (other than sponsors) has voted against the proposed business combination, he shall have the redemption right for converting his securities into a pro rata portion of the aggregate amount held in the escrow account (net of taxes payable).

(b) In the event of change in control of the SPAC, the SPAC issuer shall provide the redemption option to the shareholders (other than sponsors) for converting their securities into a pro rata portion of the aggregate amount held in the escrow account (net of taxes payable).

Conditions related to Business Combination

(a) Shall complete the business combination within the timeline disclosed in the offer document, not exceeding thirty-six months from the date of listing on the stock exchange(s).

(b) The SPAC issuer shall ensure that the businesses acquisition shall have an aggregate fair market value equal to at least 80% of the aggregate amount deposited in the escrow account, excluding deferred underwriting commissions held in escrow and any taxes payable on the income earned on the escrowed funds.

(c) The SPAC and the sponsors shall ensure that there is no related party transaction or connection of sponsor or any of their associates with the business combination.

Liquidation

If the business combination is not completed within the permitted time frame, the escrow account shall be liquidated in terms of the IFSCA Listing Regulations and disclosures in the offer document.

Post business combination

(a) The resulting issuer shall be required to meet the listing eligibility criteria set out in the IFSCA Listing Regulations within 180 days, in order to continue listing on the recognized stock exchange(s). The resulting issuer shall comply with the listing obligations and continuous disclosure requirements specified in the IFSCA Listing Regulations.

(b) The shareholding of the sponsors of the SPAC in the resulting issuer shall be locked up for a period of one year from the date of closing of the business combination. The shareholding of the promoters, promoter groups, controlling shareholders, directors and key managerial personnel of the resulting issuer shall be locked up for a period of one year from the date of closing of the business combination.

SECONDARY LISTING OF SPECIFIED SECURITIES

Listing without Public Offer

Any company which is having its specified securities listed in India (outside IFSC) or in a Foreign Jurisdiction can list its specified securities on a recognised stock exchange(s), without public offer, if it fulfils the following conditions:

a) It files an application in the manner as may be specified by the recognized stock exchanges(s);

b) It fulfils the obligations/ requirements as laid down by the recognized stock exchanges(s) and also those laid down by the Authority, from time to time.

Listing with Public Offer

a) Any company which is having its specified securities listed in India (outside IFSC) or in a Foreign Jurisdiction can list its specified securities on a recognised stock exchange(s) by undertaking public offer.

b) The provisions relating to appointment of lead manager, in-principle approval from recognised stock exchange(s), filing of offer document, offer timing, initial disclosures in offer document, pricing, offer period, issue size, minimum subscription, underwriting, allotment, listing, post-issue report, other responsibilities of lead manager and prohibition on payment of incentives provided for Initial Public Offers under the IFSCA (issuance and listing of securities) regulations, 2021, shall *mutatis mutandis* apply to secondary listing with public offer by such issuer.

DEPOSITORY RECEIPTS

Eligibility

a) A company incorporated in India (outside IFSC) or a Foreign Jurisdiction can make an issue of depository receipts, if it fulfils the below mentioned conditions –

   (i) the issuer is authorised to issue depository receipts; and

   (ii) the issuance of depository receipts by the issuer is in accordance with the applicable laws of its home jurisdiction.

b) The depository receipts can be listed only if the underlying securities which the depository receipts represent are:

   (i) freely transferable, in dematerialised form and rank on the same level with the existing securities of the same class;

   (ii) fully paid and free from all liens; and

   (iii) listed or will be listed in the home jurisdiction of the issuer before listing of depository receipts on stock exchange(s).

c) All the depository receipts are freely negotiable.

d) A dematerialization agreement has been entered into by the issuer with the depository regarding the proposed DRs.

INITIAL PUBLIC OFFER OF DEPOSITORY RECEIPTS

Offer size

The issue of depository receipts shall be of size not less than USD 700,000 (or equivalent in foreign currency), or any other amount as may be specified by the Authority from time to time.

Pricing

The price of the DRs can be determined through consultation with the lead managers(s) or through book building process.

Offer period

The initial public offer of DRs shall be kept open for at least three working days and not more than ten working days.

Minimum subscription

The listing of DRs shall be permitted only if the subscription in the offer is not less than USD 700,000 (or equivalent in foreign currency) or any other amount as may be specified by IFSCA from time to time.

Allotment

The allotment, payments and refunds must be completed within 5 working days from the date of closing of the issue.

Listing

The DRs shall list on the stock exchange(s) within the period, as specified by the stock exchange(s).

Listing and Trading (Without Public Offer)

Any company which is having its depository receipts listed in India (outside IFSC) or in a Foreign Jurisdiction can list its depository receipts on a recognised stock exchange, if it meets the following conditions:

a) An application is filed in the manner as may be specified by the recognised stock exchange(s); and

b) The listing requirements of the recognised stock exchange(s) are met.

First Listing of Depository Receipts in IFSC

Dr. Reddy's Laboratories Ltd. ("DRLL") is a listed company with equity shares listed on BSE Limited and National Stock Exchange Limited and American Depository Receipts listed on New York Stock Exchange. DRLL listed its depository receipts, as a secondary listing, on NSE IFSC Limited on December 09, 2020. This marked the first listing of DRs in IFSC (since its formation in 2015).

LISTING OF DEBT SECURITIES

The regulatory framework facilitates listing of debt securities (including issuances under Medium Term Notes) on the recognized stock exchanges in IFSC.

Eligible Debt Securities

The following categories of debt securities are eligible for listing on a recognised stock exchange in an IFSC:

a) Those issued by an issuer incorporated in IFSC;

b) Issued by an issuer incorporated in India or a Foreign Jurisdiction in any currency other than INR;

c) Issued by a supranational, multilateral or statutory organisation/ institution /agency;

d) Issued by any municipality or any statutory body or board or corporation, authority, trust or agency established or notified by any Central or State Act or any special purpose vehicle notified by the State Government or Central Government including for the purpose of raising fund by the issuer to develop infrastructure or SMART city;

e) Those which are irrevocably guaranteed by a Sovereign (India or a Foreign Jurisdiction);

f) Masala bonds;

g) Any other as may be permitted by IFSCA from time to time.

Note: The debt securities include standalone issuances or series of issuances such as Medium-Term Note programmes.

Mandatory listing for issuers based in IFSC

Issuers who are incorporated in the IFSC and are desirous of issuing debt securities shall mandatorily apply for listing of its debt securities on a recognised stock exchange.

Minimum subscription in case of private placement

In case of private placement, the minimum subscription amount per investor shall not be less than USD hundred thousand or equivalent or such amount as may be specified by the Authority from time to time.

Credit Rating

(a) Issuers can obtain credit rating for their debt securities from a credit rating agency, who may be registered with the Authority or registered in India or any Foreign Jurisdiction.

(b) If the credit rating has been obtained, it is mandatory to disclose the details of the credit ratings in the prospectus, shelf prospectus or information memorandum, as the case may be.

Public Issue

With respect to a public issue of debt securities on a recognised stock exchange, the issuer shall meet compliances such as appointment of trustee, creation of debenture redemption reserve etc. that may be specified by the Authority or the recognised stock exchange(s), from time to time.

Exempt Issuers

The recognised stock exchange(s) may relax some of the requirements for the following class of issuers:

(a) Supranational, multilateral or statutory institutions /organizations /agencies;

(b) Entities whose securities are irrevocably guaranteed by a Sovereign; and

(c) Any other entity as may be specified by the Authority from time to time.

ENVIRONMENT, SOCIAL AND GOVERNANCE (ESG) DEBT SECURITIES

The Authority aims to make IFSC a prominent centre for sustainable finance, supporting the needs of sustainable projects. Towards this end, the Listing Regulations have provisions towards listing of ESG debt securities such as green bonds, social bonds, sustainable bonds, and sustainability linked bonds.

Green/ Social/ Sustainability/ Sustainability-linked Bonds

Green bonds are targeted to finance projects or activities with positive environmental benefits. Proceeds from social bonds go towards social projects or activities to achieve positive social output or address a particular social issue. The social projects generally target communities such as those living below the poverty line, marginalized communities, migrants, unemployed, women, people with disabilities, and displaced persons. Sustainable bonds are raised to achieve a combination of green and social objectives. On the other hand, sustainability-linked bond issuers focus on improving their performance against specified Key Performing Indictors (KPIs) and link certain targets directly to the coupon paid to investors. Unlike green bonds, the use of proceeds can be for general corporate purposes also.

ESG Focused Bonds

- Aligned with Principles / Taxonomies prescribed by:
  - ICMA
  - Climate Bonds Initiative
  - ASEAN
  - European Union
  - India
  - Other international standards
- External Independent Review: Mandatory
- Additional disclosures
  - Allocation Report
  - Impact Report

Labelling of Green, Social or Sustainable Bonds

The debt securities shall be labelled as green, social or sustainability if the funds raised through the issuance of such debt securities are to be utilised for financing or refinancing projects and/or assets aligned with any of the following recognised frameworks:

(a) International Capital Market Association Principles / Guidelines;

(b) Climate Bonds Standard;

(c) ASEAN Standards;

(d) European Union Standards / Taxonomy;

(e) Any framework or methodology specified by a competent authority in India; or

(f) Other international standards.

The debt securities shall be labelled as '*sustainability-linked',* if aligned with any of the above recognised frameworks.

Review of ESG debt securities

In order to ensure review of the ESG debt securities, the issuer will have to employ an independent reviewer who can ensure compliance with the aforesaid frameworks and also comply with the following conditions:

(a) Reviewer shall be independent of the issuer, its directors, senior management, key managerial personnel and advisers;

(b) Reviewer shall be remunerated in a way that prevents any conflicts of interests; and

(c) Reviewer shall have sufficient expertise in assessing ESG debt securities.

IFSCA FRAMEWORK ON LISTING OF ESG DEBT SECURITIES – AN OVERVIEW

Listing of ESG Debt Securities

1) The debt securities shall be labelled as green, social, sustainability-linked if aligned with any of the recognized frameworks such as International Capital Market Association Principles/ Guidelines, Climate Bonds Standard, ASEAN Standards, European Union Standards/ Taxonomy, any framework or methodology specified by a competent authority in India or other international standards (to be considered on a case-by-case basis).

2) It is mandatory for the issuers to appoint an independent external reviewer to ascertain that the ESG debt securities are in alignment with the mentioned recognized framework(s).

3) The issuers of green bonds, social bonds and sustainable bonds are mandated to provide additional disclosures in the offer documents including statement on ESG objectives, details of process followed by the issuer for evaluating and selecting the projects and/ or assets, proposed utilization of the proceeds of the issue, and details of the systems and procedures to be employed for tracking the deployment of the proceeds of the issue. Post listing, the issuers are also required to provide additional disclosures on an annual basis (until full allocation of the proceeds) on (a) Utilization of proceeds of the issue, (b) Allocation Report, and (c) Impact report.

4) The issuers of sustainability linked debt securities are required to provide additional disclosures in the offer document including rationale for issuance of sustainability-linked debt securities and consistency with issuers' overall sustainability and business strategy. Further, the issuer shall adhere to pre-issuance and post-issuance obligations in accordance with the international standards that the securities are aligned with.

Listing Obligations and Disclosure Requirements under IFSCA (Issuance and Listing of Securities) Regulations, 2021

Principles governing disclosures and obligations

The listed entity which has listed securities shall make disclosures and abide by its obligations under IFSCA (Issuance and Listing of Securities) Regulations, 2021, in accordance with the following principles:

a. Information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.

b. The listed entity shall implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and shall also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

c. The listed entity shall refrain from misrepresentation and ensure that the information provided to recognised stock exchange(s) and investors is not misleading.

d. The listed entity shall provide adequate and timely information to recognised stock exchange(s) and investors.

e. The listed entity shall ensure that disseminations made under provisions of IFSCA (Issuance and Listing of Securities) Regulations, 2021 and circulars made thereunder, are adequate, accurate, explicit, timely and presented in a simple language.

f. Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by investors.

g. The listed entity shall abide by all the provisions of the applicable laws including the securities laws and also such other guidelines as may be issued from time to time by IFSCA and the recognised stock exchange(s) in this regard and as may be applicable.

h. The listed entity shall make the specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders.

i. Filings, reports, statements, documents and information which are event based or are filed periodically shall contain relevant information and shall be filed within the specified timelines.

j. Periodic filings, reports, statements, documents and information reports shall contain information that shall enable investors to track the performance of a listed entity over regular intervals of time and shall provide sufficient information to enable investors to assess the current status of a listed entity.

General obligation of compliance

The listed entity shall ensure that key managerial personnel, directors, promoters, controlling shareholders or any other person dealing with the listed entity complies with all or any of the conditions, as may be, assigned to them under the IFSCA Listing Regulations.

Compliance Officer and his Obligations

A listed entity shall appoint a **qualified company secretary** as the compliance officer and the compliance officer of the listed entity shall be responsible for-

(a) ensuring conformity with the regulatory provisions applicable to the listed entity in letter and spirit;

(b) co-ordination with and reporting to IFSCA, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities in the manner as specified from time to time; and

(c) ensuring that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under the IFSCA Listing Regulations.

Sustainable Finance at IFSC

The Authority has developed a comprehensive strategy for the development of sustainable finance at IFSC across capital markets, banking, insurance and fintech. IFSC has a well-functioning capital markets and banking ecosystem with two international Stock Exchanges, Clearing Corporations and around 20 IBUs. The cost competitiveness of IFSC and tax incentives for the entities operating from IFSC is an advantage for capital flows, through IFSC, into sustainable projects.

During the FY 2021-22, total listing of ESG-labelled debt securities on IFSC exchanges amounts to USD 5234 million. The framework for ESG-labelled debt securities, based on international standards, enabled the debut of social, sustainable, and sustainability-linked debt securities at IFSC exchanges.

On January 24, 2022, Indian Railway Finance Corporation (IRFC) listed its USD 500 million green bonds exclusively on IFSC exchanges. IRFC became the first Central Public Sector Enterprise (CPSE) to list its offshore bonds exclusively on an IFSC exchange.

IFSCA (FUND MANAGEMENT) REGULATIONS, 2022 – AN OVERVIEW

After the Authority was vested with the powers to develop and regulate IFSCs in India, it has notified various regulations under the IFSCA Act, 2019 and, thereby, repealed the corresponding regulations which were drawn from the domestic regulators so far as their applicability in IFSCs is concerned. The AIFs in IFSCs were previously governed under the provisions of SEBI (AIF) Regulations, 2012. Over a period of time, the Government, IFSCA and other regulators made certain changes with regard to AIF regime to benchmark a few key practices in line with those prevalent in various global financial centres.

Further, IFSCA issued detailed framework for Real Estate Investment Trusts (REITs), Infrastructure Investment Trusts (InvITs) and Portfolio Management Services (PMS) separately. An operational framework for investment funds meant for non-institutional investors was yet to be specified. Thus, in line with other developed financial centres, there was a need to have a unified approach concerning the various activities related to fund management.

In this backdrop, the Authority constituted an Expert Committee on Investment Funds to recommend the road map for the funds industry in IFSCs. The Committee was constituted under the Chairmanship of Mr. Nilesh Shah, MD, Kotak Mahindra Asset Management Co. Ltd. and Member, Economic Advisory Council to the Prime Minister. The Committee comprised of leaders from the Fund Management ecosystem including from areas such as technology, distribution, legal, and compliance.

The Committee submitted its report to the Authority on January 31, 2022. Subsequently, the draft IFSCA (Fund Management) Regulations, 2022 have been approved by the Authority in its meeting held in March 2022.

LESSON ROUND-UP

- Section 23 (3) of the Companies Act, 2013 has been notified on September 28, 2020, enabling listing of equity shares of public Indian companies in permissible foreign jurisdictions, including IFSC.
- The IFSCA (Issuance and Listing of Securities) Regulations, 2021 were notified and published in the Gazette of India on July 16, 2021. These regulations have been formulated with the dual objectives of ensuring ease of doing business and protecting the interests of investors in the capital market ecosystem.
- An issuer shall be eligible to make an initial public offer only if the issuer has an operating revenue of at least USD 20 million in the preceding financial year or an average pre-tax profit, based on consolidated audited accounts, of at least USD 1 million during the preceding three financial years or issuer shall have commenced business at least three years prior to the date of filing of prospectus.
- An issuer listed on a recognised stock exchange may make a follow-on public offer of specified securities in the manner provided in these regulations.
- A start-up company is eligible to list its specified securities on a recognized stock exchange(s), with or without making a public offer, if the offer document is filed within a period of ten years from the date of incorporation/ registration and annual turnover of the company for any of the financial years since incorporation/ registration should not be more than USD 20 million and start-up is working towards innovation, development or improvement of products or processes or services, or its business model has a high potential of employment generation or wealth creation.
- SPAC is a company which does not have any operating business and has been formed with the primary objective to affect a business combination. The IFSCA has specified the regulatory framework for listing of SPACs based on global best practices.
- The SPAC shall seek prior approval by way of majority of shareholders other than sponsors, for the proposed business combination.
- Any company which is having its specified securities listed in India (outside IFSC) or in a Foreign Jurisdiction can list its specified securities on a recognised stock exchange(s), without public offer, if it files an application in the manner as may be specified by the recognized stock exchanges(s) and it fulfils the obligations/ requirements as laid down by the recognized stock exchanges(s) and the Authority.
- The issue of depository receipts shall be of size not less than USD 700,000 (or equivalent in foreign currency), or any other amount as may be specified by the Authority from time to time. The DRs shall list on the stock exchange(s) within the period, as specified by the stock exchange(s).
- Issuers who are incorporated in the IFSC and are desirous of issuing debt securities shall mandatorily apply for listing of its debt securities on a recognised stock exchange.
- Green bonds are targeted to finance projects or activities with positive environmental benefits. Proceeds from social bonds go towards social projects or activities to achieve positive social output or address a particular social issue.
- The debt securities shall be labelled as green, social, sustainability-linked if aligned with any of the recognized frameworks such as International Capital Market Association Principles/ Guidelines, Climate Bonds Standard, ASEAN Standards, European Union Standards/ Taxonomy, any framework or methodology specified by a competent authority in India or other international standards (to be considered on a case-by-case basis).
- The listed entity shall ensure that key managerial personnel, directors, promoters, controlling shareholders or any other person dealing with the listed entity complies with all or any of the conditions, as may be, assigned to them under the IFSCA Listing Regulations.

GLOSSARY

Authority: Authority means the International Financial Services Centres Authority established under sub-section (1) of section 4 of the International Financial Services Centres Authority Act, 2019.

Financial Services: Financial Services shall mean activities a financial institution is allowed to carry out as specified in the respective Act of the Parliament or by the Government of India or by any regulatory authority empowered to regulate the concerned financial institution.

Convertible Securities: Convertible Securities means securities which are convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of such securities and includes convertible debt instruments and convertible preference shares.

Convertible Debt Instrument: An instrument which creates or acknowledges indebtedness and is convertible into equity shares of the issuer at a later date at or without the option of the holder of the instrument, whether constituting a charge on the assets of the issuer or not.

Designated Stock Exchange: A recognised stock exchange chosen by the issuer on which securities of an issuer are listed or proposed to be listed for the purpose of a particular issue of securities.

Information Memorandum: Listing particulars or offering memorandum or offering circular or any document that provides investors with certain information about the issuer and the securities in connection with an application for listing of securities.

Lead Manager: A merchant banker appointed by the issuer to manage the issue and in case of a book built issue, the lead manager(s) appointed by the issuer shall act as the book running lead manager(s) for the purposes of book building.

Recognised Stock Exchange: A stock exchange in an IFSC recognised by the Authority.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. Enumerate the applicability for issuance and listing of securities under the IFSCA (Issuance and Listing of Securities) Regulations, 2021.
2. What is the eligibility criteria and minimum subscription requirement for an issuer to make an initial public offer in terms of IFSCA (Issuance and Listing of Securities) Regulations, 2021?
3. An issuer may make follow-on public offer through the fast-track route, if certain conditions are fulfilled. Explain.
4. A start-up company working towards innovation and development of products has annual turnover during the year more than USD 20 million. As per the requirement, the start-up company has filed the offer document within a period of 10 years from the date of its incorporation. Is the start-up company eligible to list its specified securities on a recognized stock exchange in terms of IFSCA (Issuance and Listing of Securities) Regulations, 2021?
5. What is Special Purpose Acquisition Company (SPAC)? Briefly explain the Regulatory Framework for Listing of SPACs in IFSC.
6. What are the categories of debt securities which are eligible for listing on a recognised stock exchange in an IFSC?
7. Write a short note on Green Bonds.

LIST OF FURTHER READINGS

- The International Financial Services Centres Authority Act, 2019
- IFSCA (Issuance and Listing of Securities) Regulations, 2021
- IFSCA Rules/ Regulations/ Circulars/ Notifications/ Guidelines
- SEBI (International Financial Services Centres) Guidelines, 2015
- IFSCA FAQs

OTHER REFERENCES

- https://www.sebi.gov.in
- https://www.ifsca.gov.in

Raising of Funds from Debt and Procedural Aspects

Lesson 14

KEY CONCEPTS

■ Debentures ■ Non-Convertible Securities ■ Deposits ■ Bonds ■ Bank Finance ■ Working Capital ■ Overdrafts ■ Cash Credit ■ Factoring ■ Forfeiting ■ NBFC ■ Letter of Credit ■ Bank Guarantee

Learning Objectives

To understand:

- The concept of Debt Funding and governing framework for Debt Securities
- Major Reforms under the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021
- Concept of Online Bond Platform Providers and its significance
- Concept of Request for Quote (RFQ) Platform
- General Compliance Obligations and Pre-listing Compliances
- Role of Company Secretary in Corporate Bond Market
- Concept of Public Deposits and NBFC Funding
- Various types of credit facilities granted by banks viz. Overdrafts, cash credit, bill finance, lease finance etc.
- Operating cycle of Working Capital Management
- Concept of Letter of Credit and its types
- Bank Guarantee
- Appraisal Methodology for different type of Non-Fund Based Credit Products

Lesson Outline

- Introduction
- Debt Market
- Regulatory Framework for Debt Securities
- Debentures and its Types
- Bonds
- Online Bond Platform Providers
- Electronic Book Provider (EBP) Mechanism
- Request for Quote (RFQ) Platform
- Sustainable Finance
- Green Debt Securities
- Disclosure Requirements for issue & listing of Debt Securities
- Green Bonds and Greenwashing
- Municipal Bonds
- Compliances as per SEBI NCS Regulations
- Concept of Public Deposits and NBFC Funding
- Various types of credit facilities granted by banks viz. Overdrafts, cash credit, bill finance, lease finance etc.
- Loan against Securities and Loan against Properties
- Concept of Discounting, Factoring and Forfeiting
- Working Capital Finance
- Concept of Letter of Credit and its types
- Bank Guarantee
- Appraisal Methodology for different type of Non Fund Based Credit Products
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

SECTION – I
INDIAN FUND BASED

INTRODUCTION

A vibrant securities market, both equity and bond, has to play an increasingly pivotal role to facilitate fund mobilization for sustaining India's projected economic growth momentum.

The banking sector is a very important financial intermediary in India's debt market. Over the last few years the bond market has emerged as an alternative to the banking sector especially for the top rated firms. There is a need for mobilization of funds from the Corporate Bond Market as it provides an alternative source of finance and supplements the banking system to meet the requirements of the corporate sector to raise funds for long-term investment. It is believed that this segment acts as a stable source of finance when the equity market is volatile, and also enables firms to tailor their asset and liability profiles to reduce the risk of maturity. This trend has been pronounced ever since the banking sector started reporting high levels of non-performing assets.

The existence of a deep and liquid corporate debt market could make emerging economies less vulnerable; especially to volatile capital flows. A reasonably well developed bond market could supplement the banking system in meeting the requirements of the corporate sector for long term capital investment and asset creation. It could provide a stable source of finance; especially when the equity market is volatile and resource requirements of the corporate entities are large. In the case of India, development of a corporate bond market has become even more crucial especially, in view of the need for raising large amount of resources for infrastructure development in the country in the immediate future.

A debenture being an attractive source of funding, is a long-term debt instrument issued by corporates and Government to secure fresh funds or capital. Coupons or interest rates are offered as compensation to the lender. The Company issues non-convertible debentures to attract lenders and investors, these come with higher interest rates. The role of corporate bond market becomes even more important now, given the stress on the banking sector.

Keeping in view the larger complementary role that corporate bonds have to play along-side bank credit for financing economic activities and promoting ease of doing business in India, several policy measures have been taken by the Government and the Regulators to develop a vibrant corporate bond market.

Some important measures include:

- Framework for allowing banks to undertake priority sector lending and provide Partial Credit Enhancement for enhancing creditworthiness;
- Information Repositories developed by Exchanges and Depositories to provide consolidated information on primary issuance and secondary market trades in corporate bonds;
- Electronic Book Building mechanism for providing enhanced transparency in issuance of debt securities on private placement basis;
- Enhanced standards for Credit Rating Agencies for timely monitoring of credit quality of bonds;
- Specifications related to International Securities Identification Number (ISINs) for debt securities to encourage liquidity and reduce fragmentation of issues;
- Tri-Party Repo trading on Stock Exchanges to enhance liquidity and price discovery in corporate bonds;

DEBT MARKET

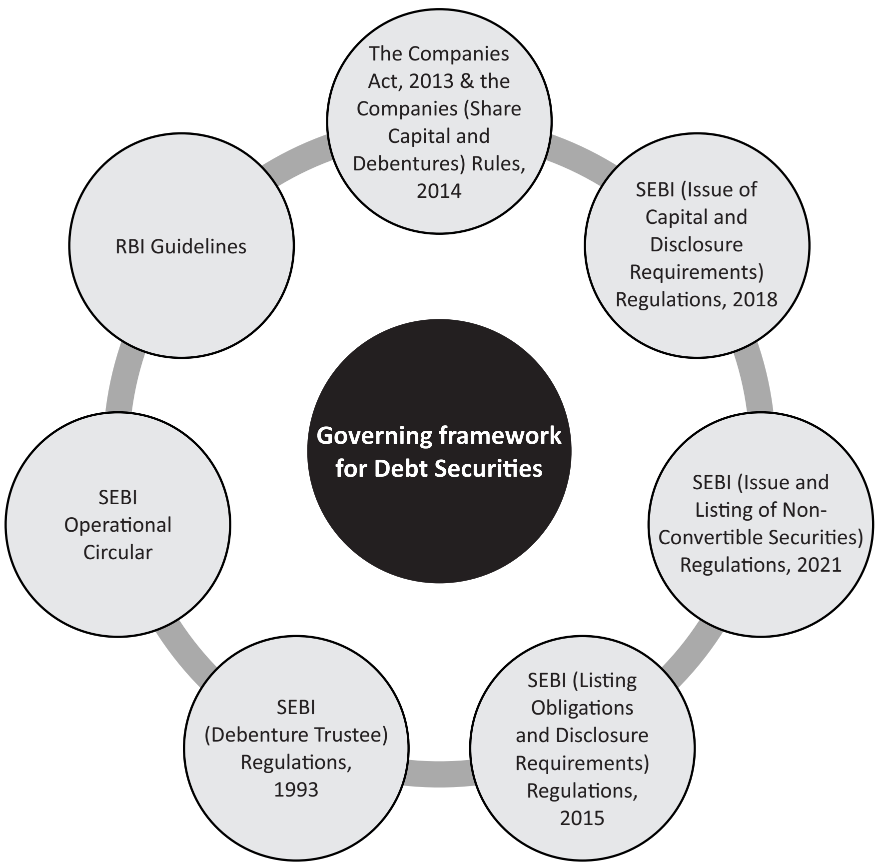
Debt markets are markets for the issuance, trading and settlement of various types and features of fixed income securities. Fixed income securities can be issued by any legal entity like central and state governments, public bodies, statutory corporations, banks and institutions and corporate bodies.

The debt market in India comprises mainly of two segments viz. the Government securities market consisting of Central and State Governments securities, Zero Coupon Bonds (ZCBs), Floating Rate Bonds (FRBs), T-Bills and the corporate securities market consisting of FI bonds, PSU bonds, and Debentures/Corporate bonds. Government securities form a major part of the market in terms of outstanding issues and trading value.

The trading of government securities on the Stock exchanges is currently through Negotiated Dealing System using members of Bombay Stock Exchange (BSE) / National Stock Exchange (NSE) and these trades are required to be reported to the exchange. The bulk of the corporate bonds, being privately placed, were, however, not listed on the stock exchanges and the trend is changing now. Most of the debt securities which are privately placed are now listed either on both the exchanges or on one of the exchange. SEBI has introduced a reform that all listed companies shall ensure that all debt is listed. Two Depositories, National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) maintain records of holding of securities in a dematerialized form. Records of holding of Government securities for wholesale dealers like banks/Primary Dealers (PDs) and other financial institutions are maintained by the RBI.

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments. NDS facilitates electronic submission of bids/application by members for primary issuance of Government Securities by RBI through auction and floatation. It will provide an interface to the Securities Settlement System.

REGULATORY FRAMEWORK FOR DEBT SECURITIES



(1) The Companies Act, 2013 & the Companies (Share Capital and Debentures) Rules, 2014

Section 71 of the Companies Act, 2013 prescribes the conditions for issue of debentures. A debenture is a legal document that represents a secure means by which a creditor can lend money to the debtor. A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

The Section covers provisions relating to Conditions for Issue, Appointment of Debenture Trustee, Signing of Trust Deed and Creation of Debenture Redemption Reserve.

The company is required to comply with Section 71 (Debentures) read with Rule 18 of the Companies (Share Capital and Debentures) Rules 2014.

(2) SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018

Debt securities which are convertible, either partially or fully or optionally into listed or unlisted equity shall be guided by the disclosure norms applicable to equity or other instruments offered on conversion in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

(3) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations)

The listing of securities is ensured by way of an agreement which is entered into between a stock exchange and the issuing company. This agreement called listing agreement. All Listed entities shall comply with the listing conditions as stipulated in Listing Regulations to provide substantial information about the company to the stock exchanges. The provisions of Chapter V from Regulation 49 to 62 of 'Listing Regulations' shall apply only to a listed entity which has listed its 'Non-convertible Securities' as well as an entity that has listed both its convertible securities and non- convertible securities on a recognised stock exchange in accordance with SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

(4) SEBI (Issue and Listing of Non-convertible Securities) Regulations, 2021

In May 2021, SEBI decided to review and merge the SEBI Issue and Listing of Debt Securities) Regulations, 2008 (hereinafter referred as "ILDS Regulations") and SEBI (Issue and Listing of Non- Convertible Preference Shares) Regulations, 2013 (hereinafter referred as "NCRPS Regulations") into a single regulation - SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (hereinafter referred as "NCS Regulations") vide its notification dated August 09, 2021.

The new NCS Regulations provide for issuance and/or listing of the following securities:

a. Debt securities;

b. Non-Convertible redeemable preference shares;

c. Perpetual debt instruments, Perpetual Non-cumulative preference shares or similar non-equity regulatory capital instruments;

d. Commercial Paper.

Since the enactment of ILDS Regulations and NCRPS Regulations, SEBI had issued multiple circulars covering procedural and operational aspects thereof. Hence, for ease of reference, all the existing circulars and one provisions were merged into a single SEBI **operational circular dated August 10, 2021** (Updated in July 2023 and renamed as Master Circular) This circular acts as a 'single-point' reference for primary issuance and listing of non-convertible securities in India.

IMPORTANT TERMINOLOGIES UNDER NCS REGULATIONS

- Debt securities, Non-convertible redeemable preference shares, Perpetual debt instruments, Perpetual Non-cumulative preference shares or similar non-equity regulatory capital instruments are collectively referred to as "**non-convertible securities**"
- "**Debt securities**" means non-convertible debt securities with a fixed maturity period which create or acknowledge indebtedness and includes debentures, bonds or any other security whether constituting

> a charge on the assets/ properties or not, but excludes security receipts, securitized debt instruments, money market instruments regulated by the Reserve Bank of India, and bonds issued by the Government or such other bodies as may be specified by the SEBI.

(Note - Students are advised to refer Lesson 10 of Capital Market and Securities Laws, Executive Programme for detailed provisions pertaining to Issue and Listing of Non-Convertible Securities)

Major reforms under the SEBI NCS Regulations

The new NCS Regulations have enshrined a number of new reforms, notably the following:

1. **Road map for listing of debt securities by a newly incorporated entity**

   The major change brought out in the NCS Regulations is that even a newly incorporated entity, is allowed to raised funds through the issuance of corporate bonds and tap the listed space of bond market provided it fulfils the following conditions:

   - Issuance of debt securities is made only on a private placement basis;
   - Such issuance is made on the Electronic Book Provider (EBP) platform irrespective of the issue size; and
   - Such issue may be subscribed by only Qualified Institutional Buyers.

   [As defined under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.]

   Earlier, one had to be in existence for a period of atleast three years to tap the bond market. This will enable Special Purpose Vehicles created for specific infrastructure purposes/ NBFCs/ listed REITs/ listed InvITs and other companies who propose to list debt securities purely on private placement basis but who do not have a three-year existence history, to list their debt securities issued on private placement basis, while, all other requirements under the NCS Regulations and operating stipulations of the EBP mechanism shall continue to apply to such issuers.

2. **Removal of restrictions – ease of doing business**

   The NCS Regulations give a huge fillip to the ease of doing business. The following requirements which exited in the earlier ILDS / NCRPS Regulations have been done away with in order to provide greater flexibility to issuers and also to have wider pool of issuers tapping the market:

   - **No Minimum rating**

     Requirement to have a minimum rating of AA- for a public issuance of NCRPS' has been removed.

   - **No minimum tenure**

     Requirement of a minimum tenure of three years for a public issuance of NCRPS has been removed.

   - **No restriction on number of issuances under a shelf prospectus**

     The Restriction of a maximum of four issuances of debt securities in a year through a single shelf prospectus has been removed, in order to enable issuers to raise funds quickly without filing a separate prospectus.

   - **No minimum issue size for pubic issues of debt**

     The Stipulation regarding minimum issue size of Rs. 100 crore for public issue of debt securities, which existed earlier, has been removed.

- **Size of Abridged prospectus reduced**

  Size of abridged prospectus in case of public issues of has been reduced from around 50 pages to around 10 pages, thereby reducing cost to the issuers coming out with public issuances. Less number of pages with more relevant information related to issuer also enhances readability for the investor.

3. Appointment of Debenture trustee

Since enactment of ILDS Regulations, certain provisions were made applicable to be complied by debenture trustee while the appointment of debenture trustee in case of debt securities was not mandatory; hence the NCS Regulations clearly provide for the appointment of debenture trustee mandatary in case of debt securities. Debenture Trustees need to undertake due diligence w.r.t defaults, creation of security, asset cover etc. irrespective of the debentures being issued publicly or on a private placement basis. The NCS Regulations now provide for due diligence by a Debenture Trustee in case of private placement also.

4. Call and put option in order to provide flexibility

The earlier ILDS Regulations provided provisions and a defined process to be followed for call and put option in debt securities issued on only public issue basis. In order to provide greater flexibility to issuers, the option for call and put has been introduced in case of debt securities issued on private placement basis. This will provide greater flexibility to the issuers and investors of debt securities and NCRPS as well.

5. Certain other changes brought out in NCS Regulations

- **Put and call option:**

  The period for exercise of call and put option has been brought down to 12 months from 24 months in order to provide increased flexibility, both to issuers as well as investors.

- **EBP Platform for issues of Rs.50 crore and above:**

  The Electronic Book Provider (EBP) platform has been made mandatory for issuance of eligible securities on private placement basis proposed to be listed amounting to INR 50 crore or above in a financial year which will improve price discovery and transparency in the corporate bond market.

  In order to streamline procedures for issuance of debt securities on private placement basis, SEBI vide its circular no SEBI/HO/DDHS/ DDHS_Div1/P/CIR/2022/00139 dated October 10, 2022 (Updated master circular issued in July 2023) has issued Operational Circular for issue and listing of Non-Convertible Securities, Security Receipt, Municipal Debt Securities and Commercial paper. Chapter VI of the Operational Circular provides framework for issuance of debt securities on Private Placement basis through an Electronic Book mechanism. This circular replaces the chapter VI (Electronic Book Provider Platform) of the SEBI circular no. CIR/HO/DDHS/P/CIR/2021/613 dated August 10, 2021

  The usage of this platform is mandatory for the issuers with an issue size of INR 50 crores and above, inclusive of green shoe option (if any). However the platform can also be used for issues less than INR 50 crores.

- **Rollover of debt securities**

  In case an issuer wishes to roll over the debt securities the provision of e-voting has been introduced in addition to postal ballot to facilitate issuers to seamlessly obtain voting for passing the resolution. This will also encourage wider investor participation in the voting.

- **Risk factors**

  Parameters for identification of risk factors have been introduced to assist issuers in disclosing pertinent risk factors on risks intrinsic to the issuer as well as the instrument, other risk factors which may have an impact on the issue etc.

- **Issuers curing default allowed to raise funds**

  Issuers who have cured the default in payment of interest/dividend/redemption amount to raise funds through non-convertible securities, have been permitted to file shelf prospectus post such curing of default provided they have cured the default atleast 30 days prior to filing the draft shelf prospectus.

- **Harmonization of provisions on creation of charge with those of the Companies Act, 2013**

  The provision of creation of charge on the assets and properties of the issuer has been harmonized with the Companies Act thus allowing issuer to have adoption to create charge over its properties or assets (movable, immovable, tangible, intangible), shares or any interest thereon, of the issuer or its subsidiaries or its holding companies or its associate companies. This will provide greater flexibility to the issuers for creation of charge.

- **Additional ALM disclosures for NBFCs**

  In case the issuer is an NBFC (including a Housing Finance Company), additional disclosures on Asset Liability Management (ALM) pertaining to the latest audited financials are required to be provided for private placements too.

DEBENTURES

Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture. They can be either convertible or non-convertible into equity shares at a later point in time. Debenture is a written instrument acknowledging a debt to the Company. It contains a contract for repayment of principal after a specified period or at intervals or at the option of the company and for payment of interest at a fixed rate payable usually either half-yearly or yearly on fixed dates.

In essence, it represents a loan taken by the issuer who pays an agreed rate of interest (decided at the time of issue only) during the life time of the instrument and repays the principal normally, unless otherwise agreed, on maturity.

> Section 2(30) of the Companies Act, 2013 defines a debenture which includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

Further, section 71 of the Companies Act, 2013 states as follows:

(1) A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

However, the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

(2) No company shall issue any debentures carrying any voting rights.

(3) Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.

(4) Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

(5) No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

(6) A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances in accordance with such rules as may be prescribed.

(7) Any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

However, the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.

(8) A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

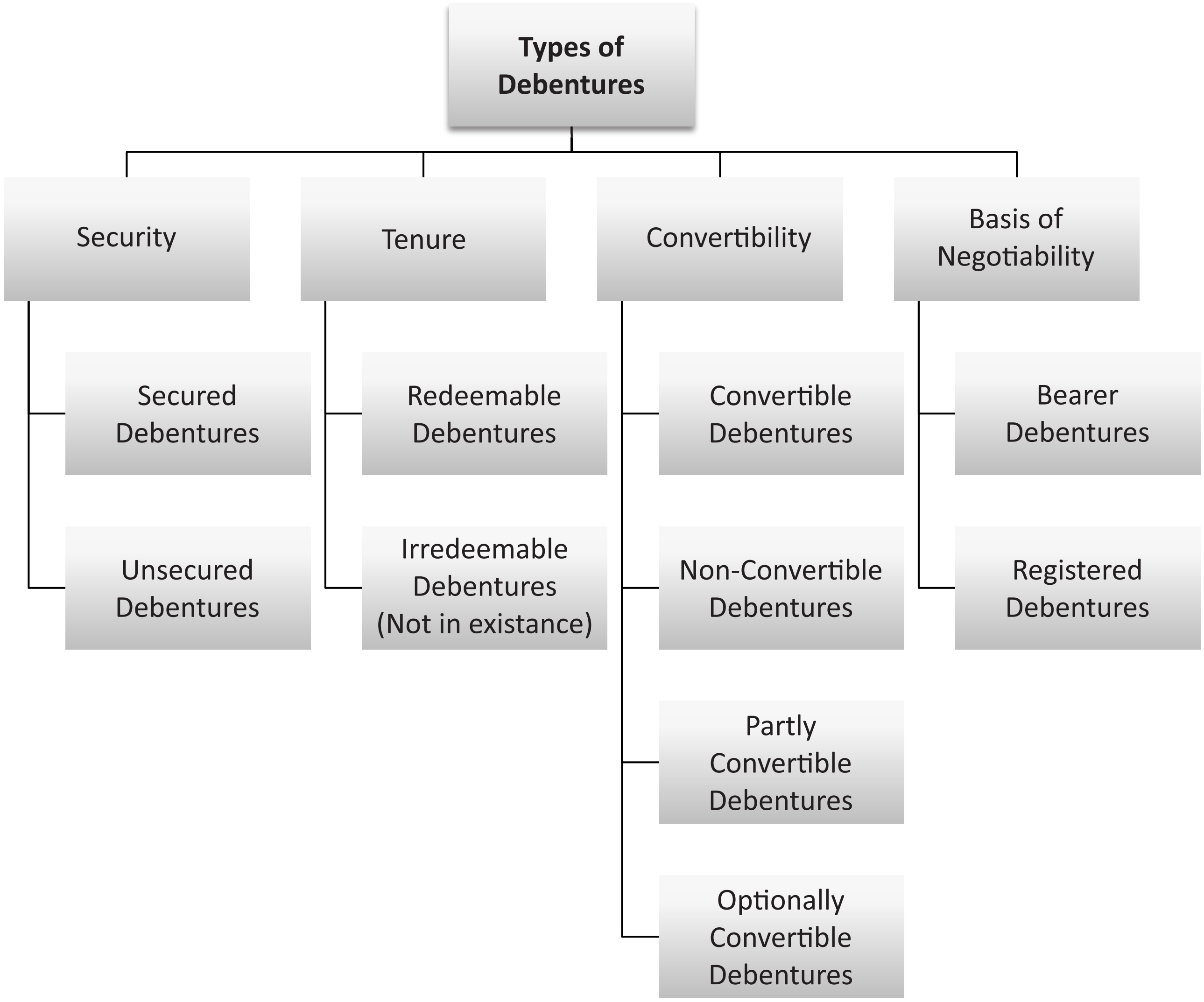
(9) Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

(10) Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

(11) A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

(12) The Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

TYPE OF DEBENTURES



Security

(a) Secured Debentures

Secured debentures refer to those debentures where a charge is created on the assets of the company (mostly immovable) for the purpose of payment in case of default.

The secured debenture holders have greater protection. Holders of secured debentures remain convinced about the payment of interest and payment of principal in the event of redemption.

(b) Unsecured Debentures

These debentures are also known as naked debentures. These debentures are not secured by way of charge on the company's assets. Interest rate payable on unsecured debentures is generally higher than that which is payable on secured debentures but the risk is comparatively high too.

Tenure

Redeemable Debentures

Redeemable debentures are those which are payable on the expiry of the specific period (Maximum period 10 years from the date of issue, or upto 30 years in case the company is engaged in infrastructure projects or is an infrastructure finance company) either in lump sum or in instalments during the lifetime of the company. Debentures can be redeemed either at par or at premium.

Convertibility

On the basis of convertibility, a debenture may be classified under the following categories:-

(a) Convertible Debenture

These debentures are fully converted into equity shares of the company on the expiry of a specified period.

(b) Non-Convertible Debenture

Non-convertible debentures do not have any option to be converted into equity shares and are redeemed at the expiry of specified period(s).

(c) Partly Convertible Debenture

Partly convertible debentures are divided into two portions, viz., convertible and non-convertible portion. The convertible portion is converted into equity shares of the company at the expiry of specified period. The non- convertible portion is redeemed at the expiry of the specified period in terms of the issue.

(d) Optionally convertible Debentures

An option is provided to the debenture holders at the maturity to get them converted into equity shares of the company are get them redeemed.

Basis of Negotiability

Debentures issued by a company may be negotiable or non-negotiable. There are following two types of debentures: -

(a) Bearer Debentures

These debentures are payable to bearer of the debentures and transferable by mere delivery. These debentures are also known as unregistered debentures.

(b) Registered Debentures

These debentures are not transferable by mere delivery of debenture certificate and shall be transferred as per the provisions of the Companies Act, by executing transfer deeds and the transfer registered by the company. Registered debentures are not negotiable instruments. A registered holder of a debenture means a person whose name appears both in the debenture certificate and in the register of debenture holders. Principal and interest amount, when due in respect of these debentures are payable to the registered holders thereof only.

Market Linked Debentures

Market-linked debt securities have an underlying principal component issued with market-linked returns obtained through exposures on exchange traded derivatives or MIBOR, GDP, inflation rate, underlying securities/indices etc. with coupon linked to a benchmark different from plain vanilla debt securities. The returns linked to equity markets are also called equity linked debt securities, stock linked debt securities, structured debt securities.

In view of the fact that such securities are different in their nature and their risk-return relationship, the following additional disclosures and requirements are specified in respect of issue and listing of structured debt securities/ market linked debt securities:

Debt securities which do not promise to return the principal amount in full at the end of the tenor of the instrument, i.e., 'principal non-protected' shall not be considered as debt securities under regulation 2(k) of SEBI NCS Regulations, 2021 and therefore will not be eligible for listing under the said regulations.

Eligibility criteria for issuers

As such securities expose the issuer to market risk, the issuer should have a minimum net worth of at least Rs. 100 crores at the time of issue.

Disclosure requirements

In addition to the disclosure requirements specified under SEBI NCS Regulations, 2021, the following disclosures shall be made in all offer documents for such securities:

a) Credit rating by any registered CRAs shall bear a prefix 'PP-MLD' denoting Principal Protected Market Linked Debt securities followed by the standardized rating symbols for long/ short term debt securities on the lines specified by the SEBI.

b) A detailed scenario analysis/ valuation matrix showing value of the security under different market conditions such as rising, stable and falling market conditions shall be disclosed in a table along with a suitable graphic representation.

c) A risk factor shall be prominently displayed that such securities are subject to model risk, i.e., the securities are created on the basis of complex mathematical models involving multiple derivative exposures which may or may not be hedged and the actual behavior of the securities selected for hedging may significantly differ from the returns predicted by the mathematical models.

d) A risk factor shall be prominently displayed stating that in case of principal/ Capital Protected Market Linked Debt securities, the principal amount is subject to the credit risk of the issuer whereby the investor may or may not recover all or part of the funds in case of default by the issuer.

e) Where indicative returns/ interest rates are mentioned in the offer document in percentage terms, such figures shall be shown only on annualized basis.

f) It shall be disclosed therein that the latest and historical valuation for such securities shall be made available on the websites of the issuer and of the valuer appointed for the purpose.

g) All commissions by whatever name called, if any, paid by issuer to distributor for selling/ distribution of such securities to end investors shall be disclosed in the offer document.

h) Conditions for premature redemption of such securities, if any, shall be clearly disclosed in the offer document.

Difference between Market Linked Debentures (MLD) and Non-Convertible Debentures (NCD)

A NCD is a fixed-income security where the issuer assures to pay a fixed interest rate on the principal amount to the investor. Non-Convertible Debentures can't be converted into equity shares of the issuing company, as the name suggests, "*non-convertible*". It has a specified maturity period, after which the investor can redeem the principal amount and the accumulated interest. On the contrary, Market Linked Debentures are structured products linked to the performance of the market index or asset, like commodities, currencies and stocks. MLDs' return on investments is not fixed because it is linked to the underlying asset's performance. So, the returns on MLDs are generally higher than NCDs when the market performs well but can be negative or zero when the market isn't performing well.

BONDS - AN INTRODUCTION

A developed and robust corporate bond market is important for the purpose of a well-rounded development of the economy. It supplements the banking system by providing an alternative and stable source of finance to meet the requirements of the corporate sector to raise funds – significantly, the infrastructure sector - while aiding diversification of risk.

A crucial element of India's Capital Market is the Corporate Bond Market. Indian Capital market has played a pivotal role in development of Indian Economy over the years. As India surges ahead to become an economic power house, the Indian capital market is expected to play a greater role and remain in forefront in the days ahead. Persistent effort by Government and SEBI in the last few years enabled a nascent Corporate Bond Market to move in the direction of maturity.

A bond is a debt instrument in which an investor loans money to an entity (typically corporate or government) which borrows the funds for a defined period of time at a variable or fixed interest rate. Bonds are used by companies, municipalities, states and sovereign governments to raise money to finance a variety of projects and activities. This Owners of bonds are debt holders, or creditors, of the issuer.

> The bond holders are generally like creditors where a company is obliged to pay the amount. The amount is paid on the maturity of the bond period. Generally the duration of a bond ranges from 3 to 10 years.

Based on the maturity period, bonds are referred to as bills or short-term bonds and long-term bonds. Bonds have fixed face value, which is the amount to be returned to the investor upon maturity of the bond. During this period, the investors receive a regular payment of interest, semi-annually or annually, which is calculated as a certain percentage of the face value and known as a 'coupon payment.

What are Bonds?

A bond is a debt instrument requiring the issuer (also called the debtor or borrower) to repay to the lender/ investor the amount borrowed plus interest over a specified period of time.

For investors, bonds provide an investment option that give steady returns for a fixed period while for the issuer they are a source of low-cost funds for their investment needs.

Bonds are generally one of the safe investment options generally providing predictable income flows. Depending on the risk appetite, an investor can choose various risk instruments.

Role of Corporate bond markets

Corporate bond markets are an important part of the global capital markets and play a key role in financing the real economy. They act as the alternative to the banking channels. Hence, it is imperative to ensure fair, efficient and transparent functioning of these markets.

The total capital raised in primary markets during the financial year 2023-24 stood at Rs. 9.2 lakh crore, out of which funds raised through corporate bonds were around 8.6 lac crore According to CRISIL, the outstanding corporate bond market in India is expected to double and shall reach Rs. 65-70 lakh crore by the year 2025. In April 2024, SEBI reduced the face value of a bond issued through private placement from Rs.1,00,000 to Rs.10,000, which is expected to bring in more individual investors to the bond markets.

Different Kinds of Bonds

Fixed-rate bonds: In Fixed Rate Bonds, the interest remains fixed throughout the tenure of the bond. Owing to a constant interest rate, fixed rate bonds are resistant to changes and fluctuations in the market.

Floating rate bonds (FRBs): Floating rate bonds have a fluctuating interest rate (coupons) as per the current market reference rate.

Inflation-Indexed Bonds: Bonds linked to inflation are called inflation linked bonds. The interest rate of Inflation linked bonds is generally lower than fixed rate bonds.

Perpetual Bonds: Bonds with no maturity dates are called perpetual bonds. Holders of perpetual bonds enjoy interest throughout.

Bonds with Call or Put Option: Callable bonds are high coupon paying securities that give the issuer the right to call back the bonds at a pre-agreed price and date. Puttable bonds give the bondholder the right to return the bond and ask for repayment of principal at a pre-agreed date before maturity. Since the benefit offered is for investors, these bonds pay lower returns.

Zero-Coupon Bonds: As the name implies, these bonds do not pay periodic coupons during their tenure. Though, these bonds are issued at a discount and repayable at the par value.

Convertible bond: The investors holding convertible bonds get the right to convert the bond to a predefined number of equity shares in the issuing company at a particular time from the tenure.

Green Bonds: These are bonds which are primarily raised for Green investments such as Solar power projects, Land rehabilitation, Sewage management etc.

Municipal bonds: These Bonds are issued by Municipal authorities to finance the infrastructure needs of cities.

Secured and unsecured bonds: Bonds whose issuance is backed by some fixed or a tangible asset is called secured bonds while those that are not backed by any asset are unsecured bonds.

G-Secs: Bonds issued by the sovereign authority to finance its fiscal and investment needs are called Government bonds. These are risk free instruments which serve as a base for pricing other bond issuances.

Various risks associated with Bond investment

Risk is an inherent part of investing. Generally, investors must take greater risks to achieve greater returns. The main risks of investing in bonds include:

- *Interest Rate Risk*: Rising interest rates are a key risk for bond investors. Generally, rising interest rates will result in falling bond prices, reflecting the ability of investors to obtain an attractive rate of interest on their money elsewhere.
- *Credit Risk*: This is the risk that an issuer will be unable to make interest or principal payments when they are due, and therefore default.
- *Inflation Risk*: Inflation reduces the purchasing power of a bond's future coupons and principal. As bonds tend not to offer extraordinarily high returns, they are particularly vulnerable when inflation rises.
- *Reinvestment Risk*: When interest rates are declining, investors may have to reinvest their coupon income and their principal at maturity at lower prevailing rates.
- *Liquidity Risk*: This is the risk that investor may have difficulty in finding a buyer when they want to sell and may be forced to sell at a significant discount to market value.

ONLINE BOND PLATFORM PROVIDERS

Securities and Exchange Board of India on November 14, 2022, notified the circular, 'Registration and regulatory framework for Online Bond Platform Providers ('OBPP') for regulating online bond trading platforms.

Meaning and Scope

"Online bond platform provider" (OBPP) means any person operating or providing an online bond platform and "online bond platform" means any electronic system, other than a recognised stock exchange or an electronic book provider platform, on which the debt securities which are listed or proposed to be listed, are offered and transacted.

A framework has been prescribed for entities operating/ desirous of operating as OBPPs under regulation 51A of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ('NCS Regulations'):

(a) Such entity shall be a company incorporated in India and register itself as a stock broker in the debt segment of the Stock Exchange(s);

(a) An entity acting as an OBPP on or prior to November 14, 2022, shall divest itself of offerings of products or services or securities on its OBP or any other website/ platform other than the following:

- Listed debt securities, listed municipal debt securities and listed securitised debt instruments;
- Debt securities, municipal debt securities and securitised debt instruments proposed to be listed through a public offering;
- Listed Government Securities, State Development Loans and Treasury Bills; and
- Listed Sovereign Gold Bonds.

SEBI on November 14, 2022, notified the circular, 'Registration and regulatory framework for Online Bond Platform Providers ('OBPP') for regulating online bond trading platforms. Vide this circular it has been prescribed that any entity operating or desirous of operating an Online Bond Platform (OBP) ('entity') shall, after obtaining registration as a stock broker in the debt segment of Stock Exchange(s), apply to a recognized stock exchange to act as an Online Bond Platform Provider (OBPP) as specified under NCS Regulations. In its application, the entity shall ensure that the following requirements are met and confirmations / undertakings are provided:

- The entity has appointed a **Company Secretary** as a compliance officer;
- The entity has appointed at least two qualified key managerial personnel with experience of at least three years in the securities market;
- The entity has obtained a SEBI Complaints Redress System (SCORES) authentication and has put in place a well-defined mechanism to address grievances that may arise or likely arise while carrying out OBP operations;
- The entity owns, operates and maintains robust technology infrastructure with a high degree of reliability, availability, scalability and security in respect of its systems, data and network, appropriate to support its operations and manage the associated risks;
- The entity shall ensure compliance with the minimum disclosure requirements as specified by SEBI;
- The entity undertakes to ensure that its advertisements shall be in conformity with the Advertisement Code;
- The mechanism for the redress of the investor grievances shall be as specified in Chapter VII on "Investor Grievance Redressal" of Master Circular for Stock Brokers dated May 17, 2023 and as amended from time to time.
- Entity has a comprehensive risk management framework covering all aspects of its operations and shall ensure that risks associated with its operations are identified properly and managed prudently;
- The entity undertakes to establish appropriate safeguards and procedures to deal with exigencies like suspension or cessation of trading in debt securities, cancellation of orders or transactions by the investors and sellers, malfunctions or erroneous use of its systems by investors and sellers, or other unforeseen situations;
- The entity undertakes to identify and disclose on its OBP, all instances of conflict of interest, if any, arising from its transactions or dealings with related parties;

- The entity undertakes to maintain all data relating to its activities in an easily retrievable media and confidentiality and security of all data relating to its activities and strictly control access to such data;
- The entity shall, in addition to the information required to be submitted under various SEBI regulations, submit such information as may be required by the Stock Exchange(s) in relation to their operations.

Minimum Disclosure Requirements for each debt security offered for sale on the OBP

- Name of the Issuer, Security Name and ISIN
- Nature of instrument: Listed Secured/ Listed unsecured
- Seniority: Senior/ non-senior
- Original Mode of Issue and date of issue: Public issue/ Private Placement
- Rating of the Instrument – Outstanding Rating; date of rating; Rating agency; latest Rating rationale
- Face Value, Clean price and Dirty price
- Coupon: fixed/ floating, Rate /value, Frequency
- Date of maturity/ Tenor
- Name of Debenture trustee
- Yield: Current yield and yield to maturity; calculation of such yields
- Offer documents - Prospectus / Private Placement Memorandum
- Any other documents as may be specified by SEBI from time to time.

ELECTRONIC BOOK PROVIDER (EBP) MECHANISM

Corporate debt can be raised either through public issuances or private placement route.

Historically, the private placements of debt securities were usually negotiated by the issuers directly by issuers with investors such as Qualified Institutional Buyers (QIBs) /HNIs or placed through arrangers over-the-telephone market and then listed on stock exchanges. It is usually post listing that many investors get to know about the more granular details of the issue. Thus, this mechanism lacked transparency, was time consuming and hence not an efficient way to discover price.

Primary Issuance of Debt Securities - EBP Mechanism

In order to streamline the issuance procedure in the year 2016, SEBI placed a consultation paper dated December 04,2015 for discussion on the EBP platform. After taking into account the comments of stakeholders including stock exchanges, SEBI vide circular dated April 21, 2016 introduced a framework for issuance of debt securities on private placement basis which are subsequently proposed to be listed through an Electronic Book Provider (EBP) platform with an aim to provide an efficient way of price discovery and more transparency by disseminating bidding data. The framework was subsequently reviewed by SEBI in the year 2018 and 2021.

EBP platform is a web-based portal for online bidding and allotment of debt securities on private placement basis in primary market. The requirements for primary issuance of Debt Securities are as under:

1. **Eligible participants on the EBP Platform**

   a) QIBs as defined under Regulation 2(ss) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (hereinafter referred to SEBI ICDR Regulations, 2018).

b) Any non-QIB, who/ which has been authorized by the issuer, to participate in a particular issue on the EBP Platform.

2. Issues of securities through the EBP platform

(i) A private placement of debt securities and NCRPS as per the provisions of SEBI NCS Regulations, 2021, if it is:

a) a single issue, inclusive of green shoe option, if any, of Rs. 50 crore or more;

b) a shelf issue, consisting of multiple tranches, which cumulatively amounts to Rs. 50 crore or more, in a financial year; and

c) a subsequent issue, where aggregate of all previous issues by an issuer in a financial year equals or exceeds Rs. 50 crore.

(ii) Issues of debt securities and NCRPS on private placement basis, irrespective of issue size, by issuers who are in existence for less than three years, in accordance with Schedule II to the SEBI NCS Regulations, 2021.

(iii) The issuance of PDIs, PNCPS, PCPS, RNCPS, and instruments of similar nature which are essentially non-equity regulatory instruments, forming part of a bank's or NBFC's capital, issued as per RBI stipulations and listed under Chapter V of the SEBI NCS Regulations, 2021, irrespective of the issue size.

3. An issuer, if desirous, may choose to access EBP platform for private placement of municipal debt securities or CPs or CDs also.

4. Issuers of debt securities and NCRPS on private placement basis of issue size less than Rs. 50 crore may also choose to access the EBP platform for such issuances.

5. The obligations of issuers

a) The issuer shall ensure compliance with all requisite laws, rules, regulations, etc. with respect to private placement of securities including ensuring compliance with Section 42 of the Companies Act, 2013.

Provided that, the issuer, shall include the number of non-QIB eligible participants, on whose behalf arranger(s) is making bids in a particular issue, for the purposes of compliance with the provisions of Section 42 of the Companies Act, 2013 and other relevant statutes.

b) The Issuer shall provide the Placement Memorandum and term sheet (i.e. summary of important terms and conditions related to an issue) to the EBP at least two working days prior to the issue opening date.

However, the issuer issuing the securities for the first time through EBP platform shall provide the above information at least five working days prior to the issue to the opening date.

c) The Placement Memorandum and the term sheet, *inter-alia,* discloses the following:

i. Details of size of the issue and green shoe portion, if any.

However, the green shoe portion shall not exceed five times the base issue size.

ii. Interest rate parameter - Zero coupon, fixed coupon or floating coupon.

iii. Bid opening and closing date.

iv. Minimum Bid Lot.

v. Manner of bidding in the issue i.e. open bidding or closed bidding.

vi. Manner of allotment in the issue i.e. uniform yield allotment or multiple yield allotment.

vii. Manner of settlement in the issue i.e. through clearing corporation or through escrow bank account of issuer.

viii. Settlement cycle i.e. T+1 or T+2 day.

d) The issuer may choose to disclose estimated cut-off yield to the EBP, however the same has to be disclosed at least one hour prior to opening of the bidding for the issue.

e) Subsequent to closure of the issue, the issuer shall ensure following details of the issue are provided on the EBP platform:

Table 1: Details of allotment in private placement

Details of Investors to whom allotment has been made			
Name	**QIB/ Non-QIB**	**Category i.e. Scheduled Commercial Banks, MF, Insurance Company, Pension Fund, Provident Fund, FPI, PFI, Corporate, Others**	**Amount invested in Rs. crore**

6. Participants:

a) Participants, prior to entering into the bidding process shall be required to enroll with EBP. Such enrollment of a participant on an EBP will be onetime exercise and shall be valid till the time such enrolment is annulled or rescinded.

b) The KYC verification and enrolment of the eligible participants on the EBP platform shall be done in the following manner:

i. KYC verification shall be undertaken by obtaining/ utilizing existing KYCs of clients from KYC Registration Agencies (KRAs) registered with SEBI or on the basis of the guidelines as prescribed by SEBI from time to time.

ii. For QIB investors bidding directly or through arranger(s), KYCs and enrolment shall be done by the EBP.

iii. For non-QIB investors bidding directly, KYCs shall be done by the issuer and enrolment shall be done by the EBP.

iv. For non-QIB investors, which are bidding through arranger(s), KYC and enrolment on EBP shall be ensured by arranger(s).

c) EBPs shall ensure that all eligible participants have access to the Placement Memorandum (PM), term sheet and other issue specific information available with them.

d) Each eligible participant shall provide confirmation to the EBP that it is not using any software, algorithm, Bots or other automation tools, which would give unfair access for placing bids on the EBP platform.

e) Each EBP shall ensure that it does not provide any preferential access to any bidder on a selective basis.

f) An eligible participant cannot bid for an amount more than Rs. 100 crore or 5% of the base issue size, whichever is lower, through arranger(s) on the EBP platform. However, Foreign Portfolio Investors may bid through their custodians.

g) An arranger can bid, on behalf of multiple participants, subject to the limits for each participant, as mentioned above.

h) For bids made by an arranger for any particular issue, such arranger shall disclose the following to the EBP at the time of bidding:

   i. Specify that whether the bid is:

      a. a proprietary bid; or

      b. a client bid i.e. entered on behalf of an eligible participant; or

      c. a consolidated bid i.e. an aggregate bid consisting of proprietary bid and Client bids.

   ii. For consolidated bid, arranger shall disclose breakup between proprietary bid and client bid(s). Further, for client bids, the following shall be disclosed:

      a. Names of such eligible participants;

      b. Category (i.e. QIB or non-QIB); and

      c. Quantum of bid of each eligible participant.

7. Bidding, allotment and settlement process:

a) Bidding timings and period:

   i. In order to ensure operational uniformity across various EBP platforms, the bidding on the EBP platform shall take place between 9 a.m. to 5 p.m. only, on the working days of the recognized stock exchanges.

   ii. The bidding window shall be open for the period as specified by the issuer in the bidding announcement; however, the same shall be open for at least one hour.

   iii. An issuer can provide details of the eligible participant(s) for a particular issue, to the EBP, not later than one hour before the bidding start time.

b) Bidding announcement:

   i. Issuer shall make the bidding announcement on EBP at least one working day before initiating the bidding process.

   ii. Bidding announcement shall be accompanied with details of bid opening and closing time, and any other details as required by the EBP from time to time.

   iii. Any change in bidding time and/ or date by the issuer shall be intimated to the EBP, ensuring that such announcement is made within the operating hours of the EBP, at least a day before the bidding date. However, such changes in bidding date or time shall be allowed for a maximum of two times.

c) The bidding process on EBP platform shall be on an anonymous order driven system.

d) Bid shall be made by way of entering bid in:

   i. Price; or

   ii. Coupon (in %), up to four decimal places; or

   iii. Spread in basis points (bps).

   Further, the bid amount shall be specified in Rupees (INR).

e) Bidding process shall be based on the following:

   i. *Coupon specified by issuer:* The face value and coupon remaining constant, bids/ quotes shall be placed by the bidders in terms of price.

   ii. *Coupon/ spread discovered during bidding:* The face value remaining constant, bids/ quotes shall be placed by the bidders in terms of coupon/ spread.

f) Investors may place multiple bids in an issue.

g) Modification or cancellation of the bids shall be allowed i.e. bidder can cancel or modify the bids made in an issue, subject to the following:

   i. such cancellation/ modification in the bids can be made only during the bidding period;

   ii. no cancellation of bids shall be permitted in the last 10 minutes of the bidding period; and

   iii. in the last 10 minutes of the bidding period, only revision allowed would be for:

      a. downward revision of coupon/ spread or upward modification of price; and/ or

      b. upward revision in terms of the bid size.

h) The bid placed in the system shall have an audit trail which includes bidder's identification details, time stamp and unique order number. Further against such bids, the EBP shall provide an acknowledgement.

i) All the bids made in a particular issue shall be disclosed on the EBP platform, in the following format:

Table 2: Details of cumulative demand received on EBP platform

Coupon/price/ spread	*Amount demand at that particular coupon/ price/ spread (in Rs. crore)*	*Cumulative amount demand (in Rs. crore)*

For issues with open bidding, the aforesaid information shall be disseminated on a real time basis; however, for issues with closed bidding, the information shall be disseminated after closure of bidding.

j) Allotment and settlement amount for the bidders shall be based on the following:

   i. *Coupon specified by issuer:* All bids shall be arranged as per 'price time priority'.

      a. In case of *'uniform yield allotment'*, allotment and settlement value shall be based on the cut-off price determined in the bidding process.

      b. In case of '*multiple yield allotment*', allotment and settlement value shall be based on the price quoted by each bidder/ allottee in the bidding process.

   ii. *Coupon discovered during bidding*: All bids shall be arranged as per 'yield time priority'.

      a. In case of *'uniform yield allotment'*, allotment and settlement value shall be based on the face value.

      b. In case of *'multiple yield allotment'*, allotment and settlement value shall be based on the price adjusted as per the coupon/ spread quoted by each bidder/ allottee in the bidding process.

iii. If two or more bids have the same coupon/ price/ spread and time, then allotment shall be done on *'pro-rata'* basis.

8. Anchor portion within the base issue size:

a) Issuer shall have an option to avail an '*anchor portion'* within the base issue size, subject to the below mentioned conditions:

i. Issuer shall have the discretion to select the anchor investor(s) for the anchor portion.

ii. The quantum of allocation(s) to the anchor investor(s) shall be at the discretion of the issuer, subject to total allocation to the anchor(s) not exceeding 30% of the base issue size.

iii. There shall be no bidding for anchor portion on the EBP platform.

iv. If the issuer opts for anchor portion, the same shall be suitably disclosed in the placement memorandum and the term sheet, along with the relevant quantum (maximum 30%).

v. Issuer shall disclose details of the anchor investor(s) and the corresponding quantum allocated, to the EBP, along with the Placement Memorandum and the term sheet.

vi. The settlement amount for the anchor investor(s) shall be determined on the basis of the following:

a. Coupon specified by the issuer:

Uniform yield allotment: The 'cut-off' price determined in the bidding process (in case of issues with anchor portion, it will imply total issue size less the anchor portion).

Multiple yield allotment: Face value of the security.

However, in case of re-issuance, the '*cut-off'* price determined in the bidding process shall be applicable on the anchor investor(s).

b. Coupon/ spread determined in the bidding process:

Uniform yield or multiple yield allotment: Face value of the security

b) The remaining portion of the issue (i.e. the non-anchor portion within the base issue size and the green shoe portion), shall be open for bidding by the eligible participants at the chosen time slot on the EBP platform. The anchor investor(s) may also participate in the said portion if identified as eligible participant(s) by the issuer.

9. Pay-in obligations:

a) Pay-in towards the allotment of securities shall be done from the account of the bidder, to whom allocation is to be made. For bids made by the arranger on behalf of eligible participant(s), pay-in towards allotment of securities shall be made from the account of such eligible participants.

b) Pay-in of funds through escrow bank account of issuer: The pay-in of funds towards an issue on EBP shall be permitted either through clearing corporations of stock exchanges or through the escrow bank account of an issuer. An issuer, in its PM, shall disclose the manner of pay-in of funds so chosen and details thereof. The process of pay-in of funds by investors and pay-out to issuer can be done on either T+1 or T+2 day, where T day is the issue day, and the same shall be disclosed by the issuer in the PM.

c) In case of non-fulfillment of pay-in obligations by allottees and anchor investor(s), such allottees and anchor investor(s) shall be debarred from accessing the bidding platform across all EBPs for a period of thirty days from the date of such default.

d) In case of three instances of non-fulfillment of pay-in obligations, across all EBPs, by client(s) for whom an arranger has bid, then such arranger shall be debarred from accessing the bidding platform on any EBP, for a period of seven days from the date of the such third or subsequent default.

e) Pay in shall be done through the clearing corporations of stock exchanges, as per their operating guidelines, or through an escrow bank account of the issuer, as mentioned below.

However, where the issuer has selected the escrow bank account as the mechanism for pay-in, EBP, pursuant to successful closure of issue, shall share the allocation details with the Registrar to an Issue, associated with the issue.

f) Process flow of settlement, where funds pay-in is to be made to escrow bank account of issuer:

i. Successful bidders, in an issue, will make pay-in of funds towards the allocation made to them, in the escrow bank account within the timelines, as provided by the issuer in the PM/ IM. The funds pay-in by the successful bidders will be made only from the bank account(s), which have been provided/ updated in the EBP system. Further, pay-in received from any other bank account will lead to cancellation of bid and consequent debarment of the investor from accessing EBP platform for 30 days.

ii. Escrow bank, pursuant to receipt of funds will provide a confirmation to the RTA, associated with the issue, about receipt of funds along with details including name of bank account holder, bank account number and the quantum of funds received.

iii. RTA, will then reconcile the information received from escrow bank with the details as provided by EBP and after reconciliation RTA shall intimate to the issuer about receipt of funds. Subsequently, issuer will initiate the process of corporate action through the RTA to Depository.

iv. RTA, after passing on the instructions for corporate action to the depositories, will issue instruction to the escrow bank to release money to the issuers bank account.

10. Withdrawal of offer by an issuer:

a) An issuer, at its discretion, may withdraw from the issue process at any time; however, subsequent to such withdrawal, the issuer shall not be allowed to access any of the EBP platforms for a period of seven days from the date of such withdrawal. A withdrawal from the issue process shall imply withdrawal of the total issue including anchor portion.

b) If an issuer withdraws from the issue because of any of the reasons as outlined below, the restrictions mentioned in the above paragraph shall not be applicable:

i. issuer is unable to receive the bids up to the base issue size; or

ii. bidder has defaulted on payment towards the allotment, within stipulated timeframe, due to which the issuer is unable to fulfill the base issue size; or

iii. cut-off yield (i.e. the highest yield at which a bid is accepted) in the issue is higher than the estimated cut-off yield (i.e. the yield estimated by the issuer, prior to opening of issue) disclosed to the EBP, where the base issue size is fully subscribed.

c) Disclosure of estimated cut-off yield on the EBP platform to the eligible participants, pursuant to closure of issue, shall be at the discretion of the issuer.

d) In case an issuer withdraws issues on the EBP platform because of the cut-off yield being higher than the estimated cut-off yield, the EBP shall mandatorily disclose the estimated cut-off yield to the eligible participants.

11. Responsibilities of various entities involved in the process:

a) Issuer shall:

i. open an escrow bank account/ have an escrow bank account jointly with a RTA, where the role of the RTA in operating such bank account shall be limited to the responsibilities as provided under this circular;

ii. provide the details of escrow bank account in which pay-in of funds has to be made and the timelines by which such pay-in shall be done by the successful bidders; and

iii. effect corporate action for credit of securities to the successful bidders, after receiving confirmation from the RTA about receipt of funds.

b) RTA shall:

i. undertake reconciliation between information received from the escrow Bank and EBP. Further, after reconciliation, shall intimate the issuer about the receipt of funds and shortfall, if any, and the reasons thereof;

ii. issue instructions to the escrow bank account for the release of funds, after passing on the instructions for corporate action to the depositories; and

iii. intimate to the EBP, upon closure of the issue, the status of the issue i.e. successful or withdrawn, details of defaulting investors etc.

12. Obligations and duties of EBP:

a) An EBP shall:

i. provide an on-line platform for placing bids;

ii. have necessary infrastructure like adequate office space, equipment, risk management capabilities, manpower and other information technology infrastructure to effectively discharge the activities of an EBP;

iii. ensure that the PM, term sheet and other issue related information is available to the eligible participants on its platform immediately on receipt of the same from the issuer;

iv. have adequate backup, disaster management and recovery systems; and

v. ensure safety, secrecy, integrity and retrievability of data.

b) EBPs shall ensure that all details regarding the issuance is updated on its website.

c) EBPs shall together ensure that the operational procedure is standardized across all EBP platforms and the details of such operational procedure are disclosed on their websites.

d) Where an issuer has disclosed estimated cut-off yield to the EBP, the EBP shall ensure its electronic audit trail and secrecy. However, in case issuers withdraw issues on the EBP because of the cut off yield being higher than the estimated cut off yield, the EBP shall mandatorily disclose the estimated cut off yield in its platform.

e) EBPs shall ensure coordination amongst themselves and also with depositories so as to ensure that the cooling off period for issuers and debarment period for investors is adhered to.

f) EBPs shall ensure that bidding is done in the manner as specified.

g) The EBP shall be responsible for accurate, timely and secured bidding process of the electronic bid by the bidders.

h) The EBP shall provide a facility to the eligible participants to define the limits/ range, within which quotes may be placed, from its user interface, to avoid 'fat finger' errors.

i) The EBP shall be responsible for addressing investor grievances arising from bidding process.

13. CISA Audit of EBP Platform:

The EBP platform so provided by the EBP shall be subject to audit by a CISA at least once a year.

Benefits of EBP Mechanism

The EBP mechanism offers a lot of benefits to various stakeholders, including the following:

- Transparent process for price discovery through anonymous bidding
- Dissemination of bidding data on anonymous basis to the market which is absent till now
- Facility to do multiple bidding at different yields
- Institutional investors can also participate on behalf of arrangers/ sub arrangers
- Allotment data to be made available on the website of the EBP website which would bring required transparency in the secondary market of such private placements.

EBP has helped in developing an institutional market for corporate bonds wherein all QIBs (i.e. which are institutional investors) can participate after one-time registration, therefore gives an equal access to participation on all issuances to all such institutional participants. Further, details of proposed issuances (by any issuer) is disclosed before the start of bidding, in order to enable them to enable participants to choose their investments options in advance. Further, bidding and allotment is done in a transparent manner and appropriate disclosures viz. market price, amount etc. are available to all investors after successful closure of the bid. This has resulted in not only reduction in cost but also timelines for both investors and issuers.

SECONDARY MARKET FOR DEBT SECURITIES: REQUEST FOR QUOTE (RFQ) PLATFORM

RFQ is an electronic platform to enable sophisticated, multi-lateral negotiations to take place on a centralized online trading platform with straight through processing of clearing and settlement to complete a trade.

'Request for Quote' (RFQ) is a platform for interaction amongst the market participants who wish to negotiate transactions amongst themselves. This platform is a participant-to-participant model where an initiator may request other participants for a quote in corporate bonds, securitized debt instruments, municipal debt securities, Government securities, State development loans, Treasury bills, Commercial papers and Certificates of deposit or any other security as specified by Exchange from time to time. This platform effectively automates or provides an electronic form of transacting in OTC deals. The RFQ platform shall provide users a range of options to seek a quote and to respond to a quote, while keeping an audit trail of all the interactions i.e. quoted yield, mutually agreed price, deal terms etc. This may bring pre-trade transparency for over- the-counter transactions in eligible securities.

Secondary market trades in corporate bond are predominantly an OTC market, driven by institutional investors. Therefore, unlike trading in equity shares where buy and sell orders are matched on electronic order books, corporate bonds are traded over the counter. Prices are negotiated off-line, bilaterally and reported / cleared on a DVP-1 (Delivery vs Payment- 1) basis.

Robust price discovery in corporate bonds remains a challenge, even internationally. Enhancing and coalescing the fragmented liquidity of corporate bonds is a felt need of the market participants. One way in which this could possibly be achieved is through an electronic platform that enables sophisticated, multi-lateral negotiations to take place i.e. an enhanced 'Request for Quote (RFQ)' kind of arrangement. Negotiations that currently take place offline and bilaterally would have to be done on an electronic platform, with straight through processing of clearing and settlement to complete the trade. This is expected to lead to more transparency, centralization and pooling of investor interest and hopefully, a more efficient and liquid market.

In February 2020, pursuant to approvals from SEBI, both National Stock Exchange of India Limited and BSE Limited launched RFQ platforms, as an extension of their existing trade execution and settlement platforms,to bring in transparency in "Over the Counter"deals which were negotiated bilaterally. RFQ platform has been developed by BSE and NSE which acts as a single interface for price givers as well as price takers in the corporate bond market from a diverse range of clients which will act as a catalyst to better price discovery. RFQ using request for quote protocol shall provide participants a range of options to seek a quote and to respond to a quote, while keeping an audit trail of all interactions i.e. quoted yield, mutually agreed price, deal terms etc. A participant may request other participants for a quote for eligible securities. Ever since its introduction, it has seen traction from market players.

1. Basic features of the RFQ platform

1.1. The RFQ platform is a system or interface for inviting and/ or giving quotes on an electronic platform.

1.2. A participant who seeks quote(s) is termed as an Initiator and a participant who acts/ responds to the quote requests of the Initiator is termed as a Responder.

1.3. A participant may request other participants for a quote for eligible securities.

1.4. The Initiator has the option to place quote(s) by disclosing its name or anonymously.

1.5. The quote can be placed to an identified counterparty (i.e. '*One to One'* (OTO) mode) or to all the participants (i.e. '*One to Many'* (OTM) mode).

1.6. The platform provides the participants a range of options to seek a quote and to respond to a quote, while keeping an audit trail of all interactions i.e. quoted yield, mutually agreed price, deal terms etc.

1.7. The quotes will be bilaterally negotiated between the counterparties, based on specified parameters. The acceptance of a quote by a participant will be considered as mutual agreement between the parties for the given deal.

2. Securities eligible for being traded on the RFQ platform

2.1. Non-convertible securities;

2.2. Securitised Debt Instruments;

2.3. Municipal Debt Securities;

2.4. Commercial Paper;

2.5. Certificate of Deposit;

2.6. Government Securities;

2.7. State development Loans;

2.8. Treasury Bills; and

2.9. Any other instrument, as may be specified by Stock Exchanges in consultation with SEBI.

3. Mandatory trades on RFQ platform

In February 2020, the RFQ platform was introduced as a '*participant-based'* model wherein all regulated entities, listed bodies corporate, institutional investors and all India financial institutions were eligible to register, access and transact. To enhance liquidity on the RFQ platforms of the stock exchanges, SEBI has, *inter alia*, mandated registered Mutual Funds, AIFs and Portfolio Management Services, to undertake a specified percentage of their total secondary market trades in Corporate Bonds through RFQ platform of stock exchanges. IRDAI has also prescribed similar stipulations for Insurers.

4. Permitting Stock Brokers on RFQ platform

SEBI has allowed stock brokers registered under the debt segment of the Stock Exchange(s) to place/ seek bids on the RFQ platform on behalf of client(s), in addition to the existing option of placing bids in a proprietary capacity.

The RFQ model will provide market participants with better price discovery and make information available near real-time to all the participants. This is expected to lead to more transparency, centralization and pooling of investor interest and hopefully, a more efficient and liquid market.

GROWING IMPORTANCE OF THE ROLE OF COMPANY SECRETARY IN ENTITIES THAT HAVE LISTED CORPORATE BONDS

Over the years, the role of a Company Secretary has developed and increased into much more than fulfilling the basic statutory requirements like maintaining the company's minute books, advising the board of directors relating to the legal and financial risks of the company and ensuring that the company complies with statutory regulations. This in turn has served to direct company's focus on effectiveness.

A Company Secretary is a vital link between the company and its Board of Directors, shareholders, government and regulatory authorities and all other stakeholders. A Company Secretary can play an important role in fulfilling the role as a governance professional for companies with listed debt securities.

Given all the provisions above and other roles and responsibilities, it would be appropriate to say that company secretaries acting as compliance officers are responsible for ensuring that the organisational processes comply with needed laws and regulations. Any risk of violation of applicable laws and regulations can expose the company to financial and reputational losses.

Hence, Company Secretaries can add real value to their role and increase their impact by bringing commercial acumen, strategic understanding and softer people skills in addition to their already much sought after legal and governance knowledge.

Therefore, in nutshell, the Company Secretary monitors, manages the information updates and conducts regular assessment to ensure that company remains abreast of the regulatory standards.

SUSTAINABLE FINANCE

SEBI is actively involved in promoting sustainable financing in India. Towards this objective, SEBI has defined the term green bonds and has attempted to encourage mobilization of sustainable finance. The issuance of

Green Debt Securities exclusively covers the financing projects in areas such as renewable and sustainable energy, low carbon transport modes, sustainable land use, water and waste management, climate change adaptation, energy efficiency, bio diversity conservation, etc.

Green Debt Securities

SEBI has recently redefined '*green debt security'*. A few circulars were issued on disclosure requirements and other obligations for issuers of green bonds as well as on greenwashing. Recently, on May 4, 2023, SEBI also issued the requirements for issuers of transition bonds.

Accordingly, Regulation 2(1)(q) of NCS Regulations, defines green debt security as under:

"*Green debt security" means a debt security issued for raising funds subject to the conditions as may be specified by SEBI from time to time, to be utilised for project(s) and/ or asset(s) falling under any of the following categories:*

i. renewable and sustainable energy including wind, bioenergy, other sources of energy which use clean technology,

ii. clean transportation including mass/public transportation,

iii. climate change adaptation including efforts to make infrastructure more resilient to impacts of climate change and information support systems such as climate observation and early warning systems,

iv. energy efficiency including efficient and green buildings,

v. sustainable waste management including recycling, waste to energy, efficient disposal of wastage,

vi. sustainable land use including sustainable forestry and agriculture, afforestation,

vii. biodiversity conservation,

viii. pollution prevention and control (including reduction of air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy efficient or emission efficient waste to energy) and sectors mentioned under the India Cooling Action Plan launched by the Ministry of Environment, Forest and Climate Change,

ix. circular economy adapted products, production technologies and processes (such as the design and introduction of reusable, recyclable and refurbished materials, components and products, circular tools and services) and/or eco efficient products,

x. blue bonds which comprise of funds raised for sustainable water management including clean water and water recycling, and sustainable maritime sector including sustainable shipping, sustainable fishing, fully traceable sustainable seafood, ocean energy and ocean mapping,

xi. yellow bonds which comprise of funds raised for solar energy generation and the upstream industries and downstream industries associated with it,

xii. transition bonds which comprise of funds raised for transitioning to a more sustainable form of operations, in line with India's Intended Nationally Determined Contributions, and

Explanation: Intended Nationally Determined Contributions (INDCs) refer to the climate targets determined by India under the Paris Agreement at the Conference of Parties 21 in 2015, and at the Conference of Parties 26 in 2021, as revised from time to time.

xiii. any other category, as may be specified by the SEBI from time to time.

DISCLOSURE REQUIREMENTS FOR ISSUE AND LISTING OF GREEN DEBT SECURITIES

SEBI vide its circular dated February 06, 2023 has prescribed the disclosure requirement and responsibilities of an issuer of green debt securities.

Initial Disclosure Requirements

1. **An issuer desirous of issuing green debt securities shall make the following additional disclosures in the offer document for public issues / private placements:**

   1.1 A statement on environmental sustainability objectives of the issue of green debt securities;

   1.2 Brief details of decision-making process followed/proposed for determining the eligibility of project(s) and/or asset(s), for which the proceeds are being raised through issuance of green debt securities, such as:

   a) process followed/ to be followed for determining how the project(s) and/or asset(s) fit within the eligible green projects categories as defined under Regulation 2 (1) (q) of NCS Regulations,

   b) the criteria making the project(s) and/ or asset(s) eligible for using the green debt securities proceeds; and

   c) details of taxonomies, green standards or certifications both Indian and global, if any referenced and the alignment of projects with said taxonomies, related eligibility criteria, and exclusion criteria, if applicable.

   d) Details of the alignment of the objective of the issue with the India's Intended Nationally Determined Contributions in case of the proceeds raised though issuance of transition bonds

   1.3 Details of the system/procedures to be employed for tracking the deployment of the proceeds of the issue.

   1.4 Details of the project(s) and/or asset(s) or areas where the issuer, proposes to utilise the proceeds of the issue of green debt securities, including towards refinancing of existing green project(s) and/or asset(s), if any.

   1.5 Details of an indicative estimate of distribution of proceeds raised though issuance of green debt security between financing and refinancing of project(s) and/ or asset(s); if applicable.

   1.6 Details of the intended types of temporary placement of the unallocated and unutilised net proceeds from the issue of green debt securities.

   1.7 Details related to the perceived social and environmental risks and proposed mitigation plan associated with the project(s) proposed to be financed/ refinanced through the proceeds from the issue of green debt securities.

   1.8 The issuer shall appoint an independent third party reviewer/ certifier, for reviewing/certifying the processes including project evaluation and selection criteria, project categories eligible for financing by green debt securities, etc.

   The said requirement of appointing a third party reviewer/ certifier is applicable on a *'comply or explain'* basis for a period of two years. *'Comply or explain'* for the purpose of the above, shall mean that the issuer shall endeavour to comply with the provisions and achieve full compliance by two years from the date of issuance of the circular. In case the entity is not able to achieve full compliance with the provisions till such time, the issuer shall, in its annual report, explain the reasons for such non-compliance/ partial compliance and the steps initiated to achieve full compliance.

Continuous Disclosure Requirements

2. An issuer who has listed green debt securities, shall provide following Additional Disclosures Requirement along with its annual report and financial results:

2.1 Utilisation of the proceeds of the issue, as per the tracking done by the issuer using the internal process as disclosed in offer document. Utilisation of the proceeds shall be verified by the report of an external auditor, to verify the internal tracking method and the allocation of funds towards the project(s) and/or asset(s), from the proceeds of green debt securities.

2.2 Details of unutilized proceeds including the temporary placement/utilization of unallocated and unutilized proceeds from each ISIN of green debt security issued by the issuer.

2.3 The following additional disclosures shall be made in the Annual Report:

a) List of project(s) and/or asset(s) to which proceeds of the Green Debt Securities have been allocated/invested including a brief description of such project(s) and/or asset(s) and the amounts disbursed.

b) Qualitative performance indicators and, where feasible, quantitative performance measures of the environmental impact of the project(s) and/or asset(s). If the quantitative benefits/ impact cannot be ascertained, then the said fact may be appropriately disclosed along with the reasons for non-ascertainment of the benefits/impact on the environment

c) Methods and the key underlying assumptions used in preparation of the performance indicators and metrics;

d) Details of the deployment of the mitigation plan (as disclosed in the offer documents) for the perceived social and environmental risks

2.4 Impact Reporting: Information, on a project-by-project basis, pertaining to reporting of the environmental impact of the projects financed by the green debt securities. Reporting standards or taxonomies followed by the issuer with regard to reporting of environmental impact, if any, shall also be disclosed.

2.5 Disclosures of major elements of Business Responsibility and Sustainability Reporting (BRSR) – Principle 6 pertaining to Environment.

Appointment of a Third Party Reviewer/certifier

3. An issuer shall appoint a third party reviewer/certifier for a green debt security for the following:

3.1 Post-issue management of the use of proceeds from the green debt security,

3.2 Verification of the internal tracking and impact reporting.

The said requirement of appointing a third party reviewer/ certifier is applicable on a '*comply or explain*' basis for a period of two years. *'Comply or explain'* for the purpose of the above, shall mean that the issuer shall endeavour to comply with the provisions and achieve full compliance by two years from the date of issuance of the circular. In case the entity is not able to achieve full compliance with the provisions till such time, the issuer shall in its annual report, explain the reasons for such non-compliance/ partial compliance and the steps initiated to achieve full compliance

Responsibilities of the issuer

4. An issuer of green debt securities shall:

4.1 maintain a decision-making process which it uses to determine the continuing eligibility of the project(s) and/or asset(s). This includes, without limitation statement on the environmental objectives of the green debt securities and a process to determine whether the project(s) and/or asset(s) meet the eligibility requirements;

4.2 ensure that all project(s) and/or asset(s) funded by the proceeds of green debt securities, meet the documented objectives of green debt securities;

4.3 utilise the proceeds only for the stated purpose, as disclosed in the offer document; and

4.4 ensure compliance with the SEBI circular SEBI/HO/DDHS/DDHS-RACPOD1/P/CIR/2023/020 dated February 03, 2023 on *"Dos and don'ts relating to green debt securities to avoid occurrences of greenwashing".*

Green Bonds and Greenwashing

Recently, SEBI revised its green bond framework, applicable for green bond issues after April 1, 2023. Pursuant to the review of the green bond regulatory framework, the following changes have been brought in by SEBI:

- *Expanding the scope of 'Green Debt Securities' by revising the definition through the of SEBI (Issue and Listing of Non-Convertible Securities) Amendment Regulations, 2023;*
- *Enhancement of disclosure requirements and mandating third-party reviewers through amendments to existing Chapter IX of the Operational Circular; and*
- *Guidance on avoidance of green-washing through introduction of Chapter IX-A to the existing Operational Circular.*

While there are no universally accepted taxonomies on greenwashing, the generally accepted definition of 'Greenwashing' is, *'making false, misleading, unsubstantiated, or otherwise incomplete claims about the sustainability of a product, service, or business operation'*.

As part of its green bond framework, SEBI has also released a list of '*Dos and don'ts on Greenwashing',* vide circular dated February 3, 2023. SEBI is one of the few regulators to issue such a list and it is expected to act as a strong deterrent to the deceptive practice.

To address the concerns of market participants, regarding greenwashing, an issuer of green debt securities shall ensure the following to avoid its occurence:

(i) While raising funds for transition towards a greener pathway, it shall continuously monitor to check whether the path undertaken towards more sustainable form of operations is resulting in reduction of the adverse environmental impact and contributing towards sustainable economy, as envisaged in the offer document.

(ii) It shall not utilize funds raised through green bonds for purposes that would not fall under the definition of *'green debt security'* under the NCS Regulations.

(iii) In case any such instances mentioned in (ii) above come to light regarding the green debt securities already issued, it shall disclose the same to the investors and, if required, by majority of debenture holders, undertake early redemption of such debt securities.

(iv) It shall not use misleading labels, hide trade-offs or cherry pick data from research to highlight green practices while obscuring others that are unfavourable in this behalf.

(v) It shall maintain highest standards associated with issue of green debt security while adhering to the rating assigned to it.

(vi) It shall quantify the negative externalities associated with utilization of the funds raised through green debt security.

(vii) It shall not make untrue claims giving false impression of certification by a third-party entity.

Transition Bonds - Additional requirements for issuers

Since transition bonds are green debt securities as per the NCS Regulations, SEBI felt a need to ensure that the funds raised for transition finance through transition bonds are indeed used for the purpose. Accordingly, certain stipulations additionally have been brought in by SEBI for issuers of transition bonds.

1. On February 2, 2023, the revised definition of *'green debt security'* was notified in the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021. On February 6, 2023, SEBI issued the revised disclosure requirements for such issuances. [See Regulation 2(1)(q) of the SEBI NCS Regulations, 2021]

2. As mentioned earlier, *'Transition bonds'* is one of the sub categories of the revised definition of '*green debt security'.* As per the SEBI (Issue and Listing of Non-Convertible Securities), transition bonds comprise of *"funds raised for transitioning to a more sustainable form of operations, in line with India's Intended Nationally Determined Contributions."*

3. Transition finance market is moving from operations that are carbon intensive to carbon neutral. For transition, a significant helping hand through funding is required for carbon-intensive sectors to decarbonize. SEBI believes that transition bonds find their use in this space.

4. In order to facilitate transparency and informed decision making amongst the investors in the transition bonds and to ensure that the funds raised through transition bonds are not being misallocated, SEBI decided to prescribe certain additional requirements for issuance and listing of *transition bonds*, as follows:

   SEBI brought a circular on May 04, 2023, requiring an issuer desirous of issuing transition bonds to make the following additional disclosures:

   - **Disclosure in the offer document for public issues /private placements of such transition bonds:**

     a. To differentiate transition bonds from other categories of green debt security, Issuer of transition bonds shall use a denotation '***GB-T'***. The denotation shall be disclosed in the offer documents on the cover page and in *type of instrumen*t field in the term sheet.

     b. Transition Plan, which shall contain the following:

        (i) Details of interim targets / milestones along with an indicative timeline for achieving the targets.

        (interim targets should also reflect the indicative figure regarding how much emissions the issuer is envisaging to reduce)

        (ii) Brief of the project implementation strategy

        (iii) Details regarding the usage of technology for the project implementation

        (iv) Mechanism to oversee the utilization of the funds raised through transition bonds and the implementation of the transition plan. Issuers may form a committee to oversee the implementation and ensure timely completion of the defined targets.

- **Disclosure in the Centralised Database for corporate bonds:**

  An issuer shall disclose the denotation in the Centralized Database for corporate bonds/ debentures by filling the denotation i.e. **GB-T** in sub point 6 i.e. *Others* of point 10. i.e. *Type of Instrument* of Annex-XIV-A to Chapter XIV (Centralized Database for corporate bonds/ debentures) of the Operational Circular dated August 10, 2021 (and as amended from time to time).

  The Depositories shall update the denotation i.e. **GB-T** as prefix in "*instrument details"* field in Centralized Database for corporate bonds/ debentures.

- **Disclosure to Stock Exchanges, in case of a revision in the transition plan:**

  An Issuer of transition bonds, during the year, shall disclose the revised transition plan along with an explanation for any such revision to the already disclosed plan; if applicable.

- **Disclosure in the Annual report:**

  The Issuer, shall disclose the transition plan along with a brief on the progress of the implementation of the transition plan.

Municipal Bonds

The importance of infrastructure especially urban infrastructure and the role of entities tasked to create that infrastructure in India cannot be overstated. The funding requirement of municipalities is expected to increase given the pace of reforms being witnessed in the country. The current sources of revenues in the form of Tax & Non-tax and Grants from state/ central government are felt to be insufficient for the enormous scale of infrastructure development and upgradation required to meet the growth aims at various levels (State/ Centre).

SEBI has issued the SEBI (Issue and Listing of Municipal Debt Securities) Regulations, 2015 ('ILDMS Regulations').

In accordance with these Regulations, "municipal debt securities" shall mean non-convertible debt securities which create or acknowledge indebtedness, and include debenture, bonds and such other securities of an issuer and "municipality" shall mean an institution of self-government constituted under Article 243Q of the Constitution of India.

Municipal bonds are a good alternative source of finance to fund projects undertaken by Municipal Corporations. In India, the Municipal Debt market is in a nascent stage. SEBI is taking steps to increase awareness through such events. Since 2017 upto March 2024, sixteen twelve issues of Municipal Bonds have been made by ten Municipal Corporations in the country, raising almost Rs.2000 2700 Cr. The funds raised through these bonds have been used for various developmental projects like liquid waste management projects, water supply projects, tertiary sewage treatment plants, residential projects etc. A few municipalities have also issued green bonds.

Unless otherwise provided in these Regulations, An issuer making an offer of municipal debt securities shall satisfy the conditions of theset SEBI Municipal Bond Regulations as on the date of filing of the draft offer document for preliminary public issue or private placement.

These regulations, inter-alia, deal with:

- the eligibility requirement for public issue of municipal debt securities,
- listing requirements for both public issues and private placement,

- conditions for trading of debt securities,
- obligations of intermediaries and issuers etc.

An issuer under ILMDS may issue a green debt security if it falls within the definition of “green debt security”, as per Regulation 2(1)(q) of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations). Such issuer, shall, in addition to the requirements prescribed under the ILMDS Regulations and circulars issued thereunder, comply with the provisions for ‘green debt security’, as specified under the NCS Regulations and circulars issued thereunder.

Amounts raised through municipal bonds*

The following table gives a snapshot of the amounts raised through Municipal bonds recently:

Name of Municipality	***Date of Issue***	***Amount of Issue (Rs. in cr.)***	***Coupon (%)***
Pune Municipal Corporation	June 20, 2017	200	7.59
Greater Hyderabad Municipal Corporation	Feb 16, 2018	200	8.9
Indore Municipal Corporation	June 28, 2018	139.9	9.25
Greater Hyderabad Municipal Corporation	Aug 14, 2018	195	9.38
Bhopal Municipal Corporation	Sept 25, 2018	175	9.55
Greater Vishakhapatnam Municipal Corporation	Dec 21, 2018	80	10
Ahmedabad Municipal Corporation	Jan 11, 2019	200	8.7
Surat Municipal Corporation	Feb 27,2019	200	8.68
Greater Hyderabad Municipal Corporation	August 20, 2019	100	10.23
Lucknow Municipal Corporation	November 13, 2020	200	8.5
Ghaziabad Nagar Nigam	March 13, 2021	150	8.1
Vadodara Municipal Corporation	March 24, 2022	100	7.15
Indore Municipal Corporation	February 10, 2023	244	8.25
Pimpri Chinchwad Municipal Corporation	July 28, 2023	200	8.15
Ahmedabad Municipal Corporation	February 07, 2024	200	7.9
Vadodara Municipal Corporation	March 06, 2024	100	7.9

The issue by Indore Municipal Corporation is the first municipal bond issue under the green bond framework of SEBI.

* *For information only.*

Introduction of an information database by SEBI for Municipal Bond issuers through a QR Code

At a SEBI outreach programme on Municipal Bonds and Municipal Finance in January 2023, an Information Database including a repository of information pertaining to Municipal Bonds was launched on the SEBI website. The database is intended not merely to serve as a guide but also to create awareness about municipal debt securities. The Information database can also be accessed by way of a Quick Response Code (QR Code) that is provided in the press release.

The information database contains a wide range of information such as:

- *Statistics and regulations, circulars, guidance note and Frequently Asked Questions issued by SEBI in respect of Municipal Debt Securities;*
- *Checklists for pre-listing requirements and sample letters and certificates from various intermediaries to be obtained by an Issuer who plans to tap the Municipal Bond Market;*
- *Templates for agreements between various stakeholders; and*
- *Indicative Due Diligence Questionnaire for Merchant Bankers*.

This Information database is expected to be useful to many stakeholders including the Municipal Corporations, Stock Exchanges, Credit Rating Agencies, Merchant Bankers, Debenture Trustees, Lawyers, NGOs and Institutional investors.

COMPLIANCES AS PER SEBI NCS REGULATIONS

An issue of non-convertible securities (private placement proposed to be listed or a public issue) is governed by the SEBI NCS Regulations and the Operational Circular No. SEBI/HO/DDHS/P/CIR/2021/613 dated August 10, 2021 (Updated in July 2023 and renamed as Master Circular). The SEBI NCS Regulations prescribes a host of requirements to be complied with at the time of issuance and listing of non-convertible securities and the obligation for ensuring the same lies on the lead manager (in case of public issue)/ compliance officer (in case of private placement). Currently, majority of the issues of non- convertible securities are private placements as against public issues.

Issue related Compliances [Regulations 5-23]

In particular, for private placements of listed Non-convertible Securities, the Company Secretary shall ensure that the regulatory provisions contained in the NCS Regulations are complied with by the Issuer Company. The major provisions are briefly enumerated below.

The Issuer shall:

- make an application to one or more stock exchange(s) and obtain an in-principle approval for listing of its Non-convertible Securities;
- comply with the conditions relating to the issue of International Securities Identification Number;
- enter into an arrangement with a depository for dematerialization of the Non-convertible Securities;
- appoint a Debenture Trustee and enter into a Debenture Trust Deed;
- appoint a Registrar to the Issue;
- obtain a credit rating from at least one Credit Rating Agency, and disclose the same in the offer document;

- create a recovery expense fund by depositing an amount equal to 0.01% of the issue size subject to maximum of Rs. 25 lakhs per issuer;
- pay regulatory fees to SEBI through the stock exchange ;
- make all payments on working days;
- follow the Actual/ Actual day count convention for calculation of interest/ dividend payments ;
- create a Debenture Redemption Reserve or Capital Redemption Reserve in accordance with the relevant provisions of the Companies Act, 2013;
- create and maintain security, in case of secured non-convertible securities; and
- comply with the guidelines for 'Security and Covenant Monitoring' using Distributed Ledger Technology (DLT).
- Ensure compliances with reference to Electronic Book Provider (EBP) Mechanism in case the issue is on private placement and is of the size of Rs.50 crore or more.

Further, the Company Secretary shall ensure that the Issuer satisfies the eligibility conditions viz. none of the promoters or directors of the company are wilful defaulters, fugitive economic offender, have been debarred or disqualified from being appointed or continuing as directors of companies.

The Company Secretary also ensures that the listed entities comply with the requirements prescribed for large corporates.

Issuers without track record

As per SEBI NCS Regulations, issuers (other than unlisted Real Estate Investment Trust (REITs) and InvITs) who have been in existence for less than 3 years have been facilitated to tap the bond market, provided:

a. Issuance of their debt securities is made only on a private placement basis;

b. The issue is made on the EBP platform irrespective of the issue size; and

c. The issue is open for subscription only to QIBs.

This is aimed to enable Special Purpose Vehicles created for specific infrastructure purposes/ NBFCs/ listed REITs/ listed InvITs and other companies who propose to list debt securities purely on private placement basis but who do not have a three-year existence, to list their debt securities even without three years' financials. All other requirements under the SEBI NCS Regulations and operating stipulations of the Electronic Book Provider mechanism continue to apply to such issuers. In such cases, the role of the Company Secretary assumes paramount importance. The Company Secretary undertakes necessary due diligence and the ensures compliance with the regulatory requirements.

Specific obligations with respect to treatment of applicants [Regulation 23]

The NCS Regulations require that the Issuer shall:

- apply for Securities and Exchange Board of India Complaints Redress System (SCORES) authentication.
- treat all applicants to an issue of non-convertible securities in a fair and equitable manner as per the procedures as may be specified by the Board.
- not employ any device, scheme, or artifice to defraud in connection with issue or subscription or distribution of non-convertible securities which are listed or proposed to be listed on the recognized stock exchange.

Disclosures in the Offer Document [Regulations 27, 28 and 45]

Disclosures are paramount for issue of any listed securities to ensure safety of the investors' funds. While a Merchant Banker is compulsorily appointed in case of a public issue of non-convertible securities, which performs a critical role of ensuring due disclosures; for private placements, appointment of a merchant banker being optional, the role of the Company Secretary assumes significant importance in ensuring due disclosures.

The Company Secretary is required to ensure that the offer document contains all material, true, fair and adequate disclosures which are necessary for the subscribers of the debt securities and non-convertible redeemable preference shares to take an informed investment decision and shall not omit/ include any material fact which may make the statements made therein, in light of the circumstances under which they are made, misleading or untrue. The Company Secretary shall also ensure that the audited financial statements contained in the placement memorandum and tranche placement memorandum are not more than six months old as computed from the later of date of filing placement memorandum or the issue opening date.

Details of Compliance Officer who is also the Company Secretary of the issuer has to be necessarily disclosed on the front page of the offer document viz. name and contact particulars including postal and email address, telephone number. Such disclosure is essential for creating awareness and accessibility for the investors and underscores the importance of the Company Secretary in such issuances.

Advertisements for Public Issues [Regulation 30]

The Company Secretary should ensure that the advertisement by the issuer for the public issue is truthful, fair and clear and shall not contain a statement, promise or forecast which is untrue or misleading; it shall solicit investment only on the basis of information contained in the offer document.

Incentives [Regulation 31]

The Company Secretary shall ensure that no person connected with the issue offers any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the issue, except for fees or commission for services rendered in relation to the issue.

DEPOSITS

Corporates also have access to another market called the Inter Corporate Deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. Existing mainly as a refuge for low rated corporates, this market allows corporates with surplus funds to lend to other corporates facing shortage of funds. Another aspect of this market is that the better-rated corporates can borrow from the banking system and lend in this market to make speculative profits. As the cost of funds for a corporate in much higher than that of a bank, thus, the rates in this market are higher than those in the other markets. ICDs are unsecured, and hence the risk inherent is high. The ICD market is an unorganized market with very less information available publicly about transaction details.

PUBLIC DEPOSITS

Introduction

Bank deposits consist of money that is placed by investors in banks and financial institutions. Deposits can be made in savings accounts and pure Deposit accounts. They are also known as fixed deposits as the interest and term of the deposits are fixed. A depositor can withdraw the amount at the end of the tenure of the deposit or on demand, as per the terms of the deposit. Since deposits are taken from the public at large, they are also known as public deposits. The cost and procurement of public deposits is cheaper and easier, respectively, than other forms of sources of finance. Generally public deposits, from the bank's or financial institution's point of view, are a source of short / medium term finance.

Provisions of the Companies Act, 2013

The provisions concerning deposits are covered under Sections 73 to 76 of the Companies Act, 2013, which are to be read with the prescribed Rules i.e. the Companies (Acceptance of Deposits) Rules, 2014. As per the Companies Act, 2013, a deposit is any money that is received, either by means of a deposit or a loan or any other form as may be prescribed, but does not include certain classes of transactions. Companies may accept deposits from both, members and the general public as per the provisions of the Companies Act, 2013.

Under Section 2 (31) of the Companies Act, 2013, "deposit" includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India. Under the rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014, deposit has been granularly defined as *any receipt of money by way of deposit or loan or in any other form by a company, but does not include the following amounts*:

- Received from the Central Government or a State Government, or any such source where the repayment will be guaranteed by the State or the Centre.
- Received from foreign banks or international banks, foreign governments, multilateral financial institutions subject to the provisions of FEMA, 1999.
- Received by way of financial assistance or loan from Public Financial Institutions notified by the Central Government or Scheduled Banks or Insurance Companies.
- Received as a loan or facility from any banking company or the State Bank of India or any of its subsidiaries.
- Received by a company from any other company.
- Received against the issue of commercial paper or any other instruments issued in accordance with the RBI guidelines.
- Received against an offer made towards the subscription of securities, by way of share application money or advance towards allotment. The money shall be considered as a deposit provided *the company fails to allot such securities within 60 days and after the expiry of the aforesaid 60 days, the money that is received has still not been refunded in the next 15 days.*
- Received from an employee of the company not exceeding his annual salary in the nature of non-interest bearing security deposit.
- Received amount that is non-interest bearing in nature or held in trust.
- Received from a director or a relative of a director who provides a declaration stating that the amount is not given out of borrowings or a loan or a deposit from any person.
- Raised by way of issue of debentures or bonds secured by a first charge or any other way.
- Brought in by the promoters as a loan, unsecured in nature, in pursuance with the stipulation of bank or lending financial institution.
- Accepted by a Nidhi Company as per the provisions of Sec 406 of the Act.
- Received in the course/for the purpose of business as an advance:-
    a) Received in connection with consideration for an immovable property under an agreement.

b) Received for the supply of capital goods under long term projects.

c) For the supply of goods/provision of services as long as the advance is appropriated against the supply of goods/provision of services within 365 days of accepting the same.

d) Received as a security deposit for the performance of a contract.

e) Towards consideration for providing future services in the form of a warranty or maintenance contract as per written agreement or arrangement.

f) Received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government.

g) For subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications.

- Received by way of subscription in respect of a chit under the Chit Fund Act, 1982.
- Received by the company under any collective investment scheme in compliance with regulations framed by SEBI.
- An amount of twenty five lakh rupees or more received by a start-up company, by way of a convertible note (convertible into equity shares or repayable within a period not exceeding ten years from the date of issue) in a single tranche, from a person.

Eligibility of a company to accept Deposits

Rule 2(1)(e) of the Companies (Acceptance of Deposits) Rules, 2014 states that a public company having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies and where applicable, with the Reserve Bank of India before making any invitation to the Public for acceptance of Deposits can accept deposits.

However, such company which is accepting deposits within the limits specified under clause (c) of sub-section (1) of Section 180, may accept deposits by means of an ordinary resolution.

Non-applicability of Section 73

However, section 73 categorically states that the above provisions will not apply to:

- Any banking company.
- Non Banking Financial Companies as per the RBI Act 1934.
- Any other company notified by the Central Government in consultation with the RBI.

Conditions for Acceptance of Deposits (Sec. 73)

There are a few conditions that have to be fulfilled in order for a company to accept deposits. The following is the procedure to be followed by a company to accept deposits:

- A resolution has to be passed by shareholders in a General Meeting.
- The members shall be informed about the following:

a) Financial statements of the company

b) Credit rating obtained

c) Total number of depositors

d) Amount due to the depositors with regard to deposits collected in the past by the company

- File a copy of the above information and the statements with the Registrar at least 30 days prior to the issue of the circular.
- 20% of the total amount of deposits maturing in the following financial year to be deposited with a Scheduled bank in a separate account, *"Deposit Repayment Reserve Account"* before the 30th of April, of every year.
- The company shall certify the fact that it has not defaulted on the repayment of the deposits or any payment of interest on such deposits, whether those deposits were accepted before or after the commencement of the Act.
- In case there has been a default in the past and the company has made good the same, a period of five years should have passed since the default has been made good.
- A security has to be provided for secured deposits; others will be treated as unsecured deposits.

Tenure of deposits:

The Rules also say that the tenure of deposits shall be less than 6 months or more than 36 months from the date of acceptance or renewal of such deposit.

For more information about Deposits, the students may refer Lesson 6 of Company Law & Practice Paper of Executive Programme.

NON-BANKING FINANCIAL COMPANIES (NBFCs)

Introduction

NBFCs are important to the Indian economy. NBFCs reach the nook and corner of the country and have been pivotal in the financial inclusion in India - from personal to vehicle finance loans, gold to microfinance loans and what not. They have promoted credit growth in the unorganised, un-banked, and under-banked sections of the economy. The relevance of NBFCs as providers of commercial credit increased significantly in the 2010s, especially since the banking sector began experiencing acute asset quality stress after 2015. NBFCs thus primarily operate in niche segments where they can overcome their funding cost disadvantage and serve a useful purpose through other capabilities such as more efficient sourcing of customers, prompt provision of services and specialized sector expertise. NBFCs not only complement but also act as substitutes for banks by widening the ambit of and access to financial services. As of March 2024, around 10,000 NBFCs were registered with RBI, with an asset size of almost Rs.50 lakh crore.

NBFC - Definition

As per Section 45 I(f) of Reserve Bank of India Act, 1934, "**Non-Banking Financial Company**" means:

1. a financial institution which is a company;
2. a non-banking institution which is a company, and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
3. such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify;

What is a Non-Banking Financial Company (NBFC)?

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Major Difference between Banks and NBFCs

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

i. NBFC cannot accept demand deposits;

ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;

iii. deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Registration as NBFC

A company incorporated under the Companies Act, 2013 and desirous of commencing business of non-banking financial institution as defined under Section 45 I(a) of the RBI Act, 1934 should comply with the following:

i. it should be a company registered under Section 3 of the Companies Act, 2013

ii. it should have a minimum net owned fund of ₹10 crore (earlier ₹ 2 crore)

RBI has specified a glide path to achieve the revised Net Owned Fund (NOF) requirements for the existing NBFCs as provided in the table below:

NBFCs	***Current Net owned Fund***	***To be achieved by March 31, 2025***	***To be achieved by March 31, 2027***
NBFC-ICC	₹2 crores	₹5 crores	₹10 crores
NBFC-MFI	₹5 crores (₹2 crore in NE Region)	₹7 crores (₹5 crore in NE Region)	₹10 crores
NBFC-Factors	₹5 crores	₹7 crores	₹10 crores

Section 45-IA of the Reserve Bank of India Act, 1934 governs the registration and maintaining minimum Net Owned Funds requirement of NBFCs. The relevant provisions are as under:

Non-banking financial company shall not commence or carry on the business of a non-banking financial institution without:

1. obtaining a certificate of registration; and

2. having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding hundred crore rupees, as the Bank may, by notification in the Official Gazette, specify:

However, the Bank may notify different amounts of net owned fund for different categories of non-banking financial companies.

Certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration.

Principal Business

Financial activity as principal business is when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI. The term 'principal business' is not defined by the Reserve Bank of India Act. The Reserve Bank has defined it so as to ensure that only companies predominantly engaged in financial activity get registered with it and are regulated and supervised by it.

Investigation powers of RBI vis-à-vis NBFCs

- Insertion of Section 45-ID by the Finance Act, 2019 gives the power to RBI, if satisfied, in the public interest or to prevent affairs of NBFC in detrimental manner, to remove from office a director (by whatever name called) of such company other than Government owned NBFC after giving opportunity of being heard.
- Further, RBI also has the powers by virtue of section 45-IE, to supersede the Board of Directors of NBFC other than Government Company.
- RBI also has the powers to provide for resolution of NBFC in the public interest
- RBI can also call for information from group companies and if required cause an inspection or audit to be made of group companies.
- RBI also has powers to take action against auditors of NBFCs as per Section 45 MAA of the RBI Act, 1934.

Classification of NBFCs

On the basis of activities, NBFCs can be classified as under:

- *Investment and Credit Company (NBFC-ICC)* – Conducting primarily Investing, Lending and Asset Finance activities, other specialized classifications.
- *Micro-finance Company (NBFC-MFI)* – Conducting the principal business of providing micro finance.
- *Infrastructure Finance Company (NBFC-IFC)* – Conducting the principal business of providing infrastructure finance through loans.
- *Factoring Company (NBFC-Factor)* – Conducting the principal business of factoring.
- *Housing Finance Companies (NBFC-HFC)* – Engaged in the principal business of Housing Finance.
- Core Investment Company (Systemically Important if Asset Size above Rs. 100 Cr.) (CIC).
- *Account Aggregators (NBFC-AA)* – Conducting the activity of account aggregation.
- *Peer to Peer Lending Platforms (NBFC-P2P)* – Conducting the business of a peer to peer lending platform, majorly IT driven.

- *Infrastructure Debt Fund NBFC (IDF-NBFC)* – It facilitates the flow of long term debt into infrastructure projects.
- Mortgage Guarantee Companies (MGC).

Classification of NBFCs based on supervision

Recently, RBI has classified NBFCs into four layers, like banks, for supervision, particularly risk based supervision. The layers are explained as under:

a. **Base layer (NBFC-BL)**

The base layer will be equivalent to the existing non-deposit taking non-systemically important NBFCs (NBFC-NDs) Systemically important, non-deposit taking NBFCs below the asset size of Rs. 1,000 crore (except those necessarily featuring in the middle layer) will be part of NBFC-BL. It will specifically include:

- NBFC-P2P (NBFC-Peer to Peer lending platform);
- NBFC-AA (NBFC-Account Aggregator);
- NOFHC (Non-Operative Financial Holding Company); and
- NBFCs without public funds and customer interface.

While higher level of prudential regulations will not be applicable to such entities, there will be an increase in the transparency requirements through additional disclosures and improved governance standards.

b. **Middle layer (NBFC-ML)**

The middle layer will be equivalent to the existing deposit taking NBFCs (NBFC-D) and systemically important non-deposit taking NBFCs (NBFC-ND-SI). It will specifically include the SPD (i.e. Standalone Primary Dealers) and IDF (Infrastructure Debt Funds) (which will always remain in the middle layer). It will also include NBFC-D, irrespective of their asset size, NBFC-ND-SI with asset size greater than Rs. 1,000 crore, CIC, IFC and HFCs. Government owned NBFCs will not be placed in the upper layer, till further notice, and accordingly, will be placed in NBFC-BL or NBFC-ML. There will be a higher level of regulatory supervision in this layer, which aims to plug the areas of regulatory arbitrage between banks and NBFCs.

c. **Upper layer**

The upper layer has been conceived as a new category of NBFCs, in which a chosen few, systemically significant NBFCs would be specifically identified by RBI through parametric analysis of certain quantitative and qualitative criteria, which will be reviewed periodically. Accordingly, entities that meet the specified criteria will move from the middle layer to the upper layer of the scale-based framework. The top 10 eligible NBFCs in terms of their asset size will always reside in the upper layer, irrespective of any other factor. Higher prudential regulations and intensive supervision will be applicable for such entities proportionate to their systemic significance.

d. **Top layer**

The top layer would ideally remain empty and NBFCs will be slotted into this layer from the upper layer of the scale-based framework at the discretion of RBI if it is of the opinion that the entity is contributing significantly to the systemic risk. Such entities would be required to comply with significantly higher regulatory and supervisory requirements.

Recent RBI reforms on risk based supervision

The RBI reforms to enhance risk based supervision of NBFCs that were effective from October 1, 2022 are as under:

1. **Re-Classification of Non-Banking Financial Companies**

   Categorising NBFCs into various categories such as NBFC- Infrastructure Investment Company, Core Investment Company, Microfinance Institution, Systemically Important/ Non-Systemically Important, Deposit taking/Non-deposit taking etc.

   - Layer Based Classification into four layers – Base Layer, Middle Layer, Upper Layer, and Top Layer;
   - Classification in terms of Asset Size, Perceived Riskiness involved;
   - Various activities undertaken by NBFCs are considered for classification.

2. **Ceiling on Subscription through IPO**

   RBI has advised NBFCs to apply the ceiling of ₹ 1 crore per borrower for financing subscription to Initial Public Offer (IPO). However, NBFCs can fix more conservative limits.

3. **Enhanced Governance**

   RBI has amended and uniformed governance structure that will apply layer wise, as follows:

   - The governance over different layer will vary and depends on the meeting of thresholds by NBFCs;
   - Additional Disclosure Requirements for Upper and Middle Layer NBFCs are prescribed;
   - Constitution of Internal Committees and Assessments - Risk Management Committee (RMC): The NBFC shall form a RMC either at the Board or Executive level for evaluating the overall risks faced by the NBFC including liquidity risk and such Committee shall report to the Board.

4. **Directors to have bank / NBFC experience**

   At least one of the directors shall have relevant experience of having worked in a bank/ NBFC, considering the need for professional expertise in managing the affairs of the NBFCs.

5. **Loans to Directors and Senior Officers**

   NBFCs shall put in place a Board Approved Policy for granting loans to the Directors, Senior Officers, and Relatives of Directors and to entities where directors or their relatives have a major shareholding.

6. **Additional Disclosure Requirements**

   Base Layer NBFCs are required to make certain additional disclosure in Annual Financial Statements such as Related Party Transactions, Exposure to Real Estate Sector, Exposure to Capital Market, Sectoral Exposure, etc.

7. **Internal Capital Adequacy Assessment Process**

   NBFCs are now required to assess their capital in proportion to risk to the business in same way as done by Commercial Banks under Master Circular – Basel III Capital Regulations prescribes.

   - This is similar to Commercial Banks

- This ensures adequate Capital to support all risks in the business of NBFC
- This assists NBFCs to develop and use better Internal Risk Management Techniques.

8. Core Financial Service Solution

NBFCs shall maintain core financial service solution:

- Akin to Core Banking Solution adopted by Banks
- The Solution is required to be adopted by NBFC Middle Layer and Upper Layer with 10 or more Fixed Point Service Delivery Unit
- Implementation of the Solution has to be quarterly reported to RBI
- This is required for Seamless customer interface in digital offerings and transactions.

Provisioning Norms

The RBI provisioning norms for Standard Assets as well as Non-Performing Assets for NBFCs (Scale-Based Regulation) are as follows:

<table>
<tr><th>Provisioning for NBFC-ND-SI and NBFC-D</th><th>Provisioning for NBFC-ND-NSI</th><th colspan="2">Treatment for secured portion</th></tr>
<tr><td>Standard Assets</td><td>At the end of each year: 0.40%</td><td>At the end of each year: 0.25%</td><td>NA</td></tr>
<tr><td>Sub- standard assets</td><td>10% of the outstanding amount if it remains outstanding for a period of 12 months.</td><td>10% of the outstanding amount if it remains outstanding for a period of 18 months.</td><td>No specific provisions regarding Security</td></tr>
<tr><td>Doubtful Assets</td><td>100% provision to the extent to which the advance is not covered by the realizable value of the security Note: Asset will be considered doubtful if it remains substandard for 12 months</td><td>100% provision to the extent to which the advance is not covered by the realizable value of the security Note: Asset will be considered doubtful if it remains substandard for 18 months</td><td>To the extent of loan which is covered by estimated realizable value of securities, the following provisioning is required - based on the period the asset (the underlying loan) has remained doubtful
<table>
<tr><th>Period for which Considered Doubtful</th><th>% of Provision against estimated realizable value of securities</th></tr>
<tr><td>Up to - one year</td><td>20</td></tr>
<tr><td>One - three year</td><td>30</td></tr>
<tr><td>More than three years</td><td>50</td></tr>
</table>
</td></tr>
</table>

Provisioning for NBFC-ND-SI and NBFC-D	***Provisioning for NBFC-ND-NSI***	***Treatment for secured portion***	
Loss Assets	100% Write off in the books (Same treatment for the Interest)	100% Write off in the books (Same treatment for the Interest)	NA

"Standard asset" means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carries more than normal risk attached to the business

Non-performing asset" (referred as "NPA"): Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months (12 months for NBFC-ND-NSI) for the financial year ending March 31, 2018 and thereafter Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months (6 months for NBFC-ND-NSI) for the financial year ending March 31, 2018 and thereafter. (NBFC-ND-SI means a systemically important non-deposit taking non-banking finance company.)

NPA norms for NBFCs

The NPA norms for NBFCs have been changed by RBI as under:

NPA Norms	***Timeline***
>150 Days overdue	By March 31, 2024
>120 Days overdue	By March 31, 2025
> 90 Days overdue	By March 31, 2026

Corporate Governance norms for NBFCs

1. Extent of the Directions

RBI has come out with the Non-Banking Financial Companies – Corporate Governance (Reserve Bank) Directions, 2015, which apply to every non-deposit accepting Non-Banking Financial Company with asset size of Rs.500 crore and above (NBFCs-ND-SI), as per its last audited balance sheet, and all deposit accepting Non-Banking Financial Companies (NBFCs-D), henceforth called as Applicable NBFCs.

2. Non applicability

The provisions of these Directions shall not apply to a Systemically Important Core Investment Company as defined in the Core Investment Companies (Reserve Bank) Directions, 2011.

3. Constitution of Committees of the Board

(a) Audit Committee

i. All Applicable NBFCs shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

***Explanation I* :** The Audit Committee constituted by a non-banking financial company as required under Section 177 of the Companies Act, 2013 shall be the Audit Committee for the purposes of this paragraph.

***Explanation II*:** The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 177 of the Companies Act, 2013.

ii. The Audit Committee must ensure that an Information System Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the NBFCs.

(b) Nomination Committee

All Applicable NBFCs shall form a Nomination Committee to ensure 'fit and proper' status of proposed/ existing directors.

***Explanation I* :** The Nomination Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 178 of the Companies Act, 2013.

(c) Risk Management Committee

To manage the integrated risk, all Applicable NBFCs shall form a Risk Management Committee, besides the Asset Liability Management Committee.

4. Fit and Proper Criteria

(1) All Applicable NBFCs shall

- ensure that a policy is put in place with the approval of the Board of Directors for ascertaining the fit and proper criteria of the directors at the time of appointment, and on a continuing basis.
- obtain a declaration and undertaking from the directors giving additional information on the directors. The declaration and undertaking shall be on the lines specified by RBI.
- obtain a Deed of Covenant signed by the directors.
- furnish to the Reserve Bank a quarterly statement on change of directors, and a certificate from the Managing Director of the NBFC that fit and proper criteria in selection of the directors has been followed.

The statement must reach the Regional Office of the Reserve Bank within 15 days of the close of the respective quarter. The statement submitted by NBFCs for the quarter ending March 31, should be certified by the auditors.

However, the Bank, if it deems fit and in public interest, reserves the right to examine the fit and proper criteria of directors of any non-banking financial company irrespective of the asset size of such non-banking financial company.

5. Disclosure and transparency

(a) All applicable NBFCs shall put up to the Board of Directors, at regular intervals, as may be prescribed by the Board in this regard, the following:

i. the progress made in putting in place a progressive risk management system and risk management policy and strategy followed by the NBFC;

   ii. conformity with corporate governance standards viz., in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions, etc.

(b) All applicable NBFCs shall also disclose the following in their Annual Financial Statements, with effect from March 31, 2015:

   i. registration/ licence/ authorisation, by whatever name called, obtained from other financial sector regulators;

   ii. ratings assigned by credit rating agencies and migration of ratings during the year;

   iii. penalties, if any, levied by any regulator;

   iv. information namely, area, country of operation and joint venture partners with regard to Joint ventures and overseas subsidiaries and

   v. Asset-Liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures, structured products issued by them as also securitization/ assignment transactions and other disclosures.

6. Rotation of partners of the Statutory Auditors Audit Firm

All Applicable NBFCs shall rotate the partner/s of the Chartered Accountant firm conducting the audit, every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the NBFC after an interval of three years, if the NBFC, so decides. NBFCs shall incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

7. Framing of Internal Guidelines

All applicable NBFCs shall frame their internal guidelines on corporate governance with the approval of the Board of Directors, enhancing the scope of the guidelines without sacrificing the spirit underlying the above guidelines and it shall be published on the company's web-site, if any, for the information of various stakeholders.

8. Recent RBI diktat on cash disbursements:

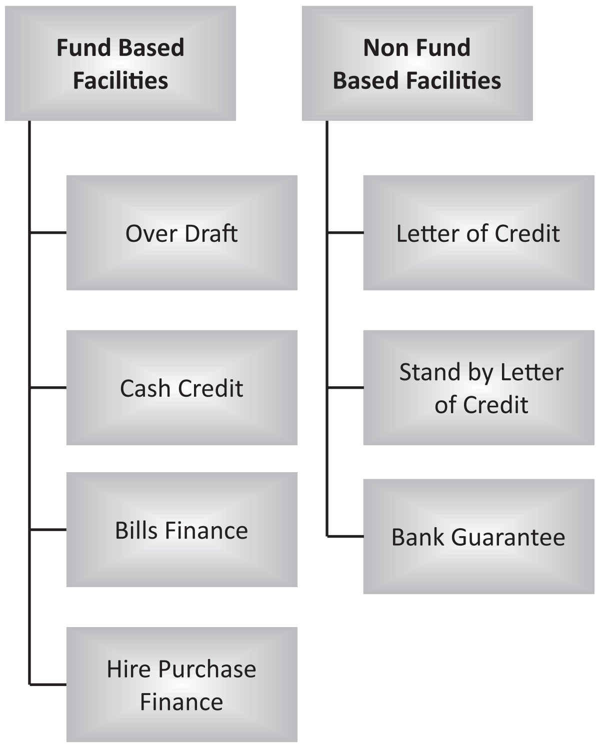
The Reserve Bank of India (RBI) has, in May 2024, directed non-bank finance companies to follow the IT Act (Section 269 SS) strictly for cash payouts. Thus NBFCs must stick to cap of Rs 20,000 while disbursing cash loans. This is likely to stop large payouts to those borrowing against cash transactions, particularly gold loans.

BANK FINANCE- MOST COMMON WAY OF FUNDING FOR CORPORATES

Banking Regulation Act, 1949 classifies bank finance into secured loans and unsecured loans. Secured loan means loans granted by the banks on the backing of some tangible security, while Unsecured loan is one for which the banker has to rely upon the personal security of the borrower. Unsecured advances are not popular in India as they impose a huge risk of money loss in case of default by the borrower. Most of the bank advances are secured ones. Only a small portion of about 11% to 15% of the total bank advance is unsecured that usually take form of Overdrafts and Cash Credit Facilities.

Bank's finance their customers not only in the form of loans, but through other types of credit facilities also. The other types of bank finance are tailor made to suit the needs of customers. The loans and advances wherein immediate flow of funds is available to borrowers, are called funds based facility. In non-fund based facilities like issuance of letter of guarantee, letter of credit etc., banks get income in the form of fee for making available the facility and there is no immediate outflow of funds from bank. Some of the credit facilities which are different from loans are described here-under:

Credit Facilities provided by the Banks



CREDIT FACILITIES PROVIDED BY THE BANKS

Fund Based Facilities and Non Fund Based Facilities

In Funded (Fund based) facility, there is cash outflow right from the initial stage. The examples of funded facility are Term Loan, Cash Credit and Bill Purchased or bill discounting. When a term loan is disbursed, cash credit facility is sanctioned or a bill is purchased or discounted cash flow takes place. The income earned by the banks when they extend funded facilities to the borrowers, is accounted under income head interest (in case of term loans and cash credits) and discount (in case of bill discounting facility).

In Non-funded (Non-fund based) facility, initially there is no cash outflow, later on there may or may not be cash outflow. The examples of non-fun based facility are Bank Guarantees (BGs) including deferred payment guarantees and Letter of Credit (LCs). When BG or LC is issued, there is no cash out flow. However latter on if the guarantee is invoked by the beneficiary, the bank will have to make the payment under the guarantee at times even if there is no balance in the account of customer. Similarly when bills negotiated under LC are due for payment the bank may have to honour the same at times by creating forced loan in the account of the buyer on whose behalf Letter of Credit is issued. The income earned by banks while issuing bank guarantees or LCs is accounted under the income head “commission”. Non-Fund based credit facilities to non-borrowers of the bank.

Banks can grant non-funded facilities including partial credit enhancement to customers, not availing fund based facility from any bank in India under following conditions :

1. Banks are to ensure that the borrower has not availed any fund based facility from any bank operating in India. At the time of granting non-funded facilities, bank to obtain declaration from the customer about the non- funded credit facilities already enjoyed by them from other banks.
2. Banks are to undertake similar credit appraisal as for fund based facilities.
3. Credit information relating to such facility shall be mandatorily be furnished to the Credit Information Companies.

FUND BASED FACILITIES

Overdrafts

After bank loans, Overdrafts is the most common way of availing credit facilities from the bank. Overdraft means allowing the customer to draw cheques over and above credit balance in the account. Bank overdraft is line of credit that overs the transaction if the Bank Account balance drops below zero. Overdraft is normally allowed to Current Account customers and in exceptional cases Savings bank account holders are also allowed to overdraw their account. High rate of interest is charged on daily debit balance of overdraft account as these are clean advances .i.e. banks do not have any securities to sell back if these facilities are not repaid. There are two types of overdraft accounts as prevalent in Banks i.e. (i) Temporary overdraft or clean overdraft and (ii) Secured overdraft. Temporary overdrafts are allowed purely on personal credit worthiness of the customer concerned and it is availed by the customer to meet some urgent commitments on rare occasions. Allowing a customer to draw against his cheques sent in clearing - known as "against clearing" also falls under this category. Secured overdraft is allowed up to a certain limit against some tangible security like bank deposits, LIC policies, National Saving Certificates shares and other similar assets. Secured overdraft is most popular with traders as lesser operating cost, simple application and document formalities are involved in this facility.

Cash Credit Account (CC A/C)

A cash credit facility is a short-term finance to a borrower company, having a tenure of up to one year which can be renewed for further period by the bank on the basis of projected sales and satisfactory operation in the account during the period of finance. Cash credit facility is extended in two forms viz. Open Cash Credit and Key Cash Credit. Open Cash credit account is a running account just like a current account where the borrower is allowed to maintain debit balance in the account up to a sanctioned limit or drawing power whichever is lower.

The Cash Credit facility is offered to a borrowers normally either against pledge (Key Cash Credit) or hypothecation of stocks of raw materials, semi-finished goods and/or finished goods and Book Debts (Receivables). In the case of Key Cash Credit, the borrower lodges the stocks in his godown and the key of the godown will be handed over to the bank. By this process, the goods lodged in the godown are pledged to the bank and the bank will allow the customer to draw funds against the value of the goods less its safety margin. This is known as Drawing Power. The pledged goods are allowed to be removed by the borrower on remitting into his CC account the amount equivalent to value of the goods. The bank would release further funds to the borrower within the Drawing Power (DP)/sanctioned limit on borrower depositing (pledging) more stock in the godown. Therefore, such facility is called Key Cash Credit/Cash Credit limits are also sanctioned to a borrower against security of term deposits, LIC policies, NSCs or Gold Jewels. This type of limit is offered mainly to traders who find it difficult to maintain stock register and submitting periodic stock statements When the security for the CC facility is jewels, life policies, NSC, Term Deposits; there is no need to submit periodic stock statements. In case of manufacturing units this facility is required for purchase of raw materials, processing and converting them into finished goods. In case of traders, the limit is allowed for purchase of goods which they deal.

Bills Finance

Bills finance is short term and self-liquidating finance in nature. The bills can be classified as Demand Bills and Usance Bills. Demand Bill is purchased and Usance bill is discounted by the banks. The credits available to the seller against the bills drawn under Letter of Credit either on sight draft or usance draft are called bills negotiated by the banks. The advantage of bills finance is that the seller of goods (borrower) gets immediate money from the bank for the goods sold by him irrespective of whether it is a purchase, discount or negotiation by the bank. The 'Demand Bills' can be documentary or clean. Usually, banks accept only documentary bills for purchase. However, clean bills from good parties also purchased by the banks which have a clean repayment record.

The 'Documentary Bills' may be drawn by a Seller of Goods ('Drawer') on D/P (Delivery against payment) or D/A (Delivery against Acceptance) terms. In case of D/P terms the documents of title to goods are delivered to the buyer of the goods (drawee) against payment of bill amount. In case of D/A bills, the documents to the title of goods are to be delivered to the drawee (Buyer) against acceptance of bills. These types of bills are called "Usance Bills' which means bills are maturing on a future date and payment will be made on due date. In case of 'Usance Bills' bills become clean after it is delivered to drawee on acceptance.

Therefore, banks take into consideration the credit worthiness not only of the borrower but also of the drawee.

Leasing Finance

A lease is a contract between the owner (lessor) and the user (lessee). There are various types of leases viz. operating lease, finance lease etc. In terms of lease agreement the lessor pays money to the supplier who in turn delivers the article to the lessee. The lessee (hirer of the article) makes periodical payment to the lessor. At the end of lease period the asset is restored to the lessor. Commercial banks in India have been financing the activities of leasing companies, by providing overdraft/ Cash credit account/Demand loan against fully paid new machinery or equipment by hypothecation of security. The repayment should be from rentals of machinery/ equipment leased out and similar other ways. The maximum period of repayment is five years or the economic life of the equipment whichever is lower. The bank is allowed to periodical inspection of the asset. Lease contracts are only for productive purpose and not for consumer durable.

Hire-Purchase Finance

Hire-Purchase transactions are very similar to leasing transactions. In the Hire-purchase finance takes place predominantly in automobile sector. Like Leasing Finance, the ownership of the vehicle continues to remain with the Leasing Company till the agreement period ends. However, at the end of the stipulated period, the hirer (lessee) has options either to return the asset to leasing company while terminating the agreement or purchase the asset upon terms set out in the hire-purchase agreement. Since hire-purchase finance takes place predominantly in automobile sector, banks have started direct finance to transport operator as the nature of advance being classified as priority sector lending. By and large most banks finance vehicles under Hypothecation arrangement instead of Hire-Purchase.

Difference between Hire-Purchase and Hypothecation

For a long time, Hypothecation was not defined legally in India, until it was defined by SARFAESI Act in 2002. It is a charge on any movable asset/property of a borrower for which bank has extended its finance. It is an equitable charge on the assets in favour of the financing bank where the asset is owned by the borrower as well as possession is with him on behalf of the bank. If a borrower fails to repay the finance extended for the movable asset the bank can repossess the asset with the consent of the borrower. If the borrower surrenders the asset to the bank, bank has a legal right to sell the asset without the intervention of the court and adjust the proceeds towards the loan dues. Under SARFAESI Act bank also has got the right to sell the movable asset of a defaulted borrower without the intervention of a court subject to following rules laid down in this regard.

Under Hire Purchase Agreement, as explained above the ownership of the financed assets remains with the lender till it is purchased by the borrower at the end of the hire purchase period as per agreed terms between the financing agency and the borrower. Under Hire Purchase the financing entity may get the benefit of depreciation as well as ownership of the asset financed.

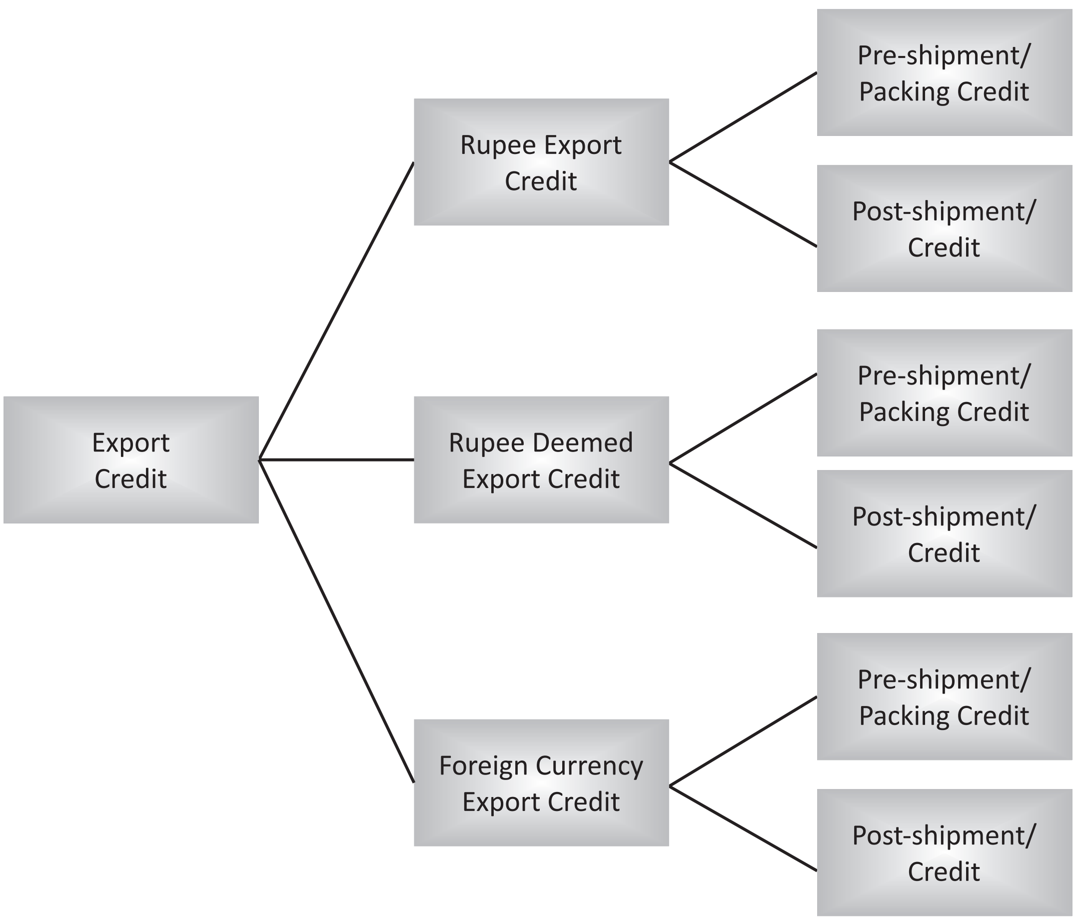
Banks cannot take advantage of Hire Purchase Arrangement, as ownership aspect of the asset will result in violating permitted line of activity under the banking license granted by RBI.

For example, if a bank finances a public transport vehicle under Hire Purchase, it implies that the bank as the owner of the public transport vehicle, is involved in the business of public transportation which is against permitted activities under the Banking license. Also, in a Hire Purchase arrangement, if an accident takes place, bank will be a party to the claim suit filed by the injured passengers which will involve monetary loss and as well as damage to the image of the bank.

CREDIT FACILITIES (FUND BASED) GRANTED TO THE EXPORTERS BY BANKS

In order to encourage exports and to help exporters financially, RBI introduced Export Credit scheme in the year 1967. As on date, Exporters can avail credit for their export activities either in Rupees or in Foreign Currency as per their choice and subject to RBI directions in this regard.

The broad financing schemes available for exporters are shown in the below diagram:



RUPEE EXPORT CREDIT

A finance facility for the exporters, available in Indian currency in the following two forms:

Pre-shipment/Packing Credit

A short-term advance/loan given to an exporter for procuring, processing, manufacturing/packing goods prior to shipping such goods. Such export credit can be given for working capital purposes also. Banks are at liberty to decide the tenor of such loans (which are usually up to three/six months or in exceptional cases nine months) depending upon individual cases. These loans are given at concessional interest rates. If these loans are not adjusted by submission of export documents within 360 days, banks will charge normal rate of interest on such loans/ advances instead of concessional rates. Pre-shipment advances are to be repaid out of finance made available at Post-shipment stage or from eligible resources of the exporting customer as per RBI directions.

Example: Pre-shipment credit

XYZ Limited, an Exporter of cotton readymade garments in India, has secured a firm export order from UK to supply 100,000 cotton shirts of a particular size. For executing this order the Indian exporter would require to buy raw cloth, get the cloth cut, stitched, ironed, check all shirts for any defects to rectify, labled, packed and shipped. The finance needed for this entire cycle by the exporter is called Pre-shipment finance/Packing credit.

Post-shipment Credit

This is again a short-term advance/loan given to an exporter after shipment of goods to the date of realization of proceeds of exported goods. Such credit facility granted to an exporter has to be repaid out of the proceeds of goods exported or from eligible resources of the exporter as permitted by RBI directions. The period of such advance/loan will be as specified by Foreign Exchange Dealers Association of India (FEDAI).

Example:

Taking the pre-shipment example of XYZ Limited mentioned above, once XYZ Limited has shipped the goods they can present the Shipping documents along with commercial documents of the transaction to their bankers for availing Post-shipment credit. XYZ's bank can grant them post-shipment credit in any of the following ways :

1. By purchase/discounting/negotiation of Export bills.
2. By providing an advance against the export bills given for collection.
3. By providing an advance against export incentives receivable from Government of India.

The loan amount of the post-shipment will be used by XYZ's bank to close the Pre-shipment advance/loan granted to the company earlier.

The post-shipment advance granted by XYZ Limited's banker will be closed out of the export proceeds that will be received by the Bank from the importer's Bank in UK subsequently.

Rupee Deemed Export Credit

A deemed export transaction is one in which goods are supplied to a project in India itself which are funded by International/ Multilateral agencies or where goods are supplied to units in SEZs or foreign shipping companies calling on Indian ports, Supply of goods to foreign tourists etc., such that the proceeds of such goods supplied will be paid in foreign currencies. Such transactions are treated as prima facie Export transactions and enjoy incentives and other concessions given to normal export transactions.

Pre-shipment and Post-shipment credit facilities granted to Rupee Deemed Export Credit transactions are similar to finance/credit extended under Rupee Export credit - Pre-shipment as well as Post-shipment as described herein. However in Deemed Export transactions the date of supply to the projects/SEZ units/ foreign tourists is taken as date of export. Also the value of the transaction will be based on Free on Rails (FOR) basis instead of usual Free on Board (FOB) basis, usually associated with export transactions.

FOREIGN CURRENCY EXPORT CREDIT

A short-term working capital finance facility available to exporters in Foreign Currency in the following manner:

Pre-shipment credit in Foreign Currency (PCFC)

The objective of PCFC facility is to provide an additional source of finance at internationally competitive rates to Indian exporters. Normally this is facility is applicable to Cash Exports where the "payment for goods is received prior to the export".

An exporter can avail PCFC in any of the following ways:

1. Avail pre-shipment credit in Rupees and convert the same in Foreign currency at the discretion of financing bank.
2. Avail pre-shipment credit in Foreign currency and discount/rediscount export bills in Foreign currency under Export Bill Rediscounting Scheme (EBR).
3. Avail Pre-shipment credit in Rupees and post-shipment credit either in Rupees or in foreign currency by discounting/re-discounting export bills under EBR.

PCFC is normally available for a maximum period of 360 days. Further extension is subject to the financing bank's terms and conditions. PCFC is liquidated by discounting or re-discounting of Export bills under EBR scheme at the post-shipment stage. PCFC is also allowed for Deemed Exports subject to a maximum period of 30 days or up to the date of payment by project authorities whichever is earlier.

PCF is also subject to the overall directions of RBI from time to time in this regard.

Post-shipment Credit in Foreign Currency (PSCFC)

Banks are permitted to extend PSCFC facility to their export customers, (by utilizing their foreign exchange resources held by them or availed by them from foreign banks by way of line of credit in foreign currency etc.) through discounting the usance export bills received from their customers who have availed PCFC or otherwise by rediscounting these bills with foreign banks.

Normally the PSCFC scheme covers export bills of usance period up to 180 days from the date of shipping. If a customer is eligible to draw bills beyond a usance period of 180 days, PSCFC facility is allowed to be provided beyond the period of 180 days too.

Banks can rediscount the export bills abroad and square up the PSCFC.

IMPORT FINANCE

Apart from the usual financing methods of short term credit facilities, import finance can also be availed by importers in India through Buyers credit, Suppliers Credit as well as through External Commercial Borrowings ('ECB'). A brief overview of the same is as under:

Buyers' Credit	Suppliers' Credit
Buyers' credit refers to loans for payment of imports into India arranged by the importer from overseas bank or financial institution.	Suppliers' credit relates to the credit for imports into India extended by the overseas supplier.

Buyers' Credit	Suppliers' Credit
Imports should be as permissible under the extant Foreign Trade Policy of the Director General of Foreign Trade (DGFT).	In this case too, imports should be as permissible under the extant Foreign Trade Policy of the DGFT.
For the overseas exporter the transaction becomes cash	The importer pays an agreed amount of down payment and the balance amounts are paid in instalments over a deferred period.
Since the facility is provided by an overseas bank the interest rates may be slightly high.	Since the facility is provided by the supplier itself, interest rates are comparatively low.

LOAN AGAINST SECURITIES

Banks and financial institutions come up with innovative ways to fulfill the monetary requirements of every individual as per their credit worthiness and paying capacity. One step in this direction has been Loan against Securities, popularly referred to as LAS. Under "Loan against Securities", loan is advanced to a customer against pledge of securities or simply put loan against insurance policy, mutual funds, NSC and other securities. The list of approved securities against which LAS can be advanced varies from bank to bank, but primarily the following are considered to be approved securities against which LAS could be given.

1. Non-Convertible Debentures
2. Mutual Fund Units
3. NABARD Bonds
4. Dematerialised Shares
5. National Saving Certificates/Kissan Vikas Patra (Accepted only in Demat form)
6. Insurance Policies.

By pledging the securities held by the borrower, a loan against Securities is provided by a bank or a financial institution as an overdraft facility. The value of the overdraft limit that is advanced is determined on the basis of the securities that are pledged. The rate of interest is calculated only on the amount withdrawn and only for the period of utilization.

> ***Example***
>
> Zen Limited is in need of funds for its upcoming project and wishes to consider the facility of LAS. The company approaches the bank and pledges shares worth Rs. 10,00,000 held by it in Ten Limited, with the help of its Depository.
>
> Depository creates a pledge on said shares in the favor of the bank and the bank disburses the payment to Zen Ltd.
>
> The pledge was created for 1 year. At the end of this tenure Zen Ltd. will repay the loan to the bank along with the interest, at the rate as decided and intimated by the bank at the time of disbursement, and the bank will release the shares to Zen Ltd.

The advantageous part of pledging your securities is one that the borrower is able to get steady cash easily at the time of need and secondly the borrower need not be devoid of the benefits as a shareholder. This means that the borrower enjoys the rights of receiving dividends and bonuses along with gaining from the price movements in the shares. This facility is ideal to meet short- term financial needs and the interest rates are lesser than that in a personal loan.

Features of Loan against Securities

1. **Secured Loan -** Loan against securities is a secured loan as the bonds, shares, debentures or mutual funds owned by the borrower are kept as collateral security when this loan is advanced.
2. **Tenure -** The tenure of loan against securities is generally one year.

3. **Rate of Interest -** Generally, interest rates at which loan against securities is advanced varies from 12%–15% per annum.

4. **Processing Fees -** Banks and financial institutions usually charge approximately 2% as processing fees.

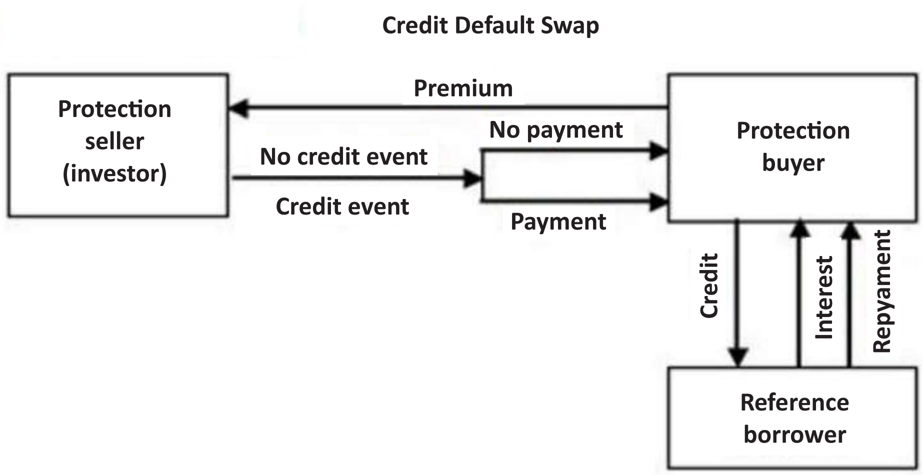
5. **Loan Amount -** The loan amount for which the borrower may be eligible depends upon the type of security that is being offered. For example, in case equity shares are offered then the amount that is eligible would be 50% of the value of such shares.

6. **Prepayment Charges -** There are generally no prepayment charges.

Credit Default Swap (CDS)

A Credit default swap (CDS) is credit derivative contract in which one counterparty (protection seller) commits to compensate the other counterparty (protection buyer) for the loss in the value of an underlying debt instrument resulting from a credit event with respect to a reference entity and in return, the protection buyer makes periodic payments (premium) to the protection seller until the maturity of the contract or the credit event, whichever is earlier.

A pictorial representation of CDS is as follows:



Benefit of CDS

Credit Default Swaps (CDS) on corporate bonds provide market participants a tool to transfer and manage credit risk in an effective manner through redistribution of risk. CDS, as a risk management product offer participant the ability to hive / hedge credit risk and also assume credit risk which otherwise may not be possible. Since CDS has benefits like enhancing investment and borrowing opportunities and reducing transaction costs while allowing risk-transfers, such products would increase investors' interest in corporate bonds and would be beneficial to the development of the corporate bond market in India.

Major differences between the old 2013 CDS Guidelines of RBI and the new 2022 directions of RBI

Particulars	*RBI CDS Guidelines, 2013*	*RBI CDS Directions, 2022*
Permitted Users	Permitted only non-retail users including Banks, NBFCs, MFs, Insurance companies, Listed corporates, and FIIs. The Guidelines did not differentiate between retail and non-retail users.	Allows both retail and non-retail users. Non-retail users to include any corporate with a minimum net worth of Rs.500 crores (listing criteria removed). Both resident in India and non-resident allowed to participate in the market.

Particulars	*RBI CDS Guidelines, 2013*	*RBI CDS Directions, 2022*
Retail Participation Restrictions	Retail Participation Not Permitted.	Allows retail users to undertake transactions in permitted credit derivatives for hedging underlying credit risk only.
Non Retail Participation Restrictions	Not allowed to maintain naked CDS protection i.e. CDS purchase position without having an eligible underlying reference obligations.	Non- retail users allowed to undertake CDS transactions for both hedging and other (trading) purposes.
Reference Entities and Obligations	Reference entity shall be a resident legal entity that is eligible to issue any of the debt instruments below ● CPs, CDs and non-convertible NCDs of original maturity up to one year ● Rated Rupee-denominated corporate bonds, both listed and unlisted ● Unrated rupee-denominated corporate bonds issued by infrastructure companies	Similar set of eligible instruments; however, clear restrictions placed on the usage of the following structured products as reference obligations: 1. ABS 2. MBS 3. Credit enhanced or guaranteed bonds 4. Convertible bonds 5. Bonds with embedded call / put options Loans continue to be ineligible for use as reference obligation. Clearly permits only single-name CDS contracts, i.e. the CDS contracts should have only one reference entity.
Market Makers	Commercial Banks, standalone Primary Dealers (PDs), Non-Banking Financial Companies (NBFCs) having sound financials and good track record in providing credit facilities and any other institution specifically permitted by the Reserve Bank.	Compared to the 2013 guidelines, HFCs (specifically) and institutions like NABARD, SIDBI, EXIM Bank, NHB etc. are now allowed act as market makers. In addition, norms around CRAR, NPA levels have been removed from both banks as well as NBFCs. While banks are not required to obtain any specific approval from the RBI, NBFCs and PDs will have to obtain specific approval from RBI.
Clearing and Settlement	Parties to CDS contract to upfront determine the procedure and method of settlement. Participants allowed to opt for any of the three settlement methods - cash/ physical/auction – provided the CDS contract envisages the said settlement methodology. For non-retail users, physical settlement is mandatory. Auction settlement allowed to be conducted in cases deemed fit by the Determination Committee. In case of auction-based settlement, physical settlement will take place at a price decided through auction.	All Exchange traded CDS contracts will need to be guaranteed cash settled both for retail as well as non-retail participants/users. FIMMDA, in consultation with market participants and based on international best practices, shall devise standard master agreement/s for the Indian CDS market which shall include credit event definitions and settlement procedures.

LOAN AGAINST PROPERTIES

Similar to loans against securities, this is a loan, banks grant against property owned by the prospective borrower. Banks take the property as security and based on the valuation of the property, they extend a loan, net of the margin fixed by them.

The types of Property against which LAP can be availed can range from owned residential properties g, self-occupied property, owned and rented property, owned land, owned commercial property, owned but rented out commercial property. The proceeds from these are used by borrowers for personal, business and consumption purposes. After due appraisal Banks sanction generally anywhere between 50% to 65% of the value of borrower's property. Banks offer repayment period of 10 to 15 years at competitive interest rates. For sanctioning loans against properties banks insist on creating a mortgage in their favour.

DISCOUNTING

Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit. Such bills being bills of exchange can be kept upto the due maturity date and encashed by the seller or may be endorsed to a third party in payment of dues owing to the latter.

The most common practice is that the seller who gets the accepted bills of exchange discounts it with the Bank or financial institution or a bill discounting house and collects the money (less the interest charged for the discounting).

> Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit.

The biggest advantage of this facility to the seller is to get the cash released fast on the trade bill drawn which would otherwise be locked in the invoices and hence a better way to get an unsecured business loan.

The volume of bills both inland and foreign, which are discounted accounted, forms a substantial part of the total scheduled commercial bank credit. Over the years this is coming down. The Reserve Bank has been attempting to develop a market for commercial bills. The bill market scheme was introduced in 1942 and a new scheme called Bill Rediscount Scheme with several new features was introduced in November, 1970. Under the latter scheme the RBI rediscount bills at the bank rates or at rates specified by it at its discretion. Since the rediscounting facility has been made restrictive, it is generally available on a discretionary basis.

The difficulties which stand in the way of bill market development are, the incidence of stamp duty, shortage of stamp paper, reluctance of buyers to accept bills, predominance of cash credit system of lending and the administrative work involved in handling documents of title to goods. To be freely negotiable and marketable, the bills should be first class bills i.e. those accepted by companies having good reputation. Alternatively, the bills accepted by companies should be co-accepted by banks as a kind of guarantee. In the absence of these criteria, bill market has not developed in India as the volume of first class bills is very small.

Forfaiting

Forfaiting is a mechanism through which exporters can avail finance by discounting their medium term/long term export receivables with an intermediary called forfaiter. Long term receivable can be as long as 10 years where as medium term can be anywhere between three to five years. Thus, receivables on deferred basis evidenced by export bills and commercial documents can be forfeited.

Forfaiting is done on a without recourse basis i.e. if the importer fails to pay, the forfaiter cannot recover the dues from the exporter for whom he has discounted the export receivable. Of course, a forfaiter covers this risk by getting the export documents co-accepted by an importer's bank/ reputable bank from the importer's country.

A brief overview of general working mechanism of Forfaiting is as follows:

A foreign importer and an Indian exporter meet an finalize the transaction between them by entering in to a contract.

↓

Thereafter the exporter readies goods and ships the same to the importer as per contract terms.

↓

Exporter simultaneously prepares set of export documents (which are in a standardized formats of the forfeiter).

↓

Before hand, the foreign importer agrees to get the co-acceptance the export documents sent by the Indian importer, from his bank/reputed bank in his country as agreed between him and the exporter – this known as "availed" document.

↓

Once the co-accepted documents reach the exporter he hands over the same to the forfeiter 'forfait' the same – i.e., discount the same, "without recourse" basis to him.

↓

The 'forfaiter' discounts the same and credits the amount of the bill after deducting his charges such as Commitment Fee, Discount and Documentation Fee.

↓

The forfeiter thereafter sends the export documents to the importer's bank/co-accepted bank for reimbursement on maturity date of the bill.

Forfaiting is an approved method of export financing by RBI. EXIM Bank in India has been authorised to facilitate the forfaiting transactions. The advantage for the exporter is that he can convert the credit sale in to cash sale without recourse to him or his banker.

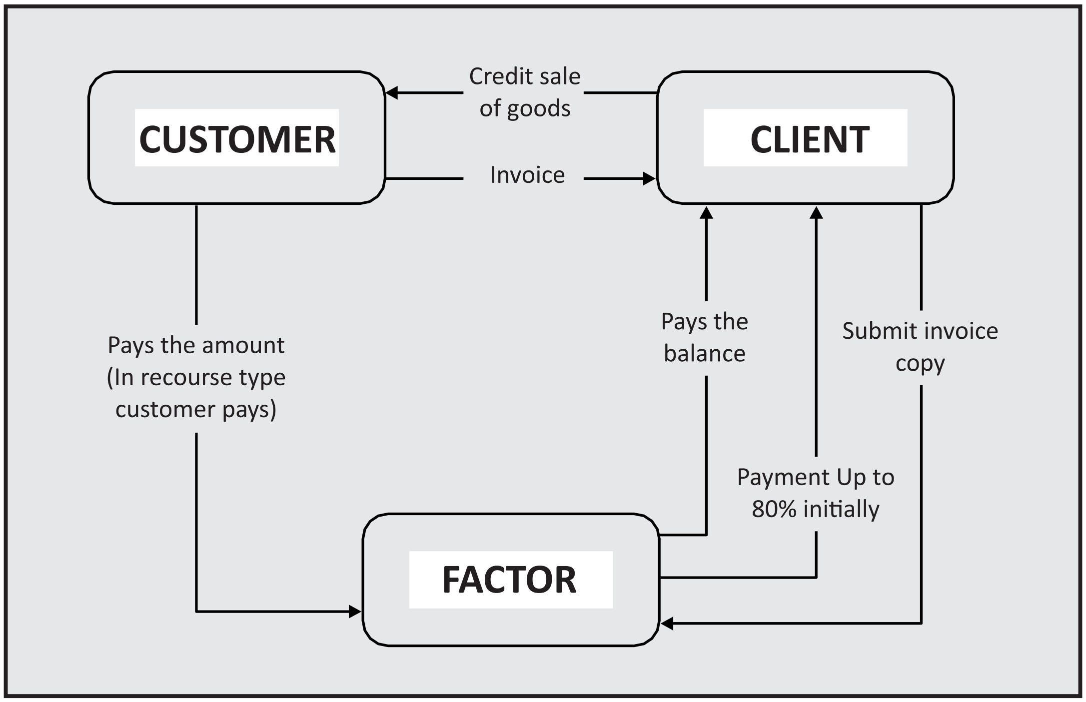
FACTORING

Factoring is a financial transaction where an entity sells its receivables to a third party called a 'factor', at discounted prices. Factoring is a financial option for the management of receivables. In simple definition it is the conversion of credit sales into cash. In factoring, a financial institution (factor) buys the accounts receivable of a company (Client) and pays up to 80% (rarely up to 90%) of the amount immediately on formation of agreement.

Examples

Factoring against goods purchased, factoring for construction services (usually for government contracts where the government body is capable of paying back the debt in the stipulated period of factoring. Contractors submit invoices to get cash instantly), factoring against medical insurance etc.

Factoring company pays the remaining amount (Balance 20%-finance cost-operating cost) to the client when the customer pays the debt. Collection of debt from the customer is done either by the factor or the client depending upon the type of factoring. The account receivable in factoring can either be for a product or service.



Parties in Factoring

The factoring transaction involves three parties:

- The Seller, who has produced the goods/services and raised the invoice.
- The Buyer, the consumer of goods/services and the party to pay.
- The Factor, the financial institution that advances the portion of funds to the seller.

Factoring Process

The steps involved in factoring are listed below:

- The seller interacts with the funding specialist/broker and explains the funding needs.
- The broker prepares a preliminary client profile form and submits to the appropriate funder for consideration.
- Once both parties agree that factoring is possible, the broker puts the seller in direct contact with the funder to ask/answer any additional questions and to negotiate a customized factoring agreement, which will meet the needs of all concerned.
- At this point, the seller may be asked to remit a fee with formal application to cover the legal research costs, which will be incurred during "due diligence". This is the process by which the buyer's credit worthiness is evaluated through background checks, using national database services.
- During the next several days, the under completes the "due diligence" process on the seller, further

verifies invoices and acknowledges any liens, UCC filings, judgments or other recorded encumbrances on the seller's accounts receivables.

– The seller is advised of the facility and is asked to advise the buyers of the Factor by letter and submit an acknowledged copy of the same to the Factor for records.

– A detailed sanction letter is given to the seller and their acceptance on the same taken, with the Required signatories.

– Sanction terms must contain the following:

  - All facilities covered under the sanction.
  - The period for which the sanction is valid.
  - When the facility comes into effect (e.g. if facility is dated 1/12/120, it can state that invoices raised from or after 15/12/20 only would be Factored).
  - Who are the authorized signatories for signing invoices for factoring?
  - The limits.
  - The seller has to advise the buyer of the Factoring agreement.
  - Copy of such advice acknowledged by the buyer should be submitted to the Factor. Buyer's consent is not required to decide on the Factor.

– The discounting rates, charges fixed.

– In case of discounts given by the seller to the buyer, which value would be financed by the factor (since the factored amount should never exceed the amount actually payable by buyer).

– Usually within 7 to 10 days of the initial contact with the factor, agreements are signed, customers are notified, UCC forms filed and the first advance is forwarded to the company. This advance can vary between 70 - 80% of the face value of the invoices being factored. In the construction industry, the advances may be in the range of 60 - 70%. The remaining amount is called the "reserve" which is held by the factor until the invoices are paid. The factor then deducts his fee and returns the remaining funds to the seller.

– The seller performs services or delivers products, thus creating an invoice.

– The seller sends or faxes a copy of the invoice directly to the factor.

– The funder verifies the invoice and the advance is sent to the seller as per the agreement with the factor. In certain cases, the funder wires the funds to the seller's account for an additional fee.

– The buyer pays the factor. The factor then returns any remaining reserve, minus the fee, which has been predetermined in the negotiated agreement.

Advantages to the Seller

The Seller gets funds immediately after the sale is effected and on presentation of accepted sales invoices and Promissory notes. Major part of paper work and correspondence is taken care of by the factor. The follow-up, for recovery of funds, is done mainly by the factor. The Interest rates are not as high as normal discounting. There is an increased cash flow to meet payroll. There is an Immediate funding arrangement, no additional debt is incurred on balance sheet. Other assets are not encumbered and approval is not based on seller's credit rating.

Types of Factoring

Non-Recourse or Full Factoring

Under this type of factoring the bank takes all the risk and bear all the loss in case of debts becoming bad debts.

Recourse Factoring

Under this type of factoring the bank purchases the receivables on the condition that any loss arising out or bad debts will be borne by the company which has taken factoring.

Maturity Factoring

Under this type of factoring bank does not give any advance to the company rather bank collects it from customers and pays to the company either on the date of collection from the customers or on a guaranteed payment date.

Advance Factoring

Under advance factoring arrangement the factor provides an advance against the uncollected and non-due receivables to the firm.

Undisclosed Factoring

Under this type of factoring, the customer is not informed of the factoring arrangement. The firm may collect dues from the customer on its own or instruct to make remit once at some other address.

Invoice Discounting

Under this type of factoring the bank provide an advance to the company against the account receivables and in turn charges interest rate from the company for the payment which bank has given to the company.

Difference between Forfaiting and Factoring

- Factoring applies to domestic and international trade both, whereas forfaiting is limited to international trade.
- While factoring focuses on accounts receivables, forfaiting also covers negotiable instruments such as promissory notes and bills of exchange.
- Factoring deals with short-term receivables, whereas forfaiting is for medium and long-term receivables.
- Factoring usually provides 80-90% of the accounts receivable, whereas forfaiting can in some cases provide up to 100%.
- Factoring is normally for ordinary products or services, whereas forfaiting is for capital goods.
- Factoring can be recourse or non-recourse, whereas forfaiting is almost always non-recourse.
- Factoring supports the seller, whereas forfaiting supports both the buyer (importer) and the seller (exporter).

WORKING CAPITAL FINANCE

Main objective of running any industry is earning profits. An industry will require funds to acquire “Fixed assets” like land, building, plant, machinery, equipments, vehicles, tools etc., & also to run the business i.e. its day to day operations.

Funds required for day to-day working like for purchase of raw materials/ stores/ fuel, for employment of labour, for power charges etc., for storing finishing goods till they are sold out & for financing the sales by way of sundry debtors/ receivables, are financed through working capital limit.

Capital or funds required for an industry can therefore be bifurcated as fixed capital & working capital. Working capital in this context is the excess of current assets over current liabilities. The excess of current assets over current liabilities is treated as net working capital or liquid surplus & represents that portion of the working capital which has been provided from the long term source.

Thus, Working Capital Requirement is dependent on :

(a) The volume of activity (viz. level of operations i.e. Production & sales)

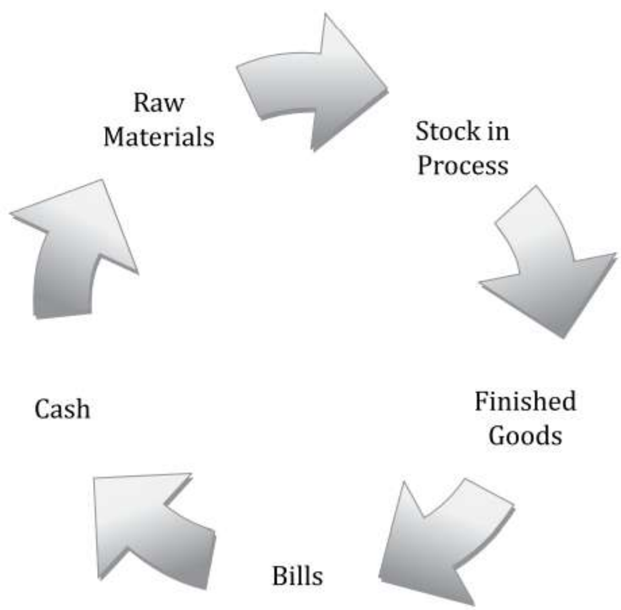
(b) The activity carried on viz. manufacturing process, product, production programme, the materials & marketing mix.

Various methods of accessing Working Capital requirements of a business:

1. **Operating Cycle Method:** Any manufacturing activity is characterized by a cycle of operations consisting of purchase of raw materials for cash, converting these into finished goods & realizing cash by sale of these finished goods.

   The time gap between cash outlay & cash realization by sale of finished goods & realization of sundry debtors is known as the length of the operating cycle.

   Operating cycle is also called the cash-to-cash cycle & indicates how cash is converted into raw material, stocks in process, finished goods, bills (receivables) & finally back to cash. Working capital is the total cash that is circulating in this cycle. Therefore, working capital can be turned over or redeployed after completing the cycle.



a) The operating cycle consists of:

- Time taken to acquire raw materials & average period for which they are in store;
- Conversion process time;
- Average period for which finished goods are in store; and
- Average collection period of receivables (Sundry Debtors).

2. **Turnover Method (Nayak Committee)** : This method of assessing working capital requirement of a firm is given by “Nayak Committee”. The committee headed by Mr. P.R. Nayak examined the adequacy of institutional credit to SSI sector and gave its recommendations which are as under:

   Under this method, bank credit for working capital purposes for borrowers requiring fund based limits up to Rs. 5 crore for Small Scale Industries borrowers and Rs. 2 crore in case of other borrowers, may be assessed at minimum of 25% of the projected annual turnover of which should be provided by the borrower (i.e. minimum margin of 5% of the annual turnover to be provided by the borrower) and balance 4/5th (i.e. 20% of the annual turnover) can be extended by way of working capital finance.

   The projected turnover or output value may be interpreted as projected gross sales which will include excise duty also.

   Since the bank finance is only intended to support the need based requirement of a borrower, if the available Net Working Capital (net long term surplus funds) is more than 5%of the turnover the former should be reckoned for assessing the extent of bank finance.

3. **Maximum Permissible Banking Finance Method (Tandon Committee)** : A committee headed by Mr. P.L. Tandon, ex-chairman of PNB, was constituted with view to suggest improvement in the existing ash credit system. It submitted its report on guidelines for follow up of credit in August 1974, suggesting three methods of lending as follows:

   - ***1st Method of Lending:*** 75% of the working capital gap (Working Capital Gap= Total current assets-Total current liabilities other than bank borrowings) is financed by the bank and the balance 25% of the Working Capital Gap considered as margin is to come out of long term source i.e. owned funds and term borrowings.

   - ***2nd Method offending:*** Bank will finance maximum up to 75% of total current assets (TCA) and borrower has to provide a minimum of 25% of total current assets as the margin out of long term sources. This will give a minimum current ratio of 1.33:1.

   - ***3rd Method of Lending:*** This is same as 2nd method of lending, but excluding core current assets from total assets and the core current assets are financed out of long term funds of the company. The term ‘core current assets’ refers to the absolute minimum level of investment in current assets, which is required at all times to carry out minimum level of business activity.

4. **Chore Committee** : The RBI constituted, in April 1979, a working group under the chairmanship of Shri K.B Chore, to review the system of cash credit with the particular reference to the gap between sanctioned limit and the extent of their utilization. It was also asked to suggest alternative type of credit facilities which would ensure greater credit discipline and enable the banks to relate the credit limits to increase in output or other productive activities.

   The committee recommended assessment of working capital requirements have to be mandatorily assessed based on 2nd method of lending suggested by Tandon Committee except for sick/Units under rehabilitation.

5. **Cash Budget System** : In case of tea, sugar, construction companies, film industries and service sector requirement of finance may be at the peak during certain months while the sale proceeds may be realised throughout the year to repay the outstanding in the account. Therefore, credit limits are fixed on the basis of projected monthly cash budgets to be received before beginning of the season.

SECTION–II
INDIAN NON FUND BASED

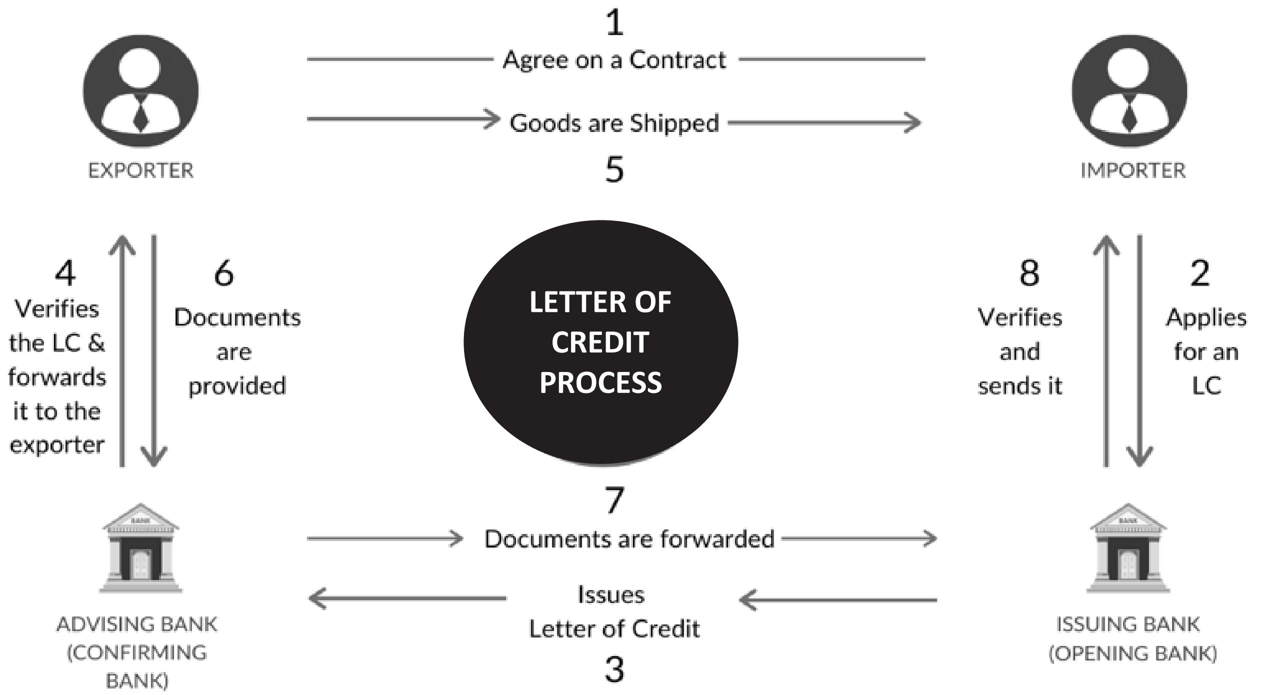
NON-FUND BASED FACILITIES

Letter of Credit

A letter of credit is a document from a bank that guarantees payment. It is an undertaking/ commitment by the bank, advising/informing the beneficiary that the documents under a letter of credit would be honoured, if the beneficiary (exporter) submits all the required documents as per the terms and conditions of the letter of credit.

A Letter of Credit is issued by a bank at the request of its customer (importer / buyer) in favor of the beneficiary (exporter / seller).

Letter of Credit



Types of Letter of Credit

- **Sight Credit -** Under this letter of credit, documents are payable at sight/ upon presentation, i.e., Payment is made to the seller immediately (maximum within 7 days) after the required documents have been submitted.
- **Acceptance Credit/ Time Credit -** The Bills of Exchange which are drawn, payable after a period, are called usance bills. Under acceptance credit usance bills are accepted upon presentation and eventually honoured on due dates. The documents of title to goods (R/R, L/R, MTR, Bill of Lading etc.) are delivered to the applicant (importer / buyer) on acceptance of Bill of exchange drawn under LC by the Seller / exporter. To that extent these LCs are unsecured.
- **Revocable and Irrevocable Credit -** A revocable letter of credit is a credit, in which the terms and conditions of the credit can be amended/cancelled by the Issuing bank, any time and without prior notice to the beneficiaries. If the negotiating bank makes a payment to the beneficiaries prior to receiving notice of cancellation / amendments, it is obligatory for issuing bank to make payment to reimburse the negotiating bank. An irrevocable letter of credit is a credit, the terms and conditions

of which can neither be amended nor cancelled without the consent of the beneficiaries. Hence, the opening bank is bound by the commitments given in the letter of credit. If nothing is stated, the LC is treated as irrevocable.

- **Confirmed Credit -** Only Irrevocable letter of credit can be confirmed. A confirmed letter of credit is one when a banker other than the Issuing bank, adds its own confirmation to the credit. In case of confirmed letter of credits, the beneficiary's bank would forward the LC to the confirming banker with a request to add their confirmation. The liability of the confirming bank is same as the issuing bank.
- **Back-to-Back Letter of Credit -** Back-to-Back Letter of Credit is a negotiable instrument in which the seller gets a Letter of Credit from the buyer and the seller further transfers the Letter of Credit to its supplier. In simple words, the seller first gets the Letter of Credit from the buyer to ensure timely payment and further the same seller hands over the Letter of Credit to someone from whom he buys goods or materials. There are various advantages and disadvantages of Letter of Credit.

Example: Back-to-Back Letter of Credit

A pen manufacturer DNP Limited sells its product to Mr. Pankaj. In return, Mr. Pankaj did not make the payment. Instead, he gave DNP Limited a Letter of Credit. This Letter of Credit is an assurance to DNP Limited that if Mr. Pankaj fails to make timely payment, DNP Limited can use the negotiable instrument to get its claim from the bank. To process the order of Mr. Pankaj, DNP Limited purchases raw material from its supplier, CS Limited. DNP Limited does not make any payment to it. Instead, it hands over the original Letter of Credit received from Mr. Pankaj after changing the beneficiary name with its intermediary bank. Now CS Limited is assured that it will receive the payment for the material purchased by DNP Limited. This transfer of Letter of Credit from one seller to another seller is Back-to- Back Letter of Credit (BBLC).

- **Transferable Credit -** While a letter of credit is not a negotiable instrument, the Bills of Exchange drawn under it are negotiable. A Transferable letter of credit is one in which a beneficiary can transfer his rights to third party / parties in whole or in part (in that case the unused portion can be transferred back to the original beneficiary). Such letter of credit should clearly indicate that it is a 'Transferable' letter of credit. Transferable Letter of Credit is transferrable only once.
- **Red Clause Letter of Credit -** Red clause letter of credit is an advance payment letter of credit. Under the red clause letter of credit, the issuing bank will make an advance payment to the exporter i.e. the seller before the seller ships the goods to the importer i.e. buyer. This is usually done to provide aid to the seller in the form of working capital to purchase raw material, processing and packaging of goods, etc. The advance payment will be done against documentary requirement under the red clause letter of credit. Generally, documents required are written undertaking and receipts.
- **Green Clause Letter of Credit -** Green clause letter of credit is an extension of red clause letter of credit. Which means it provides the advance not only for the purchase of raw materials, processing, and packaging of goods, etc. but also for pre-shipment warehousing at the port of origin and insurance expense. In usual cases, the advance under this letter of credit is granted only after the purchased goods are stored in bonded warehouses. This type of letter of credit is usually used in transactions related to commodity market such as wheat, rice, gold, etc
- **Standby Letter of Credit -** In certain countries there are restrictions to issue guarantees, as a substitute these countries use standby credit. In case the guaranteed service is not provided, the beneficiary can claim under the terms of the standby credit. In case of Standby letter of credits, the documents required are proof of non- performance or a simple claim form.

- **Revolving Credit -** Here the amount of drawings made would be reinstated and made available to the beneficiary again and again for further drawings during the currency of credit provided. At times an overall turnover cap is also stipulated.

PARTIES INVOLVED IN LETTER OF CREDIT FINANCE

Applicant	Issuing Bank	Advising Bank	Beneficiary	Negotiating Bank	Reimbursing Bank	Confirming Bank

1. **Applicant (The buyer/importer of goods):** This person has to make payment of letter of credit to the issuing bank if the documents are in accordance with the terms and conditions of LC.
2. **Issuing Bank:** Importer's or buyer's bank who lends its name or credit, is issuing Bank. It is liable for payment of LC in case the documents are received by it from the nominated or negotiating bank and the documents are in terms of letter of credit. This bank gets 5 days to check the documents.
3. **Advising Bank:** Issuing bank branch or correspondent in exporter country to whom the letter of credit is sent for onward transmission to the seller or beneficiary, after authentication of genuineness of the credit. Where it is unable to verify the authenticity, it can seek instructions from the opening bank or can advise the LC to the beneficiary, without any liability on its part. This bank has no obligation to negotiate the document.
4. **Beneficiary:** The party to whom the credit is addressed i.e. seller or the exporter or the supplier of the goods. It gets payment against documents as per LC from the nominated bank within validity period of negotiation maximum 21 days from date of shipment.
5. **Negotiating Bank:** The bank nominated by the issuing bank to negotiate the documents when submitted by the exporter or alternatively the bank to whom the beneficiary presents the documents for negotiation. It claims payment from the reimbursing bank or opening bank and gets 5 banking days to check the documents.
6. **Reimbursing Bank:** Third bank which repays, settle or funds the negotiating bank at the request of its principal, the issuing bank.
7. **Confirming Bank:** The bank adding confirmation to the credit, which undertakes the responsibility of payment by the issuing bank and on his failure, to pay. The confirmation, is added on request of the opening bank.

Documents handled under Letters of Credit

Documents play a crucial role in trade transactions. Documents are integral part of LCs. The banks involved in LC transactions deal only with documents and on the evidence of the correct and proper documents only the paying banks (opening bank/confirming bank) need to make payment. In view of these factors, banks have to be careful while handling documents/ LCs. At various stages, different banks (Negotiating bank {beneficiary's bank}, confirming bank, opening bank) have to verify whether all the required documents are submitted strictly as per the terms and conditions of credit.

The important documents handled under LCs are broadly classified as under:

(a) Bill of Exchange

Bill of exchange, is drawn by the beneficiary (exporter) on the LC issuing bank. When the bill of exchange is not drawn under a LC, the drawer of the bill of exchange (exporter), draws the bill of exchange on the drawee (importer). In such a case, the exporter takes credit risk on the importer, whereas, when the Bill of Exchange is drawn under LC, the credit risk for the exporter is not on the importer but on the LC issuing bank. Banks should be careful in ensuring that the Bill of Exchange is drawn strictly as per the terms and conditions of the credit.

Some others important aspects are:

(i) It should be drawn by the beneficiary on the opening bank.

(ii) It should clearly indicate the amount and other details.

(iii) Depending upon the LC terms a Bill of Exchange may be drawn as a sight bill or an usance bill.

(iv) It should clearly indicate the LC number.

(b) Commercial Invoice

This is another important document. Commercial invoice is prepared by the beneficiary, which contains

(i) relevant details about goods in terms of value, quantity, weights (gross/net), importer's name and address, LC number.

(ii) Commercial invoice should exactly reflect the description of the goods as mentioned in LC.

(iii) Another important requirement is that the commercial invoice should indicate the terms of sale contract (Inco terms) like FOB, C&F, CIF, etc.

(iv) Other required details like shipping marks, and any specific detail as per the LC terms should also be covered.

(c) Transport Documents (Documents of title to the goods)

When goods are shipped from one port to another port the transport document issued is called the bill of lading. Goods can be transported by means of airways, waterways, roadways and railways depending upon the situations. In case goods are transported by means of water ways, the document is called bill of lading (B/L), by airways it is known as airway bills (AWB) and by roadways called as lorry receipt (LR) and by railways it is known as railway receipt (RR). In case of a single transaction, when different modes are used to transport the goods from the beneficiary's country to the importer's destination, a single transport document can be used viz., Multi Modal Transport Document.

(d) Bill of Lading (B/L)

The B/L is the shipment document, evidencing the movement of goods from the port of acceptance (in exporter's country) to the port of destination (in importer's country). It is a receipt, signed and issued by the shipping company or authorized agent. It should be issued in sets (as per the terms of credit).

Other important features

As per the terms and conditions of the credit, a bill of lading should clearly indicate:

(i) the description of goods shipped, as indicated in the invoice;

(ii) conditions of goods "Clean" or otherwise (not in good condition/ shortage/damaged);

(iii) drawn to the order of the shipper, blank endorsed or in favour of the opening bank;

(iv) the gross and net weight;

(v) Freight payable or prepaid;

(vi) Port of acceptance and port of destination.

(e) Insurance Policy/ Certificate: This document is classified as a document to cover risk.

(a) It must be issued by the insurance company or their authorized agents;

(b) It should be issued in the same currency in which the LC has been issued;

(c) It should be issued to cover "All Risks";

(d) The date of issuance of the policy/ certificate should be on or before the date of issuance of the shipment, and should clearly indicate that the cover is available from the date of shipment;

(e) Unless otherwise specified, it should be issued for an amount of 110% of CIF value of goods;

(f) The description of the goods in the policy/certificate should be as per the terms of the credit;

(g) The other important details like the port of shipment, port of destination etc. needs to be clearly indicated.

(g) Other documents

As per the terms of LC, all required documents have to be submitted by the beneficiary. Documents like Certificate of Origin (issued by the Chamber of Commerce), indicates the origin of goods. The origin of goods should not be from any prohibited nations. Packing list, required certificates, etc. should be drawn as per the terms and conditions of the credit.

Standby Letter of Credit (SLOC)

A standby letter of credit (SLOC or SBLC), also known as a standby or LOC, is a lender's guarantee of payment to an interested third-party in the event the client defaults on an agreement. Standby letters of credit are formal documents that specify the duties and obligations of each party and serve as an act of good faith. The bank issuing the SLOC performs general underwriting duties to ensure the financial credibility of the party seeking the letter of credit. Then it sends a notification to the bank of the party requesting the letter of credit (typically a seller or creditor).

Example

A financial SLOC, the most common type, is typically used in international trade or other high-value purchase contracts where litigation or other non-payment actions may not be feasible. A financial SLOC guarantees payment to the beneficiary if contract requirements are unfulfilled. For example, an exporter sells goods to a foreign buyer who guarantees payment in 30 days. When no payment is received by the deadline, the exporter presents the SLOC to the buyer's bank to receive payment.

A performance SLOC ensures that time, cost, amount, quality of work, and other criteria are fulfilled in a manner acceptable to the client. The bank pays the beneficiary if any contractual obligations are unmet. For example, a contractor guarantees a construction project will be finished in 90 days. If work remains incomplete after the 90-day period, the client can present the SLOC to the contractor's bank and receive payment.

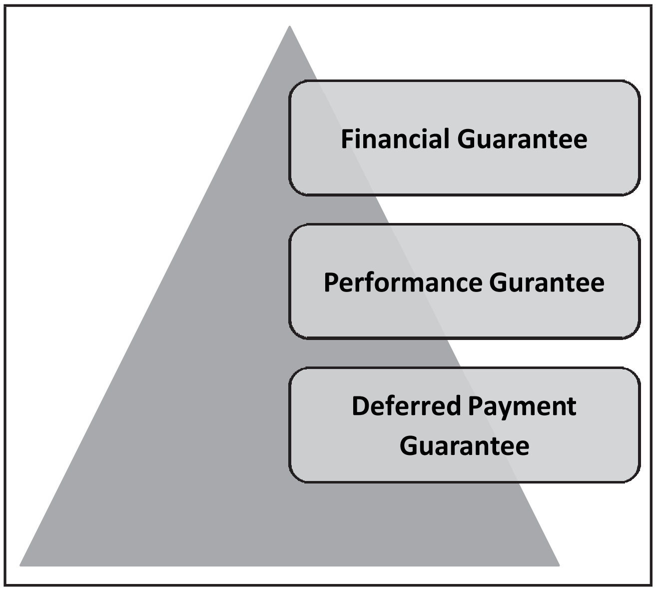
Standby letters of credit and bank guarantees are both methods of providing assurance to a vendor of payment on credit. A bank guarantee is a commitment by a bank to pay its client's obligation up to a certain amount, while standby letter of credit is a more formal document that details the obligations of both parties.

BANK GUARANTEE

Bank guarantees are part of non-fund based credit facilities provided by the bank to the customers. Bank issue bank guarantee on behalf of his client as a commitment to third party assuring her/ him to honour the claim against the guarantee in the event of the non- performance by the bank's customer. A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfill his commitment to the beneficiary.

Banks issue different types of guarantees, on behalf of their customers, as illustrated below:

- **Financial Guarantee:** The banker issues guarantee in favour of a government department against caution deposit or earnest money to be deposited by bank's client. At the request of his customer, in lieu of a caution deposit/ earnest money, the banker issues a guarantee in favour of the government department. This is an example of a Financial Guarantee. This type of guarantee helps the bank's customer to bid for the contract without depositing actual money. In case, the contractor does not take up the awarded contract, then the government department would invoke the guarantee and claim the money from the bank.



- **Performance Guarantee:** Performance Guarantees are issued by banks on behalf of their clients. In performance guarantee bank issue on behalf of his client to assure the third party to complete some work on time or as per the terms of contact between the parties. If the work is not completed as per the term of contract then the third party can request the bank to invoke the bank guarantee and make payment for default.

  Performance Bank Guarantees are issued guaranteeing due performance of contract or obligation of the Borrower under the contract. In the event of non-performance of obligation in terms of contract the bank assumes monetary liability up to the amount specified in the Guarantee.

  Purpose of issuing Performance Bank Guarantee

  i. Due performance of a specific contract undertaken by a customer in favour of Govt. bodies / Others - for e.g. supply of materials, Construction of Roads, Buildings Dams, Civil Work, etc.

  ii. To secure any claims by the buyer on the seller arising from default in delivery or performance of the terms of the contract (e.g. construction, assembly, execution).

  iii. Due performance of an equipment/project after completion for a specific period due to possible defects appearing after delivery during warranty period of the equipments.

  iv. Execution of Long Term Infrastructure Projects such as Seaports, Airports, Road Construction, Bridges, Sanitation and Sewerage Projects, Telecommunication Services, Construction of Educational Institutions and Hospitals, Generation/ Transmission/ Distribution of Power, etc.

- **Deferred Payment Guarantee:** It is clear from the name that under this guarantee, the banker guarantees payments of installments spread over a period of time.

Here, the banks undertake to make payment of instalments payable by the buyer of capital goods such as machinery, on long term credit given by the supplier. Normally advance payment of 10 to 15% of the price of the capital goods is made by the borrower (margin). The balance amount with interest is payable in installments spread over may be 1 to 5 years. The supplier accordingly draws bills due on different dates which are accepted by the borrower and further co-accepted by the banker or bank issues DPG. On every due date the buyer's bank makes payment of the bill to the supplier irrespective of there being balance in the buyer's (borrower's) account or not. Banks secure such guarantees by creating charge over the assets purchased.

On expiry of the validity period of the guarantee, a registered acknowledgement due notice is to be sent to the beneficiary indicating that the liability of the bank under said guarantee stands discharged. If no reply is received from the beneficiary in reasonable time the entry is reversed in books of account. If beneficiary invokes the guarantee, the amount claimed needs to be paid immediately without any delay for whatsoever the reason.

In this bank guarantee, the extent of monetary liability and the validity period should be specific. The limitation clause is inserted for this purpose. As such even when the period of liability is specified in the guarantee, the beneficiary can claim till the limitation period is alive. No bank guarantee should normally have a maturity period of more than 10 years. The bank should have a policy approved by the Board in case guarantee for more than 10 years is to be issued.

Difference between Letter of Credit and Bank Guarantee

A bank guarantee and a letter of credit are similar in many ways but they're two different things. Letters of credit ensure a transaction proceeds as planned, while bank guarantees reduce the loss if transaction does not go as planned.

Example

A purchases a machinery on a long-term credit basis and agrees to pay in installments on specified dates over a period of time. In terms of the contract of sale, B (the seller) draws Bills of Exchange on the customer for different maturities. These bills are accepted by A. The banker (guarantor) guarantees payment of these bills of exchange on the due date. In the event of default by A, the banker need to honour the claim to the seller (beneficiary).

A letter of credit, sometimes referred to as a documentary credit, acts as a promissory note from a bank. It represents an obligation taken on by a bank to make a payment once certain criteria are met.

Once these terms are completed and confirmed, the bank will transfer the funds. The letter of credit ensures the payment will be made as long as the services are performed.

Example

An Indian wholesaler receives an order from a US company. The wholesaler has no way of knowing whether the buyer can fulfill his payment obligations, and requests a letter of credit be provided in their contract. The purchasing company applies for a letter of credit at a bank where it already has funds (LOC). After the goods have been shipped, the bank would pay the wholesaler its due as long as the terms of the sales contract are met, such as delivery before a certain time or confirmation from the buyer that the goods were received undamaged. The letter of credit substitutes the bank's credit for that of its client, ensuring correct and timely payment.

Letters of credit are especially important in international trade due to the distance involved and potentially differing laws in the countries of the businesses involved. In these transactions, it is not always possible for the parties to meet in person. The bank issuing the letter of credit holds payment on behalf of the buyer until it receives confirmation that the goods in the transaction have been shipped.

While letters of credit are used mostly in international trade agreements, bank guarantees are often used in real estate contracts and infrastructure projects.

Bank guarantees represent a more significant contractual obligation for banks than letters of credit do. A bank guarantee, like a letter of credit, guarantees a sum of money to a beneficiary; however, unlike a letter of credit, the sum is only paid if the opposing party does not fulfill the stipulated obligations under the contract. This can be used to essentially insure a buyer or seller from loss or damage due to nonperformance by the other party in a contract.

Bank guarantees insure both parties in a contractual agreement from credit risk. For instance, a construction company and its cement supplier may enter into a new contract to build a mall. Both parties may have to issue bank guarantees to prove their financial stance and capability. In a case where the supplier fails to deliver cement within a specified time, the construction company would notify the bank, which then pays the company the amount specified in the bank guarantee.

Both bank guarantees and letters of credit work to reduce financial risk. The seller takes on less risk when a letter of credit or bank guarantee is active, and would be more likely to agree to the transaction. These agreements are particularly important and useful in what would otherwise be risky transactions for the seller, such as certain real estate and international trade contracts. Banks, since they are agreeing to take on risk, thoroughly screen buyers interested in one of these transactions. After the bank has determined that the buyer is a reasonable risk, a monetary limit is placed on the agreement. The bank agrees to be obligated up to, but not exceeding, the limit. This protects the bank by providing a specific threshold of risk.

APPRAISAL METHODOLOGY FOR DIFFERENT TYPE OF NON FUND BASED CREDIT PRODUCTS

Credit Appraisal

Credit Appraisal is a process to ascertain the risks associated with the extension of the credit facility. Appraisal of credit is generally carried by the Banks/financial institutions which are involved in providing financial funding to its customers. To ascertain the credit risk associated with every credit proposal appraisal is required. Credit worthiness of a borrower can be assessed by proper credit appraisal.

I. **Letter of Credit Limit:** Letter of credit (LC) is a method of settlement of payment of a trade transaction and is widely used to finance purchase of raw material, machinery etc. It contains a written undertaking by the bank on behalf of the purchaser to the seller to make payment of a stated amount on presentation of stipulated documents and fulfillment of all the terms and conditions incorporated therein. Letters of credit thus offers both parties to a trade transaction a degree of security. The seller can look forward to the issuing bank for payment instead of relying on the ability and willingness of the buyer to pay.

Assessment of Limit of Letter of Credit

Particular	
Annual Raw Material Consumption	A
Annual Raw Material Procurement through ILC/ FLC	B
Monthly Consumption	C
Usance	D

Lead Time	E
Total Time	F=D+E
LC Time Required	G=F*C

II. Bank Guarantee Limit: Appraisal of proposals for Bank guarantees is done with same diligence as in the case of fund-base limits. Whenever an application for the issue of bank guarantee is received, Bank examine & satisfy about the following aspects:

a) The need of the bank guarantee & whether it is related to the applicant's normal trade/business.

b) Whether the requirement is one time or on the regular basis.

c) The nature of bank guarantee i.e., financial or performance.

d) Applicant's financial strength/ capacity to meet the liability/ obligation under the bank guarantee in case of invocation.

e) Past record of the applicant in respect of bank guarantees issued earlier; e.g., instances of invocation of bank guarantees, the reasons thereof, the customer's response to the invocation, etc.

f) Present o/s on account of bank guarantees already issued.

g) Margin.

h) Collateral security offered.

Assessment of Limit of Bank Guarantee

Particulars	
Outstanding Bank Guarantee as per Audited Balance Sheet	A
Add: Bank Guarantee required during the period	B
Less: Estimated maturity or cancellation of Bank Guarantee during the period	C
Requirement of Bank Guarantee	D=A+B-C

LESSON ROUND-UP

- Keeping in view the larger complementary role that corporate bonds have to play along-side bank credit for financing economic activities, several policy measures have been taken by the Government and the Regulators to develop a vibrant corporate bond market.
- Debt markets are markets for the issuance, trading and settlement of various types and features of fixed income securities.
- Debenture is a document evidencing a debt or acknowledging it and any document which fulfills either of these conditions is a debenture. They can be either convertible or non convertible into equity shares at a later point in time.

- Debt securities, Non-convertible redeemable preference shares, Perpetual debt instruments, Perpetual Non-cumulative preference shares or similar non-equity regulatory capital instruments are collectively referred to as “non-convertible securities”.
- “Debt securities” means non-convertible debt securities with a fixed maturity period which create or acknowledge indebtedness and includes debentures, bonds or any other security whether constituting a charge on the assets/ properties or not, but excludes security receipts, securitized debt instruments, money market instruments regulated by the Reserve Bank of India, and bonds issued by the Government or such other bodies as may be specified by the SEBI.
- Corporates also have access to another market called the Inter Corporate Deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. The ICD market is an unorganized market with very less information available publicly about transaction details.
- The cost and procurement of public deposits is cheaper and easier, respectively, than other forms of sources of finance. Generally public deposits, from the bank’s or financial institution’s point of view, are a source of short / medium term finance.
- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.
- A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).
- Bonds which are rupee denominated are called Masala Bonds which are becoming a very popular instrument.
- Banks also provide other types of finance including overdrafts and cash credit.
- Innovative methods of financing like Loan against shares are also available from Banks and financial institutions.
- Cash credit is the main method of lending by banks in India and accounts for about 70 percent of total bank credit. Under the system, the banker specifies a limit, called the cash credit limit, for each customer, upto which the customer is permitted to borrow against the security of tangible assets or guarantees.

GLOSSARY

Debenture Trustee: A trustee of a trust deed for securing any issue of debentures of a body corporate.

ISIN (International Securities Identification Number): A unique identification number allotted for each security in the depository system by SEBI.

CCA/c: Cash Credit Account

ODA/c: Over draft Account

DP: Drawing Power

D/P: Delivery Against Payment

D/A: Delivery Against Acceptance

CMA: Data Credit Monitoring Arrangement Data

GCC: Gulf Cooperation Council (GCC)

ROI: Return on investment

CIBIL: Credit Information Bureau (India) Limited

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.)

1. Discuss the procedure to be followed for electronic book mechanism for issue of debt securities.
2. What do you mean by 'Green Debt Securities'? Explain.
3. QUE Jay Ltd. is planning to issue 1,00,000 non-convertible debentures at Rs. 10 each through a public offer. You are the Company Secretary of the company and have been asked by the Board to prepare a Guidance Note briefing on the following points:
   a) Provisions of Companies Act, 2013 applicable on such issue.
   b) Provisions of SEBI (Issue & Listing of Non- Convertible Securities) Regulations, 2021 as applicable.
4. Sunshine Ltd. is a company with the main objective of Waste Management & Recycling. Company wants to raise funds for financing its activities from the Indian Debt Market. What is your advice to the company?
5. Xeron Ltd. issued 1,52,000 non-convertible debentures in 2019, to be redeemed in 2022. At the time of redemption, the Board of the company wants to consider the roll-over option. Can they do so? If yes, what are the conditions involved?
6. What is factoring. What are the advantages of factoring to a seller?
7. What are the factors to be taken into account for credit appraisal?
8. Differentiate between the following:
   a. Bills Finance and Project Finance
   b. Bill Discounting and Cash Credit
   c. Factoring and Forfaiting
   d. Overdraft and Cash Credit account
   e. Buyers' credit and Suppliers credit.
9. Explain the Working Capital Assessment Method as under Maximum Permissible Banking Finance Method with the help of an example.
10. In the Board Meeting of Heaven Limited the directors were discussing on the advantages and disadvantages of Hire Purchase Financing. You are the Company Secretary of the company and was asked by the Board to prepare an Advisory Note, briefing the Board about what Hire Purchase Finance is and how it is different from Project Finance.

11. The following data pertains to XYZ Ltd:

	Rs.
Projected Sales	20,00,000
Creditors	3,00,000
Bank Borrowings	3,30,000
Current Assets	7,40,000

Access the Working Capital requirements of XYZ Ltd. using the method given by Nayak Committee.

LIST OF FURTHER READINGS

- The Companies Act, 2013 & the Companies (Share Capital and Debentures) Rules, 2014
- SEBI(Issue of Capital and Disclosure Requirements) Regulations, 2018
- SEBI(Issue and Listing of Non-Convertible Securities) Regulations, 2021
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“Listing Regulations”)
- FAQs on Government Securities Market in India-A Primer available at https://www.rbi.org.in/Scripts/FAQView.aspx?Id=79
- FAQs on Banking available at https://www.rbi.org.in/Scripts/FAQDisplay.aspx?dId=49

OTHER REFERENCES

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- https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1847812
- https://unfccc.int/process-and-meetings/the-paris-agreement/nationally-determined-contributions-ndcs
- Financial Stability Report, Issue No. 25, RBI, June 2022;
- https://www.crisil.com/en/home/our-analysis/publications/crisil-bond-market-yearbook.html
- https://www.climatebonds.net/files/reports/cbi_sotm_2022_03c.pdf

Foreign Funding – Institutions

Lesson 15

KEY CONCEPTS

■ International Finance Corporation (IFC) ■ Asian Development Bank (ADB) ■ International Monetary Fund (IMF) ■ World Bank

Learning Objectives

To understand:

- Role and functions of various international agencies and development banks
- History, functions and funding by International Finance Corporation (IFC)
- IFC's Strategic Alignment with the Sustainable Development Goals (SDGs)
- Functions of Asian Development Bank (ADB) and Financing & Investment by ADB
- Mission, objective and financial assistance by IMF
- Functions of World Bank and its priorities

Lesson Outline

- International Agencies and Development Banks
- International Finance Corporation (IFC)
  - History of IFC
  - Functions of IFC
  - Funding by IFC
  - IFC's Strategic Alignment with the Sustainable Development Goals (SDGs)
- Asian Development Bank (ADB)
  - Areas of Work
  - Financing & Investment by ADB
- International Monetary Fund (IMF)
  - Mission
  - Objective
  - Financial Assistance by IMF
  - IMF Resources
- World Bank
  - Functions
  - Five Constituents Institutions under World Bank
  - Priorities of World Bank Group
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

INTERNATIONAL AGENCIES AND DEVELOPMENT BANKS

Many development banks and international agencies have come forth over the years for the purpose of international financing. These bodies are set up by the Governments of developed countries of the world at national, regional and international levels for funding various projects. The more industrious among them include International Finance Corporation (IFC), Asian Development Bank, International Monetary Fund (IMF), World Bank etc.

INTERNATIONAL FINANCE CORPORATION (IFC)

History of IFC

More than Six decades ago, a few dozen countries made a calculated bet on the transformative potential of the private sector in developing countries. They put up $100 million in capital and established IFC to reinforce the work of the World Bank in spurring growth and development. Today, IFC is the largest global development institution focused on the private sector, having delivered nearly $250 billion in financing to businesses in emerging markets.

Throughout its history, IFC has introduced new approaches to meet the needs of developing countries. Initially, it helped to bring leading multinational companies to developing countries— beginning in 1957, when IFC invested alongside Siemens in Brazil. In addition, as businesses in these countries began to thrive, IFC deployed its staff to local markets to be closer to clients. Over time, IFC helped drive growth by providing investment and advice, and by mobilizing resources from other capital providers.

IFC consistently brought to bear a distinctive set of advantages in working with the private sector to end extreme poverty and boost shared prosperity—a history of innovation, a mandate for global influence, an understanding of the demonstration effect of its actions, and a determination to achieve measurable development impact.

About IFC

The International Finance Corporation (IFC) is a sister organization of the World Bank and member of the World Bank Group is the largest global development institution focused exclusively on the private sector in developing countries. The Bank Group has set two goals for the world to achieve by 2030:

1. End Extreme Poverty; and
2. Promote shared prosperity in every country.

The International Finance Corporation (IFC) is an international financial institution that offers investment, advisory, and asset-management services to encourage private-sector development in developing countries.

IFC was founded in 1956 on a bold idea: that the private sector has the potential to transform developing countries. Since then IFC has expanded its horizons in more than 100 countries, coining the term "emerging markets" and pioneering new markets such as sustainable bonds. The mission of IFC is Advance economic development by encouraging the growth of private enterprise in developing countries.

The IFC helps the countries to develop their private sectors in a variety of ways:

- **Investing in companies** through loans, equity investments, debt securities and guarantees.
- **Mobilizing capital** from other lenders and investors through loan participations, parallel loans and other means.
- **Advising businesses and governments** to encourage private investment and improve the investment climate.

Since 2009, the IFC has focused on a set of development goals that its projects are expected to target. Its goals are to increase sustainable agriculture opportunities, prove healthcare and education, increase access to financing for microfinance and business clients, advance infrastructure, help small businesses grow revenues, and invest in climate health.

The IFC is owned and governed by its member countries but has its own executive leadership and staff that conduct its normal business operations. It is a corporation whose shareholders are member governments that provide paid- in capital and have the right to vote on its matters. Originally, it was more financially integrated with the World Bank Group, but later, the IFC was established separately and eventually became authorized to operate as a financially- autonomous entity and make independent investment decisions. It offers an array of debt and equity financing services and helps companies face their risk exposures while refraining from participating in a management capacity. The corporation also offers advice to companies on making decisions, evaluating their impact on the environment and society, and being responsible. It advises governments on building infrastructure and partnerships to further support private sector development.

Functions of IFC

- It provides a wide range of investment and advisory services that help businesses and entrepreneurs in the developing world meet the challenges they face in the marketplace.
- It offers innovative financial products to private sector projects in developing countries. These include loans for IFC's own account (also called A-loans), equity financing, quasi-equity financing, syndicated loans (or B-loans), risk management products, and partial credit guarantees. IFC often provides funding to financial intermediaries that on-lend to clients, especially small and medium enterprises.
- It also provides advisory services that help build businesses. Much of IFC's advisory work is conducted by facilities managed by IFC but funded through partnerships with donor Governments and other multilateral institutions. Other sources of funding include donor country trust funds and IFC's own resources.
- It can provide a mix of financing and advisory services that is tailored to meet the needs of each project. But the bulk of the funding, as well as leadership and management responsibility, lies with private sector owners and investors.

Funding by IFC

IFC's first investment came in September 1957. It was a $2 million, 15-year loan to help the local affiliate of German electrical equipment manufacturer Siemens build Brazil's first integrated assembly plant to supply local utilities.

Many more loans ensued in different markets in the coming years, financing steel products plants in India and Pakistan, textiles in El Salvador, and cement production in Thailand. In 1960, IFC first invested in Africa with a $2.8 million loan package for the new Kilombero Sugar Co. operation in Tanzania.

IFC is an active issuer of ESG bonds also known as Socially Responsible Investments. A subset of loan portfolio is funded through its established Green Bond program which finances climate friendly projects and Social Bond Program which finances projects that aim to alleviate social issues. Both programs are fully aligned to the capital markets' most referenced frameworks: The Green Bond Principles and The Social Bond Principles.

All projects financed by IFC must adhere to stringent ESG standards and our Sustainability Framework which help our clients do business in a sustainable way.

Under funding program, IFC issues bonds in a variety of markets, formats, and currencies—including global benchmarks bonds, green and social bonds, uridashi notes, private placements, and discount notes. In addition, IFC issues local-currency bonds to develop domestic capital markets and facilitate local-currency lending. A brief on some of the funding instruments are discussed below:

- **Benchmark & Global Bonds-** IFC issues various Benchmark and Global Bonds such as U.S. Dollar Benchmark Bonds, USD SOFR Floating Rate Notes Bonds, Australian Dollar Public Bonds, British Pound Sterling Public Bonds, New Zealand Dollar Public Bonds etc.

- **Discount Notes-** IFC's Discount Note Program was launched in June 2009 and provides an additional funding and liquidity management tool for IFC to support our trade finance and supply chain initiatives, and to expand the availability of short-term local currency finance. Our discount notes offer a high-quality, short-term investment opportunity in U.S. dollar and Chinese renminbi.

- **Green Bonds -** IFC is one of the world's largest financiers of climate-smart projects for developing countries. IFC was also one of the earliest issuers of green bonds, launching a Green Bond Program in 2010 to help catalyze the market and unlock investment for private sector projects that support renewable energy and energy efficiency.

- **Impact Notes -** IFC is one of the world's largest financiers of climate-smart projects for developing countries. Since 2005, when we started to track climate-smart components of our investments and advisory services, IFC has provided more than $28 billion in long-term financing and raised over $22.3 billion in core mobilization through partnerships with investors. IFC was also one of the earliest issuers of green bonds, launching a Green Bond Program in 2010 to help catalyze the market and unlock investment for private sector projects that support renewable energy and energy efficiency.

- **MTNs & Structured Notes-** IFC aims to maintain the position as an active and flexible issuer of plain vanilla and structured notes. Our structured notes offer investors a yield pickup and can accommodate investor needs.

  IFC currently allows:

  – Interest rate linked, foreign exchange linked, equity index linked, commodity linked, floating rate notes (FRNs), Bermudan and European callable, and hybrid notes.

  – Minimum size of $3 million equivalent with maturities ranging from one to 30 years.

  IFC has an active buyback program, serving as a liquidity backstop for IFC's issuances.

- **Social Bonds -** FC's Social Bond Program, launched in 2017, offers bond investors an opportunity to allocate investments to the achievement of certain SDGs without any additional credit risk than that of IFC as a triple-A rated issuer. Proceeds from the bonds go towards financing select projects from IFC's Banking on Women and Inclusive Business programs, which benefit under-served populations in emerging markets including women and low-income communities with limited access to essential services such as basic infrastructure, finance etc. IFC is a frequent issuer of social bonds in public and private markets, in various currencies and tenors. The Social Bond Program aligns with the Social Bond Principles published by the International Capital Market Association (ICMA).

IFC's Strategic Alignment with the SDGs

IFC seeks to create markets through several ways: by demonstrating successful innovative business models that can be replicated; by stimulating competitiveness through efficiency gains, cost and/or price reductions, and new market entrants; by improving business regulatory frameworks to enable the development and growth of a vibrant private sector in a sustainable manner; and by building capacity and skills that open new market opportunities. This will enable IFC to achieve impact beyond what is obtained with the financing from IFC's own balance sheet.

IFC is playing a key role in the World Bank Group's Maximizing Finance for Development approach. To meet the ambitious SDGs, there is a need to expand the role of the private sector and mobilize private capital while reserving scarce public resources. Together with the World Bank and the Multilateral Investment Guarantee Agency (MIGA), IFC is working on this initiative by focusing on mobilizing private sector solutions for development and by creating markets that enable private investment to contribute to the achievement of the SDGs.

IFC contributes to the SDGs through two pathways, namely: project outcomes and market creation. IFC measures and reports on project outcomes, including the direct impact on stakeholders (including customers, suppliers, government, and the community), the indirect and induced effects on the economy (value added, employment, etc.), and environment and social impacts.

In addition, IFC projects are assessed for the ability to create markets, defined as enabling the development of new markets or contributing to systemic improvements in how markets function and deliver sustainable development impact.

ASIAN DEVELOPMENT BANK

The Asian Development Bank (ADB) was conceived in the early 1960s as a financial institution that would be Asian in character and foster economic growth and co-operation in one of the poorest regions in the world.

> The Asian Development Bank (ADB) envisions a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty in the region.

The Asian Development Bank (ADB) envisions a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty in the region.

ADB assists its member and partners, by providing loans, technical assistance, growth and other equity investments to promote social and economic development. ADB is composed of 68 members 49 of which are from the Asia and the Pacific region and 19 outside.

Areas of Work

The ADB is committed to achieving a prosperous and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty. It assists its members and partners by providing loans, technical assistance, grants, and equity investments to promote social and economic development. ADB supports projects in developing member countries that create economic and development impact, delivered through both public and private sector operations, advisory services, and knowledge support.

ADB in partnership with member governments, independent specialists and other financial institutions is focused on delivering projects in developing member countries that create economic and developments impact.

As a multilateral development finance institution, ADB provides:

- loans
- technical assistance
- grants

> ADB maximizes the development impact of its assistance by :
>
> - facilitating policy dialogues, providing advisory services, and
> - mobilizing financial resources through co-financing operations that tap official, commercial, and export credit sources.

Financing and Investment by Asian Development Banks

- **Private Sector Financing**

  ADB undertakes nonsovereign operations to provide financing to eligible recipients in developing member countries (DMCs). Nonsovereign operations comprise the provision of any loan, guarantee, equity investment, or other financing arrangement to privately held, state-owned, or subsovereign entities, in each case, (i) without a government guarantee; or (ii) with a government guarantee, under terms that do not allow ADB, upon default by the guarantor, to accelerate, suspend, or cancel any other loan or guarantee between ADB and the related sovereign.

  ADB catalyzes private investments through direct financing, credit enhancements, and risk mitigation instruments. ADB provides direct funding assistance through loans and equity investments. ADB offers political risk guarantee and partial credit guarantee instruments to enhance the risk profiles of transactions to attract both foreign and local commercial lenders to projects in the DMCs, and to encourage them.

  Through cofinancing and guarantees, ADB also support local investors, domestic banks, and financial institutions to provide funds on suitable terms for ADB-assisted development projects. ADB also mobilizes additional resources for projects through a "B-loan" arrangement.

- **Loans and other Debt Instruments**

  ADB offers hard currency loans, both senior and subordinated, as well as mezzanine financing. ADB also offer local currency loans in selective markets on a case to case basis. Interest rates and other terms vary, depending on a company's or project's needs and risks.

  - **Rates** - In pricing its loans, ADB considers prevailing market rates in the relevant country and sector, factoring in country and transaction risks. ADB provides floating rate loans at a spread above the Secured Overnight Financing Rate (SOFR) or Euro interbank rate, depending on the currency. It also offers fixed-rate loans at the fixed-rate swap equivalent of floating-rate loans.
  - **Fees** - Market-based fees are charged. Typically, on floating-rate loans, ADB charges a once-only front-end fee as well as an ongoing commitment fee on the undisbursed balance. ADB also charge a fee to cover upfront costs associated with due diligence. Project sponsors or clients will reimburse out-of-pocket expenses, such as travel and external advisory services (i.e., legal counsel, technical consultants, and environmental and insurance advisors, if any).
  - **Security** - ADB will seek security appropriate for the loan and type of financing.

- **Equity investments**

  ADB may invest directly in an enterprise. It offers financing through equity investments, including direct equity investments in the form of common shares, preferred stock, or convertibles. Equity investments in enterprises, especially financial institutions, occur before an initial public offering. ADB does not seek a controlling interest in an investee company, and will not assume any management responsibilities. It will, however, typically wish to reserve the right to appoint a nominee or an observer to the board of directors of each of its investee companies and to selected board committees, and will exercise voting rights as a shareholder. It will maintain regular contact with company management and require periodic reports on the progress of capital projects, operating performance, financial condition of the enterprise, and economic value added. ADB also requires reports on specific indicators for development outputs and outcomes, and monitors continued compliance its environmental and social safeguards.

  Once the objective of its investment has been achieved, ADB will divest its shares at a fair market price. Facilitating this divestment may require the eventual listing of the shares of the investee enterprises on one or more stock exchanges, conducting a trade sale or entering into a suitable buyback agreement. In general, ADB prefers to sell shares to the nationals of the host country to broaden local ownership and further develop local capital markets. When disposing of its shares, ADB will endeavor to consult with its major investment partners and give due consideration to their views, without being precluded from disposing of its investments at its sole discretion.

- ADB may also invest in a private equity fund, up to certain exposure limits. ADB will reserve the right to appoint a nominee to the advisory board of the fund. It will maintain frequent contact with the fund manager and require detailed quarterly reports on the fund manager's investment, monitoring, value addition, and, eventually, divestment progress. With the same frequency, ADB will closely monitor financial performance as measured by net asset value. ADB makes long-term commitments of capital to private equity funds, in keeping with the long-term life cycle of such investments, and ordinarily stays invested as a shareholder or limited partner through the life of the fund.

- **Guarantees**

  ADB extends guarantees for eligible projects which enable financing partners to transfer certain risks that they cannot easily absorb or manage on their own to ADB. Guarantees can be provided when ADB has a direct or indirect participation in a project or related sector, through a loan, equity investment or technical assistance.

- **Loan Syndication**

  ADB partners with commercial banks, impact investors, institutional investors, and development finance institutions to provide debt for projects through B loan, complementary financing scheme, and parallel loan structures.

- **Blended Finance**

  Blended concessional finance is the combination of concessional finance from donors or third parties, with the normal account finance of development finance institutions (DFIs) and/or commercial finance from other investors, used to develop private sector markets, address Sustainable Development Goals, and mobilize private resources.

  ADB is a member of the DFI Working Group on Blended Concessional Finance for Private Sector Projects, which promotes best practice according to five principles: (i) rationale for using blended concessional finance, (ii) crowding-in and minimum concessionality, (iii) commercial sustainability, (iv) reinforcing markets, and (v) promoting high standards.

INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF) is an organization of 190 member countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. The IMF was established in 1944 in the aftermath of the Great Depression of the 1930s. 44 founding member countries sought to build a framework for international economic cooperation.

Today, its membership embraces 190 countries, with staff drawn from 150 nations. The IMF is governed by and accountable to the 190 countries that make up its near-global membership.

The IMF's primary purpose is to ensure the stability of the international monetary system-the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. The Funds mandate was updated in 2012 to include all macroeconomic and financial sector issues that bear on global stability.

Mission

The IMF's fundamental mission is to ensure the stability of the international monetary system. It does so in three ways:

(i) keeping track of the global economy and the economies of member countries;

(ii) lending to countries with balance of payments difficulties; and

(iii) giving practical help to members.

Objectives of IMF

IMF was developed as an initiative to promote international monetary cooperation, enable international trade, achieve financial stability, stimulate high employment, diminish poverty in the world and sustain economic growth. Initially, there were 29 countries with a goal of redoing the global payment system. Today, the organization has 190 members. The main objectives of the International Monetary Fund (IMF) are as under:

- To improve and promote global monetary cooperation of the world.
- To secure financial stability by eliminating or minimizing the exchange rate stability.
- To facilitate a balanced international trade.
- To promote high employment through economic assistance and sustainable economic growth.
- To reduce poverty around the world.

Financial Assistance by IMF

IMF lending aims to give countries breathing room to implement adjustment policies in an orderly manner, which will restore conditions for a stable economy and sustainable growth. These policies will vary depending upon the country's circumstances. For instance, a country facing a sudden drop in the prices of key exports may need financial assistance while implementing measures to strengthen the economy and widen its export base. A country suffering from severe capital outflows may need to address the problems that led to the loss of investor confidence-perhaps interest rates are too low; the budget deficit and debt stock are growing too fast; or the banking system is inefficient or poorly regulated.

The causes of crises are varied and complex. They can be domestic, external, or both.

Domestic factors include inappropriate fiscal and monetary policies, which can lead to large current account and fiscal deficits and high public debt levels; an exchange rate fixed at an inappropriate level, which can erode competitiveness and result in the loss of official reserves, and a weak financial system, which can create economic booms and busts. Political instability and weak institutions also can trigger crises.

External factors include shocks ranging from natural disasters to large swings in commodity prices. Both are common causes of crises, especially for low-income countries. With globalization, sudden changes in market sentiment can result in capital flow volatility. Even countries with sound fundamentals can be severely affected by economic crises and policies elsewhere.

The COVID-19 pandemic was an example of external shock affecting countries across the globe. The IMF responded with unprecedented financial assistance to help countries protect the most vulnerable and set the stage for economic recovery. Some other crises situations are depicted below:

- Balance of payment problems occur when a nation is unable to pay for essential imports or service its external debt.
- Financial crises stem from illiquid or insolvent financial institutions.

- Fiscal crises are caused by excessive deficits and debt.

It also provides precautionary financing to help prevent and insure against crises. The IMF's lending toolkit is continuously refined to meet countries' changing needs.

IMF Resources

IMF funds come from following three sources:

1. **Member quotas-** Quotas are the IMF's main source of financing. Each member of the IMF is assigned a quota, based broadly on its relative position in the world economy. The IMF regularly reviews quotas to assess their adequacy overall and their distribution among members. The 16^{th} review by IMF is expected to conclude by mid- December 2023. The previous review concluded in February 2020 without a quota increase. The last increase in quotas, to SDR 477 billion (US$ 637 billion), was agreed to under the 14th Review, which concluded in December 2010 and took effect in January 2016. At present, India has quota of 2.75% (with 13,114.4 Millions of Special Drawing Rights) of total quota at IMF with 2.63% of voting rights.
2. **New Arrangements to Borrow**- The New Arrangements to Borrow (NAB) constitutes a second line of defense. Through the NAB, certain member countries and institutions stand ready to lend additional resources to address challenges to the international monetary system. NAB activation requires support from 85% of participants eligible to vote.
3. **Bilateral borrowing agreements-** Bilateral Borrowing Agreements serve as a third line of defense after quotas and the NAB. Since the onset of the global financial crisis, the IMF has entered into several rounds of bilateral borrowing agreements (BBAs) to meet its members' financing needs. Activation of the agreements requires support of 85% of creditors eligible to vote.

IMF Capacity Development

The IMF provides technical assistance and training to help countries build effective economic institutions that can implement the right policies. These capacity development efforts help countries achieve their growth and development objectives and contribute strongly to their progress toward their Sustainable Development Goals (SDGs). Capacity development is one of the three core functions of the IMF and accounts for around a third of spending.

World Bank

World Bank is an international organization affiliated with the United Nations (UN) and designed to finance projects that enhance the economic development of member states. Headquartered in Washington, D.C., the bank is the largest source of financial assistance to developing countries. It also provides technical assistance and policy advice and supervises -on behalf of international creditors - the implementation of free-market reforms.

Together with the International Monetary Fund (IMF) and the World Trade Organization, it plays a central role in overseeing economic policy and reforming public institutions in developing countries and defining the global macro-economic agenda.

Five Constituent Institutions under World Bank

The World Bank Group comprises following five constituent institutions that share a commitment to reducing poverty, increasing shared prosperity, and promoting sustainable growth and development.

1. **The International Bank for Reconstruction and Development (IBRD) -** provides loans at market rates of interest to middle-income developing countries and creditworthy lower-income countries.

2. **The International Development Association (IDA)** - provides interest-free long-term loans, technical assistance, and policy advice to low-income developing countries in areas such as health, education, and rural development.
3. **The International Finance Corporation (IFC)** - operating in partnership with private investors, provides loans and loan guarantees and equity financing to business undertakings in developing countries.
4. **The Multilateral Investment Guarantee Agency (MIGA)** - Loan guarantees and insurance to foreign investors against loss caused by non-commercial risks in developing countries are provided by the MIGA.
5. **The International Centre for Settlement of Investment Disputes (ICSID) -** is responsible for the settlement by conciliation or arbitration of investment disputes between foreign investors and their host developing countries.

Priorities of World Bank Group

The priorities of World Bank Group *inter alia* covers the following:

Climate Change

Climate change, poverty, and inequality are the defining issues of our age. The World Bank Group is the biggest multilateral funder of climate investments in developing countries and intend to go further in helping countries reduce poverty and rise to the challenges of climate change.

Food Security

The World Bank Group works with partners to build food systems that can feed everyone, everywhere, every day by improving food security, promoting 'nutrition-sensitive agriculture' and improving food safety. The Bank is a leading financier of food systems.

Human Capital Project (HCP)

Human capital consists of the knowledge, skills, and health that people invest in and accumulate throughout their lives, enabling them to realize their potential as productive members of society. Investing in people through nutrition, health care, quality education, jobs and skills helps develop human capital, and this is key to ending extreme poverty and creating more inclusive societies.

The Human Capital Project is a global effort to accelerate more and better investments in people for greater equity and economic growth. As of October 2022, 86 countries at all income levels are working with the World Bank Group on strategic approaches to transform their human capital outcomes.

LESSON ROUND-UP

- International Institutions like the International Finance Corporation, Asian Development Bank, International Monetary Fund, World Bank etc. provide finance to various development activities to its member countries.
- IFC provides a wide range of investment and advisory services and offers innovative financial products to private sector projects in developing countries.
- The Asian Development Bank (ADB) assists its members and partners by providing loans, technical assistance, grants, and equity investments to promote social and economic development.

- The International Monetary Fund (IMF) is an organization of 190 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.
- World Bank is an international organization affiliated with the United Nations (UN) and designed to finance projects that enhance the economic development of member states.
- There are five constituent institutions under World Bank namely the International Bank for Reconstruction and Development (IBRD), The International Development Association (IDA), The International Finance Corporation (IFC), The Multilateral Investment Guarantee Agency (MIGA) and The International Centre for Settlement of Investment Disputes (ICSID).

GLOSSARY

Blended Finance: Blended concessional finance is the combination of concessional finance from donors or third parties, with the normal account finance of development finance institutions (DFIs) and/or commercial finance from other investors, used to develop private sector markets, address Sustainable Development Goals, and mobilize private resources.

Green Bond: A green bond is a type of fixed-income instrument that is specifically earmarked to raise money for climate and environmental projects.

Social Impact Bond: A social impact bond is a type of financial security that provides capital to the public sector to fund projects that will create better social outcomes and lead to savings.

Human capital: It consists of the knowledge, skills, and health that people invest in and accumulate throughout their lives, enabling them to realize their potential as productive members of society.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. "Achieving a prosperous, inclusive, resilient and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty" - Justify the mission of Asian Development Bank in your own words?
2. Distinguish between Asian Development Bank and International Monetary Fund?
3. International Monetary Fund (IMF) plays a vital role in the global economy. Explain its mission and activities?
4. Write a brief note on World Bank. Also, write five constituent institutions under World Bank?
5. Is International Finance Corporation (IFC) part of World Bank? Briefly write the functions of IFC?

LIST OF FURTHER READINGS

- https://www.imf.org/en/Publications/WEO/Issues/2023/01/31/world-economic-outlook-update-january-2023
- https://www.imf.org/en/Publications/GFSR/Issues/2022/10/11/global-financial-stability-report-october-2022

- https://www.ifc.org/wps/wcm/connect/CORP_EXT_Content/IFC_External_Corporate_Site/Annual+Report
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- https://www.worldbank.org/en/research
- https://www.adb.org/what-we-do/main

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2. https://www.adb.org/
3. https://www.imf.org/en/About
4. https://www.worldbank.org/en/home

Foreign Funding – Instruments, Laws and Procedures

Lesson 16

KEY CONCEPTS

■ Euro Issue ■ American Depository Receipts (ADR) ■ Global Depository Receipts (GDR) ■ Foreign Currency Convertible Bonds (FCCBs) ■ Foreign Currency Exchangeable Bonds (FCEBs) ■ One Way Fungibility ■ Two Way Fungibility

Learning Objectives

To understand:

- Concept of foreign funding
- Different sources of fund from abroad available for Indian companies
- Different routes of issue
- Regulatory framework pertaining to various sources of International Fund in India
- Concept, Purpose and Process of issuance of ADR/GDR

Lesson Outline

- Introduction
- Regulatory Framework in India
- Euro Issue
- External Commercial Borrowings
- ECB Framework
- Depository Receipts
- Depository Receipts Scheme, 2014
- American Depository Receipts (ADR) & Global Depository Receipts (GDR)
- Procedure for Issuance of GDR/ADR
- Foreign Currency Convertible Bonds
- FCCB and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993
- Foreign Currency Exchangeable Bonds (FCEBs)
- Foreign Currency Exchangeable Bonds Scheme, 2008
- Checklist on Pre-issue and Post-issue formalities for GDRs/ADRs/FCCBs
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

INTRODUCTION

Globalisation has opened doors and opportunities that were never explored before. International Financing is also known as International Macroeconomics as it deals with finance on a global level. International finance helps organizations engage in cross-border transactions with foreign business partners, such as customers, investors, suppliers and lenders. Various international sources from where funds may be raised include the following:

> The Government of India has taken various policies initiatives to allow India companies to raised funds from International Market. These policy initiatives have led to the introduction of International Instruments like American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and Foreign Currency Exchangeable Bonds (FCEBs) etc.

(i) Commercial Banks

(ii) International Agencies and Development Banks

(iii) International Capital Markets.

With economies and the operations of the business organizations going global, Indian companies have an access to funds in the global capital market.

Increased globalization and investor appetite for investing in India, offer unique opportunity to companies looking to tap a new investor base, awareness or raise capital.

Capital can be raised from international capital market in foreign currency by accessing foreign capital market. Funds raised through foreign currency are called as euro equity or debt.

- **Euro Equity:** Euro equity represents shares denominated in dollar terms, issued by non-American and non-European companies to list their shares on American and European stock exchanges by complying the regulations of respective stock exchanges where the shares are intended to be listed. The euro equity issue can be made in different forms like American Depository Receipts and Global Depository Receipts.

> Indian companies are allowed to raise capital in the international market through the issue of GDR/ADR/ FCCB/ FCEB and through External Commercial Borrowings.

- **Euro Debt:** Debts raised from international capital market by complying regulations of the respective country of which the capital market is accessed is called as euro debt. Euro debt can be issued in the form of ECB/FCCB/FCEB etc.

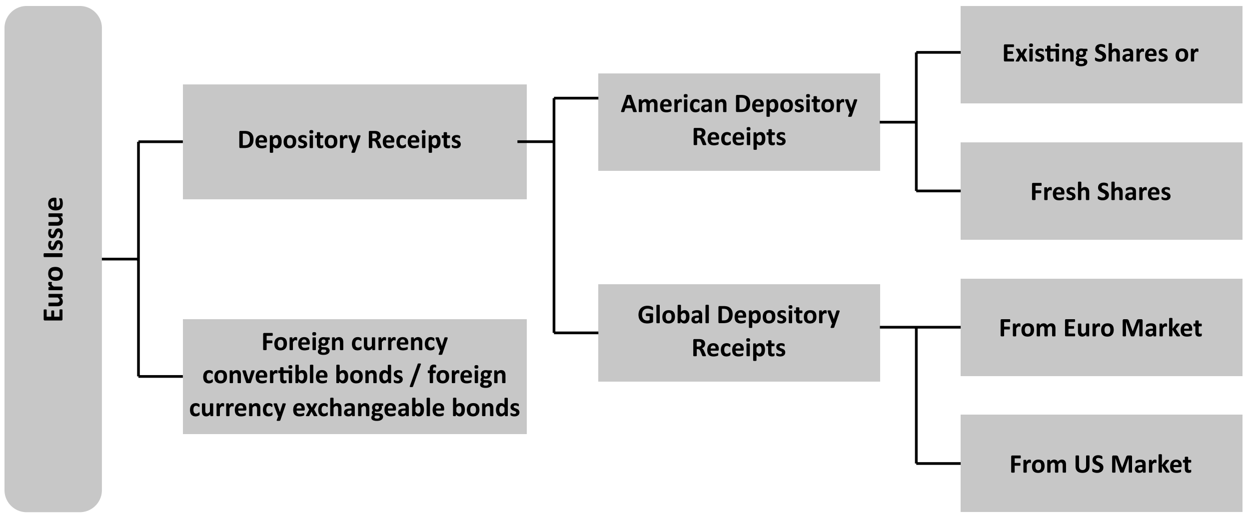
REGULATORY FRAMEWORK IN INDIA

Issue of ADR/GDR/FCCBs/FCEBs are regulated by the following regulations in India:

The Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993	Foreign Currency Exchangeable Bonds Scheme, 2008	Depository Receipts Scheme, 2014	Notifications/ Circulars issued by Ministry of Finance (MoF), GOI
Consolidated FDI Policy	RBI Regulations/Circulars	Compnaies Act and Rules thereunder	SEBI (Listing Obligations and Diclosure Requirements) Regulations, 2015

EURO ISSUE

Euro issue means modes of raising funds by an Indian company outside India in foreign currency. There are different modes of Euro issue which is as follows:



EXTERNAL COMMERCIAL BORROWING (ECB)

ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a standalone basis.

Merging of Tracks I and II as "Foreign Currency denominated ECB" and merging of Track III and Rupee Denominated Bonds framework as "Rupee Denominated ECB".

ECB FRAMEWORK

The framework for raising loans through ECB comprises the following two options:

Parameters	***FCY denominated ECB***	***INR denominated ECB***
Currency of borrowing	Any freely convertible Foreign Currency	Indian Rupee (INR)
Forms of ECB	Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; FCCBs; FCEBs and Financial Lease.	Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; and Financial Lease. Also, plain vanilla Rupee denominated bonds issued overseas (RDBs), which can be either placed privately or listed on exchanges as per host country regulations.

<table>
<tr><th>Parameters</th><th>FCY denominated ECB</th><th>INR denominated ECB</th></tr>
<tr><td rowspan="2">Eligible borrowers</td><td>All entities eligible to receive FDI. Further, the following entities are also eligible to raise ECB:
a) Port Trusts;
b) Units in SEZ;
c) SIDBI; and
d) EXIM Bank.</td><td>a) All entities eligible to raise FCY ECB; and
b) Registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registered societies/ trusts/cooperatives and Non-Government Organisations (permitted only to raise INR ECB).</td></tr>
<tr><td colspan="2">Question: Are LLPs eligible to raise ECBs?
Answer: As LLPs are not eligible to receive FDI, they cannot raise ECBs.</td></tr>
<tr><td>Recognised lenders</td><td colspan="2">The lender should be resident of FATF or IOSCO compliant country, including on transfer of ECBs. However,
a) Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders;
b) Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad; and
c) Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for FCY ECB (except FCCBs and FCEBs). Foreign branches/ subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/ underwriters/market-makers/traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed.</td></tr>
<tr><td>Minimum Average Maturity Period</td><td colspan="2">Minimum average maturity period (MAMP) will be 3 years. Call and put options, if any, shall not be exercisable prior to completion of minimum average maturity. However, for the specific categories mentioned below, the MAMP will be as prescribed therein:
<table>
<tr><th>Sr. No.</th><th>Category</th><th>MAMP</th></tr>
<tr><td>(a)</td><td>ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year.</td><td>1 year</td></tr>
<tr><td>(b)</td><td>ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans.</td><td>5 years</td></tr>
<tr><td>(c)</td><td>ECB raised for
(i) working capital purposes or general corporate purposes.
(ii) on-lending by NBFCs for working capital purposes or general corporate purposes.</td><td>10 years</td></tr>
</table></td></tr>
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<table>
<tr><th>Parameters</th><th>FCY denominated ECB</th><th>INR denominated ECB</th></tr>
<tr><td></td><td colspan="2">
<table>
<tr><td>(d)</td><td>ECB raised for
(i) repayment of Rupee loans availed domestically for capital expenditure.
(ii) on-lending by NBFCs for the same purpose.</td><td>7 years</td></tr>
<tr><td>(e)</td><td>ECB raised for
(i) repayment of Rupee loans availed domestically for purposes other than capital expenditure.
(ii) on-lending by NBFCs for the same purpose.</td><td>10 years</td></tr>
<tr><td colspan="3">for the categories mentioned at (b) to (e) –
(i) ECB cannot be raised from foreign branches / subsidiaries of Indian banks.
(ii) the prescribed MAMP will have to be strictly complied with under all circumstances.</td></tr>
</table>
</td></tr>
<tr><td rowspan="2">All-in-cost ceiling per annum</td><td>Benchmark Rate plus 550 bps spread: For existing ECBs linked to LIBOR whose benchmarks are changed to ARR.
Benchmark rate plus 500 bps spread: For new ECBs.</td><td>Benchmark rate plus 450 bps spread.</td></tr>
<tr><td colspan="2">All-in-cost ceiling has been temporarily increased by 100 bps for ECBs raised till December 31, 2022. The enhanced all-in-cost ceiling shall be available only to eligible borrowers of investment grade rating from Indian Credit Rating Agencies (CRAs). Other eligible borrowers may raise ECB within the existing all-in-cost ceiling as hitherto.</td></tr>
<tr><td>Other costs</td><td colspan="2">Prepayment charge/ Penal interest, if any, for default or breach of covenants should not be more than 2 per cent over and above the contracted rate of interest on the outstanding principal amount and will be outside the all-in-cost ceiling.</td></tr>
<tr><td>End-uses (Negative list)</td><td colspan="2">The negative list, for which the ECB proceeds cannot be utilised, would include the following:
a) Real estate activities.
b) Investment in capital market.
c) Equity investment.
d) Working capital purposes except in case of ECB mentioned in point (b) and (c) of Minimum Average Maturity Period above.</td></tr>
</table>

Parameters	*FCY denominated ECB*	*INR denominated ECB*
	e) General corporate purposes except in case of ECB mentioned in point (b) and (c) of Minimum Average Maturity Period above. f) Repayment of Rupee loans except in case of ECB mentioned in point (d) and (e) of Minimum Average Maturity Period above. On-lending to entities for the above activities, in case of ECB raised by NBFCs as given in point (c), (d) and (e) of Minimum Average Maturity Period above.	
Exchange rate	Change of currency of FCY ECB into INR ECB can be at the exchange rate prevailing on the date of the agreement between the parties concerned for such change or at an exchange rate, which is less than the rate prevailing on the date of agreement, if consented to by the ECB lender.	For conversion to Rupee, exchange rate shall be the rate prevailing on the date of settlement.
Hedging provision	The entities raising ECB are required to follow the guidelines for hedging issued, if any, by the concerned sectoral or prudential regulator in respect of foreign currency exposure. Infrastructure space companies shall have a board approved risk management policy. Further, such companies are required to mandatorily hedge 70 per cent of their ECB exposure in case average maturity of ECB is less than 5 years. The designated AD Category-I bank shall verify that 70 per cent hedging requirement is complied with during the currency of ECB and report the position to RBI through Form ECB 2 returns. The following operational aspects with respect to hedging should be ensured: (a) *Coverage*: The ECB borrower will be required to cover principal as well as coupon through financial hedges. The financial hedge for all exposures on account of ECB should start from the time of each such exposure (i.e. the day liability is created in the books of the borrower).	The overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category I banks in India. The investors can also access the domestic market through branches/subsidiaries of Indian banks abroad or branches of foreign banks with Indian presence on a back to back basis.

Parameters	FCY denominated ECB	INR denominated ECB
	(b) *Tenor and rollover:* A minimum tenor of one year of financial hedge would be required with periodic rollover duly ensuring that the exposure on account of ECB is not unhedged at any point during the currency of ECB. (c) *Natural Hedge:* Natural hedge, in lieu of financial hedge, will be considered only to the extent of off projected cash flow/revenues in matching currency, net of all other projected outflows. For this purpose, an ECB may be considered naturally hedged if the off exposure has the maturity/ cash flow within the same accounting year. Any other arrangements/ structures, where revenues are indexed to foreign currency will not be considered as natural hedge.	
Change of currency of borrowing	Change of currency of ECB from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted.	Change of currency from INR to any freely convertible foreign currency is not permitted.
Note: The ECB framework is not applicable in respect of investments in Non-Convertible Debentures in India made by Registered Foreign Portfolio Investors. Lending and borrowing under the ECB framework by Indian banks and their branches/subsidiaries outside India will be subject to prudential guidelines issued by the Department of Banking Regulation of the Reserve Bank. Further, other entities raising ECB are required to follow the guidelines issued, if any, by the concerned sectoral or prudential regulator.		

Limit and Leverage

Under the aforesaid framework, all eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under auto route. Further, in case of FCY denominated ECB raised from direct foreign equity holder ECB liability-equity ratio for ECBs raised under the automatic route cannot exceed 7:1. However, this ratio will not be applicable if outstanding amount of all ECBs, including proposed one, is up to USD 5 million or equivalent. Further, the borrowing entities will also be governed by the guidelines on debt equity ratio issued, if any, by the sectoral or prudential regulator concerned.

The automatic route limit stands increased from USD 750 million or equivalent to USD 1.5 billion or equivalent. This relaxation is available for ECBs to be raised till December 31, 2022.

Issuance of Guarantee by Indian Banks and Financial Institutions

Issuance of any type of guarantee by Indian banks, All India Financial Institutions and NBFCs relating to ECB is not permitted. Further, financial intermediaries (viz., Indian banks, All India Financial Institutions, or NBFCs) shall not invest in FCCBs/ FCEBs in any manner whatsoever.

Parking of ECB proceeds

ECB proceeds are permitted to be parked abroad as well as domestically in the manner given below:

- **Parking of ECB proceeds abroad**

  ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilization. Till utilisation, these funds can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody's; (b) Treasury bills and other monetary instruments of one-year maturity having minimum rating as indicated above and (c) deposits with foreign branches/ subsidiaries of Indian banks abroad.

- **Parking of ECB proceeds domestically**

  ECB proceeds meant for Rupee expenditure should be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India. ECB borrowers are also allowed to park ECB proceeds in term deposits with AD Category I banks in India for a maximum period of 12 months cumulatively. These term deposits should be kept in unencumbered position.

Procedure of Raising ECB

All ECBs can be raised under the automatic route if they conform to the parameters prescribed under this framework. For approval route cases, the borrowers may approach the RBI with an application in Form ECB for examination through their AD Category I bank. Such cases shall be considered keeping in view the overall guidelines, macroeconomic situation and merits of the specific proposals. ECB proposals received in the Reserve Bank above certain threshold limit (refixed from time to time) would be placed before the Empowered Committee set up by the Reserve Bank. The Empowered Committee will have external as well as internal members and the Reserve Bank will take a final decision in the cases taking into account recommendation of the Empowered Committee. Entities desirous to raise ECB under the automatic route may approach an AD Category I bank with their proposal along with duly filled in Form ECB.

Reporting Requirements

Borrowings under ECB Framework are subject to following reporting requirements apart from any other specific reporting required under the framework:

- **Loan Registration Number (LRN)**

  Any draw-down in respect of an ECB should happen only after obtaining the LRN from the Reserve Bank. To obtain the LRN, borrowers are required to submit duly certified Form ECB, which also contains terms and conditions of the ECB, in duplicate to the designated AD Category I bank. In turn, the AD Category I bank will forward one copy to the Reserve Bank of India. Copies of loan agreement for raising ECB are not required to be submitted to the Reserve Bank.

- **Changes in terms and conditions of ECB**

  Changes in ECB parameters in consonance with the ECB norms, including reduced repayment by mutual agreement between the lender and borrower, should be reported to the RBI through revised Form ECB at the earliest, in any case not later than 7 days from the changes effected. While submitting revised Form ECB the changes should be specifically mentioned in the communication.

- **Monthly Reporting of actual transactions**

  The borrowers are required to report actual ECB transactions through Form ECB 2 Return through the AD Category I bank on monthly basis so as to reach DSIM within seven working days from the close of month to which it relates. Changes, if any, in ECB parameters should also be incorporated in Form ECB 2 Return.

Question: Whose responsibility is it to ensure compliance with ECB guidelines?

Answer: The primary responsibility for ensuring that the borrowing is in compliance with the applicable ECB guidelines is that of the borrower concerned. Structures which bypass/circumvent ECB guidelines in any manner and/or raising borrowings in any other manner which is not permitted/ disguising borrowing under the wrap of other kind of transactions and/ or contravening provisions of Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2018 would also invite penal action under FEMA.

- **Late Submission Fee (LSF) for delay in reporting**

  Any borrower, who is otherwise in compliance of ECB guidelines, can regularize the delay in reporting of drawdown of ECB proceeds before obtaining LRN or delay in submission of Form ECB 2 returns, by payment of late submission fees in accordance with Master Direction- Reporting under FEMA, 1999.

- **Standard Operating Procedure (SOP) for Untraceable Entities**

  The following SOP has to be followed by designated AD Category-I banks in case of untraceable entities who are found to be in contravention of reporting provisions for ECBs by failing to submit prescribed return(s) under the ECB framework, either physically or electronically, for past eight quarters or more.

Any borrower who has raised ECB will be treated as 'untraceable entity', if entity/auditor(s)/director(s)/ promoter(s) of entity are not reachable/responsive/reply in negative over email/letters/phone for a period of not less than two quarters with documented communication/ reminders numbering 6 or more and it fulfills both of the following conditions:

A. Entity not found to be operative at the registered office address as per records available with the AD Bank or not found to be operative during the visit by the officials of the AD Bank or any other agencies authorised by the AD bank for the purpose;

B. Entities have not submitted Statutory Auditor's Certificate for last two years or more.

Action

The following actions are to be undertaken in respect of 'untraceable entities':

a. File Revised Form ECB, if required, and last Form ECB 2 Return without certification from company with 'UNTRACEABLE ENTITY' written in bold on top. The outstanding amount will be treated as written-off from external debt liability of the country but may be retained by the lender in its books for recovery through judicial/ non-judicial means;

b. No fresh ECB application by the entity should be examined/processed by the AD bank;

c. Directorate of Enforcement should be informed whenever any entity is designated 'UNTRACEABLE ENTITY'; and

d. No inward remittance or debt servicing will be permitted under auto route.

Powers delegated to AD Category I banks to deal with ECB cases

The designated AD Category I banks can approve any requests from the borrowers for changes in respect of ECBs, except for FCCBs/FCEBs, duly ensuring that the changed conditions, including change in name of borrower/lender, transfer of ECB and any other parameters, comply with extant ECB norms and are with the consent of lender(s).

The following changes can be undertaken under automatic route:

- **Change of the AD Category I bank**

  AD Category I bank can be changed subject to obtaining no objection certificate from the existing AD Category I bank.

- **Cancellation of LRN**

  The designated AD Category I banks may directly approach DSIM for cancellation of LRN for ECBs contracted, subject to ensuring that no draw down against the said LRN has taken place and the monthly ECB-2 returns till date in respect of the allotted LRN have been submitted to RBI.

Question: Can ECB raised under the earlier ECB framework be refinanced/ partially refinanced through an ECB raised under extant ECB framework?

Answer: Yes, provided that the borrower continues to be eligible to raise ECB under the extant ECB framework, all-in-cost is lower than the all-in-cost of existing ECB, residual maturity is not reduced and the new ECB is in compliance with the extant ECB framework as well.

- **Refinancing of existing ECB**

  The designated AD Category I bank may allow refinancing of existing ECB by raising fresh ECB provided the outstanding maturity of the original borrowing (weighted outstanding maturity in case of multiple borrowings) is not reduced and all-in-cost of fresh ECB is lower than the all-in-cost (weighted average cost in case of multiple borrowings) of existing ECB. Further, refinancing of ECBs raised under the previous ECB framework may also be permitted, subject to additionally ensuring that the borrower is eligible to raise ECB under the extant framework. Raising of fresh ECB to part refinance the existing ECB is also permitted subject to same conditions. Indian banks are permitted to participate in refinancing of existing ECB, only for highly rated corporates (AAA) and for Maharatna/Navratna public sector undertakings.

- **Conversion of ECB into equity**

  Conversion of ECBs, including those which are matured but unpaid, into equity is permitted subject to the following conditions:

  i. The activity of the borrowing company is covered under the automatic route for FDI or Government approval is received, wherever applicable, for foreign equity participation as per extant FDI policy;

  ii. The conversion, which should be with the lender's consent and without any additional cost, should not result in contravention of eligibility and breach of applicable sector cap on the foreign equity holding under FDI policy;

  iii. Applicable pricing guidelines for shares are complied with;

iv. In case of partial or full conversion of ECB into equity, the reporting to the Reserve Bank will be as under:

a. For partial conversion, the converted portion is to be reported in Form FC-GPR prescribed for reporting of FDI flows, while monthly reporting to RBI in Form ECB 2 Return will be with suitable remarks, viz., “ECB partially converted to equity”.

b. For full conversion, the entire portion is to be reported in Form FC-GPR, while reporting to RBI in Form ECB 2 Return should be done with remarks “ECB fully converted to equity”. Subsequent filing of Form ECB 2 Return is not required.

Question: When ECB is partially converted into equity, should the remaining ECB amount comply with all the ECB guidelines?

Answer: Yes. The part conversion of ECB into equity will be freely permitted only when the part amount remaining as ECB complies with all the applicable ECB norms.

c. For conversion of ECB into equity in phases, reporting through Form FC-GPR and Form ECB 2 Return will also be in phases.

v. If the borrower concerned has availed of other credit facilities from the Indian banking system, including foreign branches/subsidiaries of Indian banks, the applicable prudential guidelines issued by the Department of Banking Regulation of Reserve Bank, including guidelines on restructuring are complied with;

vi. Consent of other lenders, if any, to the same borrower is available or at least information regarding conversions is exchanged with other lenders of the borrower;

vii. For conversion of ECB dues into equity, the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion or any lesser rate can be applied with a mutual agreement with the ECB lender. It may be noted that the fair value of the equity shares to be issued shall be worked out with reference to the date of conversion only.

Security for raising ECB

AD Category I banks are permitted to allow creation/cancellation of charge on immovable assets, movable assets, financial securities and issue of corporate and/or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised/ raised by the borrower, subject to satisfying themselves that:

i. the underlying ECB is in compliance with the extant ECB guidelines,

ii. there exists a security clause in the Loan Agreement requiring the ECB borrower to create/cancel charge, in favour of overseas lender/security trustee, on immovable assets/movable assets/financial securities/issuance of corporate and/or personal guarantee, and

iii. No objection certificate, as applicable, from the existing lenders in India has been obtained in case of creation of charge.

Once the aforesaid stipulations are met, the AD Category I bank may permit creation of charge on immovable assets, movable assets, financial securities and issue of corporate and/or personal guarantees, during the currency of the ECB with security co-terminating with underlying ECB, subject to the following:

i. **Creation of Charge on Immovable Assets:** The arrangement shall be subject to the following:

a. Such security shall be subject to provisions contained in the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2017, as amended from time to time.

b. The permission should not be construed as a permission to acquire immovable asset (property) in India, by the overseas lender/ security trustee.

c. In the event of enforcement / invocation of the charge, the immovable asset/ property will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB.

ii. **Creation of Charge on Movable Assets:** In the event of enforcement/ invocation of the charge, the claim of the lender, whether the lender takes over the movable asset or otherwise, will be restricted to the outstanding claim against the ECB. Encumbered movable assets may also be taken out of the country subject to getting 'No Objection Certificate' from domestic lender/s, if any.

iii. **Creation of Charge over Financial Securities:** The arrangements may be permitted subject to the following:

a. Pledge of shares of the borrowing company held by the promoters as well as in domestic associate companies of the borrower is permitted. Pledge on other financial securities, viz. bonds and debentures, Government Securities, Government Savings Certificates, deposit receipts of securities and units of the Unit Trust of India or of any mutual funds, standing in the name of ECB borrower/promoter, is also permitted.

b. In addition, security interest over all current and future loan assets and all current assets including cash and cash equivalents, including Rupee accounts of the borrower with ADs in India, standing in the name of the borrower/promoter, can be used as security for ECB. The Rupee accounts of the borrower/promoter can also be in the form of escrow arrangement or debt service reserve account.

c. In case of invocation of pledge, transfer of financial securities shall be in accordance with the extant FDI/FII policy including provisions relating to sectoral cap and pricing as applicable read with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017, as amended from time to time.

iv. Issue of Corporate or Personal Guarantee: The arrangement shall be subject to the following:

a. A copy of Board Resolution for the issue of corporate guarantee for the company issuing such guarantee, specifying name of the officials authorised to execute such guarantees on behalf of the company or in individual capacity should be obtained.

b. Specific requests from individuals to issue personal guarantee indicating details of the ECB should be obtained.

c. Such security shall be subject to provisions contained in the Foreign Exchange Management (Guarantees) Regulations, 2000, as amended from time to time.

d. ECB can be credit enhanced / guaranteed / insured by overseas party/ parties only if it/ they fulfil/s the criteria of recognised lender under extant ECB guidelines.

Additional Requirements

While exercising the delegated powers, the AD Category I banks should ensure that:

i. The changes permitted are in conformity with the applicable ceilings / guidelines and the ECB continues to be in compliance with applicable guidelines. It should also be ensured that if the ECB borrower has availed of credit facilities from the Indian banking system, including foreign branches/subsidiaries of Indian banks, any extension of tenure of ECB (whether matured or not) shall be subject to applicable prudential guidelines issued by Department of Banking Regulation of Reserve Bank including guidelines on restructuring.

ii. The changes in the terms and conditions of ECB allowed by the ADs under the powers delegated and / or changes approved by the Reserve Bank should be reported to the DSIM as given at paragraph 6.2 above. Further, these changes should also get reflected in the Form ECB 2 returns appropriately.

Special Dispensations under the ECB Framework

ECB Facility for Oil Marketing Companies

Notwithstanding the provisions contained Public Sector Oil Marketing Companies (OMCs) can raise ECB for working capital purposes with minimum average maturity period of 3 years from all recognized lenders under the automatic route without mandatory hedging and individual limit requirements. The overall ceiling for such ECBs shall be USD 10 billion or equivalent. However, OMCs should have a Board approved forex mark to market procedure and prudent risk management policy, for such ECBs. All other provisions under the ECB framework will be applicable to such ECBs.

ECB Facility for Startups

AD Category-I banks are permitted to allow Startups to raise ECB under the automatic route as per the following framework:

i. **Eligibility**

An entity recognised as a Startup by the Central Government as on date of raising ECB.

ii. **Maturity**

Minimum average maturity period will be 3 years.

iii. **Recognised lender**

Lender / investor shall be a resident of a FATF compliant country. However, foreign branches/subsidiaries of Indian banks and overseas entity in which Indian entity has made overseas direct investment as per the extant Overseas Direct Investment Policy will not be considered as recognized lenders under this framework.

iv. **Forms**

The borrowing can be in form of loans or non-convertible, optionally convertible or partially convertible preference shares.

v. **Currency**

The borrowing should be denominated in any freely convertible currency or in Indian Rupees (INR) or a combination thereof. In case of borrowing in INR, the non-resident lender, should mobilise INR through swaps/ outright sale undertaken through an AD Category-I bank in India.

vi. **Amount**

The borrowing per Startup will be limited to USD 3 million or equivalent per financial year either in INR or any convertible foreign currency or a combination of both.

vii. **All-in-cost**

Shall be mutually agreed between the borrower and the lender.

viii. **End uses**

For any expenditure in connection with the business of the borrower.

ix. Conversion into equity

Conversion into equity is freely permitted subject to Regulations applicable for foreign investment in Startups.

x. Security

The choice of security to be provided to the lender is left to the borrowing entity. Security can be in the nature of movable, immovable, intangible assets (including patents, intellectual property rights), financial securities, etc. and shall comply with foreign direct investment / foreign portfolio investment / or any other norms applicable for foreign lenders / entities holding such securities. Further, issuance of corporate or personal guarantee is allowed. Guarantee issued by a non-resident(s) is allowed only if such parties qualify as lender under ECB for Startups. However, issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by Indian banks, all India Financial Institutions and NBFCs is not permitted.

xi. Hedging

The overseas lender, in case of INR denominated ECB, will be eligible to hedge its INR exposure through permitted derivative products with AD Category - I banks in India. The lender can also access the domestic market through branches/ subsidiaries of Indian banks abroad or branches of foreign bank with Indian presence on a back to back basis.

Note: Startups raising ECB in foreign currency, whether having natural hedge or not, are exposed to currency risk due to exchange rate movements and hence are advised to ensure that they have an appropriate risk management policy to manage potential risk arising out of ECBs.

xii. Conversion rate

In case of borrowing in INR, the foreign currency - INR conversion will be at the market rate as on the date of agreement.

xiii. Other Provisions

Other provisions like parking of ECB proceeds, reporting arrangements, powers delegated to AD banks, borrowing by entities under investigation, conversion of ECB into equity will be as included in the ECB framework. However, provisions on leverage ratio and ECB liability: Equity ratio will not be applicable.

Further, the Start-ups as defined above as well as other start-ups which do not comply with the aforesaid definition but are eligible to receive FDI, can also raise ECB under the general ECB route/framework.

DEPOSITORY RECEIPTS

A Depository Receipt (DR) is a negotiable financial instrument issued by a company in a foreign jurisdiction. They represent certain securities like bonds, shares etc. DR is an important mechanism for raising funds by tapping foreign investors who otherwise may not be able to participate in the domestic market.

In India, any company, whether listed or unlisted are capable of issuing DRs. The issue of DRs is regulated by Ministry of Finance and by the Depository Receipts Scheme, 2014. Depending upon the location in which DRs are issued, they are called as American Depository Receipt ("ADR") or in general as Global Depository Receipts (GDRs).

Depository Receipts are generally classified as under:

Sponsored

A sponsored issue of depository receipts is based on a stock agreement, between the foreign depository and the issuer of securities for the creation of the depository receipts. The sponsored depository receipts can be further classified as:

a) **Capital Raising:** The Indian issuer deposits the freshly issued securities with the domestic custodian. On the basis of such deposit, the foreign depository then creates/issues depository receipts abroad for sale to global investors. This constitutes a capital raising exercise, as the proceeds of the sale of depository receipts eventually go to the Indian issuer.

b) **Non-Capital Raising:** In a non-capital raising issue, no fresh underlying securities are issued. Rather, the issuer gets holders of its existing securities to deposit these securities with a domestic custodian, so that depository receipts can be issued abroad by the foreign depository. This is not a capital raising exercise for the Indian issuer, as the proceeds from the sale of the depository receipts go to the holders of underlying securities.

Unsponsored

Where there is no stock agreement between the foreign depository and the Indian issuer, any person, without any involvement of the issuer, may deposit the securities with a domestic custodian in India. A foreign depository then issues depository receipts abroad on the back of such deposited underlying securities. The proceeds from the sale of such depository receipts go to the holders of the underlying securities. Based on whether a depository receipt is traded in an organised market or in the Over the Counter ("OTC") market, the depository receipts can be classified as listed or unlisted.

a) **Listed:** Listed depository receipts are traded on stock exchanges.

b) **Unlisted:** The unlisted depository receipts are those which are inter-traded between parties and where such depository receipts are not listed on any stock exchanges.

DEPOSITORY RECEIPTS SCHEME, 2014

Depository Receipts Scheme 2014

The issuance of depository receipt is one of the mechanisms used by Indian companies to get an access to foreign investors. In simple terms, a depository receipt is a foreign currency denominated instrument which is issued by an overseas depository to non-residents against securities of the Indian company.

Hitherto, instruments issued by Indian companies to tap global capital markets, viz. American depository receipts (ADRs) or global depository receipts (GDRs) or convertible debt instruments in the form of foreign currency convertible bonds (FCCBs) were governed by the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipts Mechanism) Scheme, 1993, which had been amended from time to time.

The DR Scheme is based on the recommendations of the Sahoo Committee, which under the chairmanship of Mr. M.S. Sahoo undertook a comprehensive review of the 1993 Scheme and proposed significant deregulation and rationalisation of the manner in which Indian companies could tap global capital markets.

On October 21, 2014, the Ministry of Finance ("MoF") notified ("Notification"), the Depository Receipts Scheme, 2014 ("DR Scheme") by virtue of which issuance of DRs has been taken out of the 1993 Scheme and is now regulated by the DR Scheme. The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 stands repealed to the extent that it applies to Depository Receipts ('DRs'). It will, however, continue to apply to FCCBs. The DR Scheme came into effect from December 15, 2014.

DEFINITIONS

'Permissible Jurisdiction' as means a jurisdiction which is a member of the Financial Action Task Force on Money Laundering and the regulator of the securities market in that jurisdiction is a member of the International Organization of Securities Commission. Schedule I of the scheme provides the list of permissible jurisdictions.

The Ministry of Finance vide its notification dated October 7, 2019 amended the definition of 'permissible jurisdiction', inter alia, to include the International Financial Services Centre in India.

'Permissible securities' mean 'securities' as defined under section 2(h) of the Securities Contracts (Regulation) Act, 1956 and include similar instruments issued by private companies which:

(i) may be acquired by a person resident outside India under the Foreign Exchange Management Act, 1999: and

(ii) is in dematerialised form.

'Right to issue voting instruction' means the right of a depository receipt holder to direct the foreign depository to vote in a particular manner on its behalf in respect of permissible securities.

Eligibility for Issue of Depository Receipts

Clause 3 of the scheme describes the eligibility of issue of depository receipts.

1. The following persons are eligible to issue or transfer permissible transactions to a foreign depository for the issue of depository receipts:

   - Any Indian company, listed or unlisted, private or public;
   - Any other issuer of permissible securities;
   - Any person holding permissible securities;

   which has not been specifically prohibited from accessing the capital market or dealing in securities.

2. Unsponsored depository receipts on the back of the listed permissible securities can be issued only if such depository receipts gave the holder the right to issue voting instruction and are listed on an international exchange.

Issue of Depository Receipts

- A foreign depository may issue depository receipts by way of a public offering or private placement or in any other manner prevalent in a permissible jurisdiction.
- An issuer may issue permissible securities to a foreign depository for the purpose of issue of depository receipts by any mode permissible for issue of such permissible securities to investors.
- The holders of permissible securities may transfer permissible securities to a foreign depository for the purpose of the issue of depository receipt, with or without the approval of issue of such permissible securities through transactions on a recognized stock exchange, bilateral transactions or by tendering through a public platform.

Limits

- The aggregate of permissible securities which may be issued or transferred to foreign depositories for issue of depository receipts, along with permissible securities already held by persons resident outside India shall not exceed the limit on foreign holding of such permissible securities under the FEMA, 1999.

> **Example**: Foreign investment in a company is ordinarily permissible up to x%. However, it can be increased up to y% with the approval of the company in the general body meeting. If no such approval has been granted, the permissible securities on which depository receipts may be issued, whether sponsored or unsponsored, cannot exceed x%.

- The depository receipts may be converted to underlying permissible securities and vice versa subject to the limit mentioned above.

Pricing

The permissible securities shall not be issued to a foreign depository for the purpose of issuing depository receipts at a price less than the price applicable to a corresponding mode of issue of such securities to domestic investors under the applicable laws.

> ***Explanation***
>
> 1. A company listed or proposed to be listed on a recognized stock exchange shall not issue equity shares on preferential allotment to a foreign depository for the purpose of issue of depository receipts at a price less than the price applicable to preferential allotment of equity shares of the same class to investors under the ICDR.
> 2. Likewise, where a listed company makes a qualified institutional placement of permissible securities to a foreign depository for the purpose of issue of depository receipts, the minimum pricing norms for such placement as applicable under the SEBI (ICDR) Regulations, 2018 shall be complied with.

> ***Example:*** XYZ Limited, a listed company makes a Qualified Institution Placement of shares and the Floor price comes at Rs. 60 per share after complying with pricing norms of ICDR Regulations. NOW, if same class of shares is being issued to foreign depository for the purpose of issuing DRs, price cannot be less than Rs.60 and minimum price regulation of SEBI (ICDR) Regulations, 2018 shall be complied with.

Rights and Duties

The following are the rights and duties for the foreign depository:

1. The foreign depository shall be entitled to exercise voting rights, if any, associated with the permissible securities whether pursuant to voting instruction from the holder of depository receipts or otherwise;
2. The shares of a company underlying the depository receipts shall form part of the public shareholding of the company under Securities Contracts (Regulation) Rules, 1957, if:
   a) the holder of such depository receipts has the right to issue voting instruction; and
   b) such depository receipts are listed on an international exchange.
3. In the cases not covered under second point, shares of the company underlying depository receipts shall not be included in the total shareholding and in the public shareholding for the purpose of computing the public shareholding of the company;

4. A holder of depository receipts issued on the back of equity shares of a company shall have the same obligations as if it is the holder of the underlying equity shares, if it has the right to issue voting instruction.

Obligations

Clause 8 of the scheme imposes certain obligations on the domestic custodian as under:

- to ensure that the relevant provisions of the scheme related to the issue and cancellation of depository receipts is complied with;
- to maintain records in respect of, and report to, Indian depositories all transactions in the nature of issue and cancellation of depository receipts for the purpose of monitoring limits under the FEMA, 1999;
- to provide the information and data as may be called upon by SEBI, the RBI, Ministry of Finance; Ministry of Corporate Affairs and any other authority of law; and
- to file with SEBI a copy of the document by whatever name called, which sets the terms of issue of depository receipts issued on the back of securities, as defined under Section 2(h) of SCRA, 1956, in a permissible jurisdiction. (This is with respect to securities, and not permissible securities).

The following are the obligations imposed on the Indian Depositories that-

- they shall co-ordinate among themselves;
- they shall disseminate the outstanding permissible securities against which the depository receipts are outstanding; and
- they shall disseminate the limit up to which permissible securities can be converted to depository receipts.

A person issuing or transferring permissible securities to a foreign depository for the purpose of the issue of depository receipts shall comply with relevant provisions of the Indian law, including the scheme, related to the issue and cancellation of depository receipts.

Approval

Any approval necessary for issue or transfer of permissible securities to a person resident outside India shall apply to the issue or transfer of such permissible securities to a foreign depository for the purpose of issue of depository receipts. No approval is required if the issue of depository receipt is in accordance with the scheme.

Issue of FCCBs and Depository Receipts (DRs)

The inward remittance received by the Indian Company vide issuance of DRs and FCCBs are treated as FDI and counted towards FDI.

1. FCCBs/DRs may be issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and DR Scheme 2014 respectively, as per the guidelines issued by the Government of India thereunder from time to time.
2. DRs are foreign currency denominated instruments issued by a foreign Depository in a permissible jurisdiction against a pool of permissible securities issued or transferred to that foreign depository and deposited with a domestic custodian.
3. In terms of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 as amended from time to time, a person will be eligible to issue or transfer eligible securities to a foreign depository, for the

purpose of converting the securities so purchased into depository receipts in terms of Depository Receipts Scheme, 2014 and guidelines issued by the Government of India thereunder from time to time.

4. A person can issue DRs, if it is eligible to issue eligible instruments to person resident outside India under relevant Schedules under Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 as amended from time to time.
5. The aggregate of eligible securities which may be issued or transferred to foreign depositories, along with eligible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible securities under the relevant regulations framed under FEMA, 1999.
6. The pricing of eligible securities to be issued or transferred to a foreign depository for the purpose of issuing depository receipts should not be at a price less than the price applicable to a corresponding mode of issue or transfer of such securities to domestic investors under the relevant regulations framed under FEMA, 1999.
7. The issue of depository receipts as per DR Scheme 2014 shall be reported to the Reserve Bank of India by the domestic custodian as per the reporting guidelines for DR Scheme 2014.

AMERICAN DEPOSITORY RECEIPTS (ADR) & GLOBAL DEPOSITORY RECEIPTS (GDR)

Typically, companies in India issue securities in the form of depository receipts (DR) viz American Depository Receipts (ADR), Global Depository Receipts (GDR) or Foreign Currency Convertible Bonds (FCCB). While ADR and GDR are equity instruments, FCCB is a convertible debt instrument.

The DR Scheme 2014 is solely applicable to ADR and GDR. The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 continues to govern FCCB.

Regulation 2(c) of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 defines ADR as under:

"American Depository Receipt (ADR)" means a security issued by a bank or a depository in United States of America (USA) against underlying rupee shares of a company incorporated in India."

Regulation 2(i) of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004, defines GDR as under:

"Global Depository Receipt (GDR)" means a security issued by a bank or a depository outside India against underlying rupee shares of a company incorporated in India.

Difference between American Depository Receipts (ADR) and Global Depository Receipts (GDR)

- ADR are US $ denominated and traded only in US.
- GDRs are traded in various places such as New York Stock Exchange, London Stock Exchange, etc.

Sponsored ADR/GDR Issue

An Indian company can also sponsor an issue of ADR / GDR. Under this mechanism, the company offers its resident shareholders a choice to submit their shares back to the company so that on the basis of such shares, ADRs / GDRs can be issued abroad. The proceeds of the ADR / GDR issue are remitted back to India and distributed among the resident investors who had offered their Rupee denominated shares for conversion. These proceeds can be kept in Resident Foreign Currency (Domestic) accounts in India by the resident shareholders who have tendered such shares for conversion into ADRs / GDRs.

Two-Way Fungibility Scheme

A limited two-way Fungibility scheme has been put in place by the Government of India for ADRs / GDRs. Under this Scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs / GDRs would be permitted to the extent of ADRs / GDRs which have been redeemed into underlying shares and sold in the Indian market.

CONCEPTS ONE SHOULD KNOW

One way fungibility - Here investors could cancel their depository receipt and recover the proceeds by selling the underlying shares in the Indian market; DRs once redeemed could not be converted into shares.

Two way fungibility - It means that the shares so released can be reconverted by the company into DRs for purchase by the overseas investors. It implies that the re-issuance of DRs would be permitted to the extent of DRs that have been redeemed and underlying shares are sold in domestic market.

Sponsor - It is a process of disinvestment by the Indian shareholders of their holding in overseas market.

Provisions under the Companies Act, 2013

The Companies Act, 2013 has laid down provisions for issue of GDRs under Section 41 and prescribed the Companies (Issue of Global Depository Receipts) Rules, 2014.

According to Section 2(44) of Companies Act, 2013, "Global Depository Receipt" means any instrument in the form of a depository receipt, by whatever name called, created by a foreign depository outside India and authorised by a company making an issue of such depository receipts.

Section 41 provides that a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country in such manner, and subject to such conditions, as may be prescribed.

Companies (Issue of Global Depository Receipts) Rules, 2014

Eligibility to issue depository receipts

Rule 3 lays down that a company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

Conditions for issue of depository receipts

Rule 4 lays down the following conditions to be fulfilled by a company for issue of depository receipts:

- The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorising the company to do so.
- The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting. However, a special resolution passed under section 62 of Companies Act, 2013 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for the purpose of section 41 of Companies Act, 2013 as well.
- The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.
- The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

- The company shall appoint a merchant banker or a practising chartered accountant or a practising cost accountant or a **practising company secretary** to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practising chartered accountant or practising cost accountant or **practising company secretary**, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts.

However, that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

Manner and form of depository receipts

Rule 5 deals with the manner and form of issue of depository receipts.

- The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent in the concerned jurisdiction and may be listed or traded on the listing platform in the concerned jurisdiction.
- The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.
- The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank.

Voting rights

Rule 6 provides the provisions for voting rights of depository receipts holder.

- A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.
- Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

Proceeds of Issue

Rule 7 provides that the proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

However, the proceeds of issue of depository receipts may be remitted in an International Financial Services Centre Banking Unit (IBU) and utilized in accordance with the instructions issued by Reserve Bank of India from time to time.

Non-applicability of certain provisions of the Act

(1) The provisions of the Act and any rules issued thereunder insofar as they relate to public issue of shares or debentures shall not apply to issue of depository receipts.

(2) The offer document, by whatever name called and if prepared for the issue of depository receipts, shall not be treated as a prospectus or an offer document within the meaning of this Act and all the provisions as applicable to a prospectus or an offer document shall not apply to a depository receipts offer document.

(3) Notwithstanding anything contained under section 88 of the Companies Act, 2013, until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members of the Company.

Reporting of FCCB/ADR/GDR Issues

The Indian company issuing ADRs / GDRs has to furnish to the Reserve Bank, full details of such issue in the Form- DR (Return to be filed by an Indian Company who has arranged issue of GDR/ADR), within 30 days from the date of closing of the issue. The company should also furnish a quarterly return in the Form DR - Quarterly, to the Reserve Bank within 15 days of the close of the calendar quarter. The quarterly return has to be submitted till the entire amount raised through ADR/GDR mechanism is either repatriated to India or utilized abroad as per the extant Reserve Bank guidelines.

PROCEDURE FOR ISSUANCE OF ADRs/GDRs

A. Approvals Required

The issue of ADRs/GDRs requires the approval of a Board of Directors, shareholders, "In principle and Final" approval of Ministry of Finance, approval of Reserve Bank of India, In-principle consent of Stock Exchange for listing of underlying shares and In-principle consent of Financial institutions.

Approval of Board of Directors

A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro Capital market. A board resolution is to be passed to approve the raising of finance by issue of GDRs/FCCBs. The resolution should indicate therein specific purposes for which funds are required, quantum of the issue, country in which issue is to be launched, time of the issue etc. A director/Sub- Committee of Board of Directors is also to be authorised for seeking Government approval in connection with Euro issue and signing agreements with depository, organising road shows for fixation of price of GDRs. The Board meeting shall also decide and approve the notice of Extraordinary general meeting of shareholders at which special resolution is to be considered.

Approval of Shareholders

Proposal for making Euro issue, as proposed by Board of Directors require approval of shareholders. A special resolution under Section 62 of the Companies Act, 2013 is required to be passed at a duly convened general meeting of the shareholders of the company.

Approval of Ministry of Finance - "In Principle and Final"

With respect to ADR/GDR, guidelines issued on the subject dated 19-1-2000 brought ADR/GDR under the automatic route and therefore the requirement of obtaining approval of Ministry of Finance, Department of Economic Affairs has been dispersed with.

Further, private placement of ADR/GDR will also not require prior approval provided the issue is managed by investment banker.

In-Principle Consent of Stock Exchanges for Listing of Underlying Shares

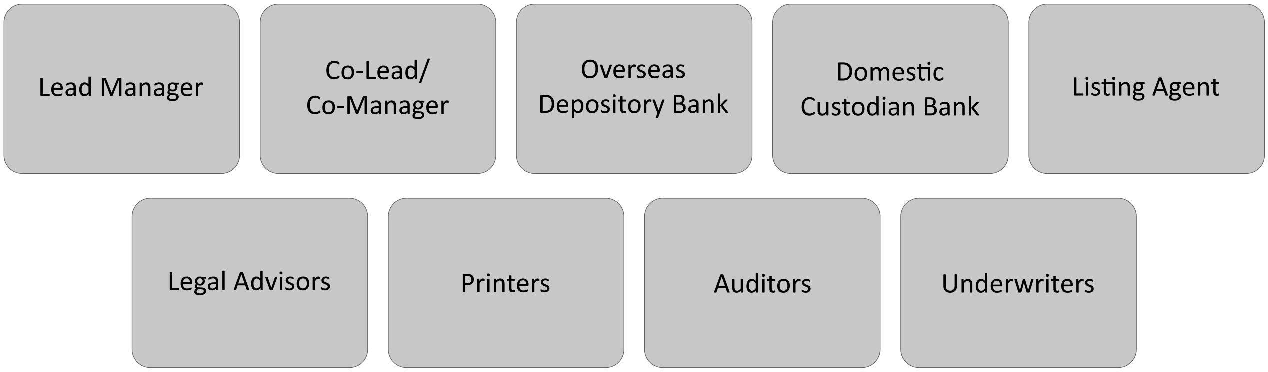
The issuing company has to make a request to the domestic stock exchange for in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian stock exchanges like any other equity shares.

In-Principle Consent of Financial Institutions

Where term loans have been obtained by the company from the financial institutions, the agreement relating to the loan contains a stipulation that the consent of the financial institution has to be obtained. The company must obtain in-principle consent on the broad terms of the proposed issue.

B. Appointment of Intermediaries

The following agencies are normally involved in the Euro issue:



- **Lead Manager**

  The company has to choose a competent lead manager to structure the issue and arrange for the marketing. Lead managers usually charge a fee as a percent of the issue. The issues related to public or private placement, nature of investment, coupon rate on bonds and conversion price are to be decided in consultation with the lead manager.

- **Co-Lead/Co-Manager**

  In consultation with the lead manager, the company has to appoint co-lead/co-manager to coordinate with the issuing company/lead manager to make the smooth launching of the Euro issue.

- **Overseas Depository Bank**

  It is the bank which is authorised by the issuing company to issue Depository Receipts against issue of ordinary shares or Foreign Currency Convertible Bonds of issuing company.

- **Domestic Custodian Bank**

  A banking company which acts as custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian company, which are issued by it. The function of the domestic custodian bank is to co-ordinate with the depository bank. When the shares are issued by a company the same are registered in the name of depository and physical possession is handed over to the custodian. The beneficial interest in respect of such shares, however, rests with the investors.

- **Listing Agent**

  One of the conditions of Euro-issue is that it should be listed at one or more Overseas Stock Exchanges. The appointment of listing agent is necessary to coordinate with issuing company for listing the securities on Overseas Stock Exchanges.

- **Legal Advisors**

  The issuing company should appoint legal advisors who will guide the company and the lead manager to prepare offer document, depository agreement, indemnity agreement and subscription agreement.

- **Printers**

  The issuing company should appoint printers of international repute for printing Offer Circular.

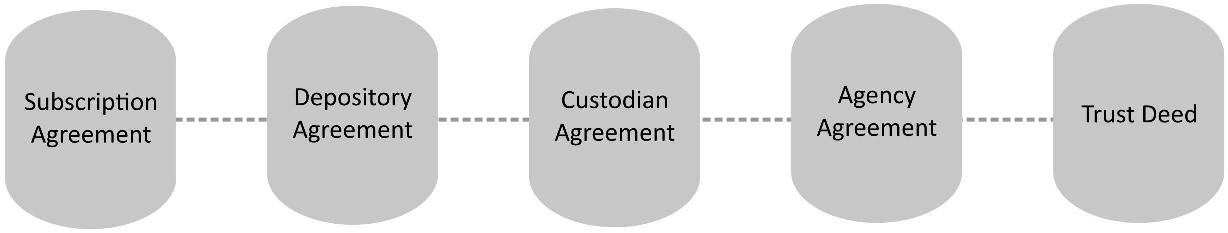
- **Auditors**

  The role of issuer company's auditors is to prepare the auditors report for inclusion in the offer document, provide requisite comfort letters and reconciliation of the issuer company's accounts between Indian GAAP/UK GAAP/US- GAAP and significant differences between Indian GAAP/UK GAAP/US-GAAP.

- **Underwriters**

  It is desirable to get the Euro issue underwritten by banks and syndicates. Usually, the underwriters subscribe for a portion of the issue with arrangements for tie-up for the balance with their clients. In addition, they will interact with the influential investors and assist the lead manager to complete the issue successfully.

C. Principal Documentation



i. Subscription Agreement

Subscription Agreement provides that Lead Managers and other managers agree, severally and not jointly, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the offering price set forth. It may provide that obligations of managers are subject to certain conditions precedent.

Subscription agreement may also provide that for certain period from the date of the issuance of GDR the issuing company will not (a) authorise the issuance of, or otherwise issue or publicly announce any intention to issue; (b) issue offer, accept subscription for, sell, contract to sell or otherwise dispose off, whether within or outside India; or (c) deposit into any depository receipt facility, any securities of the company of the same class as the GDRs or the shares or any securities in the company convertible or exchangeable for securities in the company of the same class as the GDRs or the shares or other instruments representing interests in securities in the company of the same class as the GDRs or the shares.

Subscription agreement also provides, an option to be exercisable within certain period after the date of offer circular, to the lead manager and other managers to purchase upto a certain prescribed number of additional GDRs solely to cover over-allotments, if any.

ii. Depository Agreement

Depository Agreement lays down the detailed arrangements entered into by the company with the Depository, the forms and terms of the depository receipts which are represented by the deposited shares. It also sets forth the rights and duties of the depository in respect of the deposited shares and all other securities, cash and other property received subsequently in respect of such deposited shares. Holders of GDRs are not parties to deposit agreement and thus have no contractual rights against or obligations to the company.

The depository is under no duty to enforce any of the provisions of the deposit agreement on behalf of any holder or any other person. Holder means the person or persons registered in the books of the depository maintained for such purpose as holders. They are deemed to have notice of, be bound by and hold their rights subject to all of the provisions of the deposit agreement applicable to them. They may be required to file from time to time with depository or its nominee proof of citizenship, residence, exchange control approval, payment of all applicable taxes or other governmental charges, compliance with all applicable laws and regulations and terms of deposit agreement, or legal or beneficial ownership and nature of such interest and such other information as the depository may deem necessary or proper to enable it to perform its obligations under Deposit Agreement.

The company may agree in the deposit agreement to indemnify the depository, the custodian and certain of their respective affiliates against any loss, liability, tax or expense of any kind which may arise out of or in connection with any offer, issuance, sale, resale, transfer, deposit or withdrawal of GDRs, or any offering document. Copies of deposit agreement are to be kept at the principal office of Depository and the Depository is required to make available for inspection during its normal business hours, the copies of deposit agreement and any notices, reports or communications received from the company.

iii. Custodian Agreement

Custodian works in co-ordination with the depository and has to observe all obligations imposed on it including those mentioned in the depository agreement. The custodian is responsible solely to the depository. In the case of the depository and the custodian being same legal entity, references to them separately in the depository agreement or otherwise may be made for convenience and the legal entity will be responsible for discharging both functions directly to the holders and the company. Whenever the depository in its discretion determines that it is in the best interests of the holders to do so, it may, after prior consultation with the company terminate, the appointment of the custodian and in such an event the depository shall promptly appoint a successor custodian, which shall, upon acceptance of such appointment, become the custodian under the depository agreement. The depository shall notify holders of such change promptly. Any successor custodian so appointed shall agree to observe all the obligations imposed on him.

iv. Agency Agreement

In case of FCCBs, the company has to enter into an agency agreement with certain persons known as conversion agents. In terms of this agreement, these agents are required to make the principal and interest payments to the holders of FCCBs from the funds provided by the company. They will also liaise with the company at the time of conversion/redemption option to be exercised by the investor at maturity.

v. Trust Deed

In respect of FCCBs the company enters into a Covenant (known as Trust Deed) with the Trustee for the holders of FCCBs, guaranteeing payment of principal and interest amount on such FCCBs and to comply with the obligations in respect of such FCCBs.

D. Pre and Post Launch – Additional Key Actions

Apart from obtaining necessary approvals, appointment of various agencies and proper documentation, the following additional key actions are necessary for making the Euro-issue a success.

(i) Constitution of a Board Sub-Committee; (ii) Selection of Syndicate Members; (iii) Constitution of a task force for due diligence; (iv) Listing; (v) Offering Circular; (vi) Research papers; (vii) Pre-marketing; (viii) Timing, pricing and size of the issue; (ix) Roadshows; (x) Book building and pricing of the issue; (xi) Closing of the issue; (xii) Allotment; (xiii) Investor Relation Programme; and (xiv) Quarterly Statement.

a. Constitution of a Board Sub-Committee

To launch a Euro-issue, the issuing company has to take a large number of decisions in time. These decisions normally fall within the power of Board of Directors. It is usually difficult to call Board Meetings frequently and to ensure presence of adequate Board Members. Thus, it is normally advisable to constitute a sub-committee of the Board with full delegation of powers with regard to Euro-issue. The delegation of powers to the Board sub- committee should normally include the following:

- Appointment of agencies;
- Authority to make applications for seeking various approvals;
- Authority to finalise and execute documents and agreements;
- Decisions about the timing, size and pricing of the issue; and
- Allotment of shares.

b. Selection of Syndicate Members

The success of any Euro-issue depends upon the well planned and coordinated efforts of the syndicate members and the company. The selection of the Syndicate members should be made depending upon the strength and capabilities of each member in different areas of specialisation such as marketing, financial research, distribution etc. The lead manager may be entrusted with the work of selection of syndicate members. The lead manager while selecting the above members, in addition to their strength and capability, should also evaluate their standing, image, reputation, infrastructure, past experience in handling Indian Euro-issue, etc.

c. Constitution of a task force for due diligence

The due diligence is a process in which a team consisting of legal, technical and financial experts of the lead manager meets top executives of the company and visits the sites of the company in order to understand the strengths, weaknesses, problems and opportunities of the company. The team also studies and analyses the balance sheet of the company and its subsidiaries, its financial arrangement with the group, investment pattern and also the future prospects of the company. It also scrutinize the minutes of the company, various arrangements entered into by the company with regard to marketing, purchase, technology, ancillary units, employment, etc. and analyse the impact of litigations on the profitability of the company.

The purpose of above exercise is to draft the offering circular (prospectus) and work out marketing strategies for the Euro-issue.

d. Listing

One of the conditions of Euro-issues is that the securities are to be listed on one or more Overseas Stock Exchanges. The issuing company has to fulfill all the requirements particularly disclosure and documentation as prescribed by the Overseas Stock Exchanges. The company shall take the help of the listing agent in getting its Euro-issue instruments listed on the Overseas Stock Exchanges.

The issuing company shall prepare the requisite documents as prescribed by the Overseas Stock exchange authorities and submit the same along with application to it after scrutinizing the application and obtain the formal listing approval shall be issued by the Overseas Stock Exchange.

The underlying shares against GDRs are to be listed on one or more Indian Stock Exchange(s) on which the company's existing shares are already listed. For this purpose, the company has to apply to the stock exchange authorities to get the shares represented by GDRs listed on the Indian Stock Exchanges. Trading of such shares on Indian Stock Exchange(s) will not commence until the period specified in the guidelines after the date of issue of the GDRs.

E. Offering Circular

Offering Circular is a mirror through which the prospective investors can access vital information regarding the company in order to form their investment strategies.

It is to be prepared very carefully giving true and complete information regarding the financial strength of the company, its past performance, past and envisaged research and business promotion activities, track record of promoters and the company, ability to trade the securities on Euro capital market.

The Offering Circular should be very comprehensive to take care of overall interests of the prospective investor. The Offering Circular for Euro-issue offering should typically cover the following contents:

- Background of the company and its promoters including date of incorporation and objects, past performance, production, sales and distribution network, future plans, etc.
- Capital structure of the company-existing, proposed and consolidated.
- Deployment of issue proceeds.
- Financial data indicating track record of consistent profitability of the company.
- Group investments and their performance including subsidiaries, joint venture in India and abroad.
- Investment considerations.
- Description of shares.
- Terms and conditions of global depository receipt and any other instrument issued along with it.
- Economic and regulatory policies of the Government of India.
- Details of Indian securities market indicating stock exchange, listing requirements, foreign investments in Indian securities.
- Market price of securities.
- Dividend and capitalisation.
- Securities regulations and exchange control.
- Tax aspects indicating analysis of tax consequences under Indian law of acquisition, membership and sale of shares, treatment of capital gains tax, etc.
- Status of approvals required to be obtained from Government of India.
- Summary of significant differences in Indian GAAP, UK GAAP and US GAAP and expert's opinion.
- Report of statutory auditor.
- Subscription and sale.
- Transfer restrictions in respect of instruments.

- Legal matters etc.
- Other general information not forming part of any of the above.

A copy of the Offering Circular is required to be sent to the Registrar of Companies, SEBI and the Indian Stock Exchanges for record purposes.

F. Research Papers

Research analysts team of lead manager/co-lead manager prepares research papers on the company before the issue. These papers are very important marketing tools as the international investors normally depend a lot on the information provided by the research analysts for making investment decisions.

G. Pre-marketing

Pre-marketing exercise is a tool through which the syndicate members evaluate the prospects of the issue. This is normally done closer to the issue. The research analysts along with the sales force of the syndicate members meet the prospective investors during pre-marketing roadshows. This enables the syndicate members to understand the market and the probable response from the prospective investors. The pre-marketing exercise helps in assessing the depth of investors' interest in the proposed issue, their view about the valuation of the share and the geographical locations of the investors who are interested in the issue. The response received during pre-marketing provides vital information for taking important decisions relating to timing, pricing and size of the issue. This would also help the syndicate members in evolving strategies for marketing the issue.

H. Timing, pricing and size of the Issue

After pre-marketing exercise, the important decisions of timing, pricing and size of the issue are taken. The proper time of launching the issue is when the fundamentals of the company and the industry are strong and the market price of the shares are performing well at Indian Stock Exchanges. The timing should also not clash with some other major issues of the Indian as well as other country companies. The decision regarding the size of issue is inversely linked with the pricing i.e. larger the size, the comparatively lower the price or vice-versa.

I. Roadshows

Roadshows represent meetings of issuers, analysts and potential investors. Details about the company are presented

in the roadshows and such details usually include the following information about the company making the issue:

- History
- Organisational structure
- Principal objects
- Business lines
- Position of the company in Indian and international market

During road shows, the investors give indication of their willingness to buy a particular quantity at particular terms. Their willingness is booked as orders by the marketing force of lead manager and co-lead manager. This process is known as book building.

- Past performance of the company

- Future plans of the company
- Competition - domestic as well as foreign
- Financial results and operating performance
- Valuation of shares
- Review of Indian stock market and economic situations.

Thus at road shows, series of information presentations are organised in selected cities around the world with analysts and potential institutional investors. It is, in fact, a conference by the issuer with the prospective investors.

Road show is arranged by the lead manager by sending invitation to all prospective investors.

J. Book building and pricing of the Issue

Price is a very critical element in the market mix of any product or service. This is more so in case of financial assets like stocks and bonds and specially in case of Euro issues. The market price abroad has a strong correlation to the near future earnings potential, fundamentals governing industry and the basic economic state of the country. Several other factors like prevalent practices, investor sentiment, behaviour towards issues of a particular country, domestic market process etc., are also considered in determination of issue price. Other factors such as the credit rating of the country, interest rate and the availability of an exit route are important.

K. Closing of the Issue and Allotment

Closing is essentially an activity confirming completion of all legal documentation and formalities based on which the company issues the share certificate to the depository and deposits the same with the domestic custodian. Once the issue is closed and all legal formalities are over, the allotment is finalised. Thereafter, the company issues shares in favour of the Overseas Depository Bank and deposits the same with the domestic custodian for custody. The particulars of the Overseas Depository Bank are required to be entered into the Register of Members of the company.

L. Investor Relation Programme

The international investors expect that the issuing company maintains contact with them after the issue. These investors always like to be informed by the company about the latest developments, the performance of the company, the factors affecting performance and the company's plans. It is, therefore, essential for the GDR issuing company to set up an investor relation programme. Good investor relation ensures goodwill towards the company and it would help the company in future fund raising efforts.

FOREIGN CURRENCY CONVERTIBLE BONDS (FCCB)

Foreign Currency Convertible Bonds (FCCBs) are optionally convertible bonds issued in a currency other than Indian Rupees. A convertible bond is a mix between a debt and equity instruments. It acts like a bond by making regular coupon and principal payments, but these bonds also give the bondholders the option to convert the bond into shares at the expiry the term of the Bond.

The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company. Interest and redemption price (if conversion option is not exercised) is payable in dollars. FCCBs shall be denominated in any freely convertible Foreign Currency. However, it must be kept in mind that FCCB issue proceeds need to conform to ECB end use requirements.

Apart from the policy of ECB, issue of FCCB is also required to adhere to FEMA Regulations and in accordance with the scheme viz., "Issue of Foreign Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

Foreign investors also prefer FCCBs because of the dollar denominated servicing, the conversion option and, the arbitrage opportunities presented by conversion of the FCCBs into equity at a discount on prevailing Indian market price.

In addition, 25% of the FCCB proceeds can be used for general corporate restructuring.

The major drawbacks of FCCBs are that the issuing company cannot plan its capital structure as it is not assured of conversion of FCCBs. Moreover, the projections for cash outflow at the time of maturity cannot be made.

Difference between Foreign Currency Convertible Bonds (FCCBs) and Global Depository Receipts (GDR)

- FCCB is a type of Eurobond which can be exchanged for equity shares at some later date after issue of the Bond.
- GDR is a negotiable instrument in the form of depository receipts or certificate created by the overseas depository bank outside India and issued to non-resident investor against the issue of ordinary shares of Foreign currency convertible bonds of the issuing company.

Benefits to the Issuer Company

- Being Hybrid instrument, the coupon rate on FCCB is particularly lower than pure debt instrument there by reducing the debt financing cost.
- FCCBs are book value accretive on conversion. It saves risks of immediate equity dilution as in the case of public shares. Unlike debt, FCCB does not require any rating nor any covenant like securities, cover etc.
- It can be raised within a month while pure debt takes a longer period to raise. Because the coupon is low and usually payable at the time of redeeming the instrument, the cost of withholding tax is also lower for FCCBs compared with other ECB instruments.

Benefits to the Investor

- It has advantage of both equity and debt.
- It gives the investor much of the upside of investment in equity, and the debt portion protects the downside.
- Assured return on bond in the form of fixed coupon rate payments.
- Ability to take advantage of price appreciation in the stock by means of warrants attached to the bonds, which are activated when price of a stock reaches a certain point.
- Significant Yield to maturity (YTM) is guaranteed at maturity.
- Lower tax liability as compared to pure debt instruments due to lower coupon rate.

FCCB AND ORDINARY SHARES (THROUGH DEPOSITORY RECEIPT MECHANISM) SCHEME, 1993

FCCBs are governed by the 'Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depositary Receipt Mechanism) Scheme, 1993' as amended from time to time and Notification FEMA No.120/RB-2004 dated July 7, 2004.

The issuance of FCCBs was brought under the ECB guidelines in August 2005. In addition to the requirements of:

(i) having the maturity of the FCCB not less than 5 years,

(ii) the call & put option, if any, shall not be exercisable prior to 5 years,

(iii) issuance of FCCBs only without any warrants attached,

(iv) the issue related expenses not exceeding 4% of issue size and in case of private placement, shall not exceed 2% of the issue size, etc.

as required in terms of Notification FEMA No. 120/RB-2004 dated July 7, 2004, FCCBs are also subject to all the regulations which are applicable to ECBs.

Important Definitions under the Scheme, 1993	
Domestic Custodian Bank	It means a banking company which acts as a custodian for the ordinary shares or Foreign Currency Convertible Bonds of an Indian Company which are issued by it against Global Depository Receipts or certificates.
Foreign Currency Convertible Bonds	It means bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments.
Issuing Company	It means an Indian Company permitted to issue Foreign Currency Convertible Bonds or ordinary shares of that company against Global Depository Receipts.
Overseas Depository Bank	It means a bank authorised by the issuing company to issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.
Redemption and Restructuring of FCCBs	
Redemption of FCCBs	Keeping in view the need to provide a window to facilitate refinancing of FCCBs by the Indian companies which may be facing difficulty in meeting the redemption obligations, Designated AD Category - I banks have been permitted to allow Indian companies to refinance the outstanding FCCBs, under the automatic route, subject to compliance with the terms and conditions set out hereunder: ➢ Fresh ECBs/ FCCBs shall be raised with the stipulated average maturity period and applicable all-in- cost being as per the extant ECB guidelines; ➢ The amount of fresh ECB/FCCB shall not exceed the outstanding redemption value at maturity of the outstanding FCCBs; ➢ The fresh ECB/FCCB shall not be raised six months prior to the maturity date of the outstanding FCCBs ; ➢ The purpose of ECB/FCCB shall be clearly mentioned as 'Redemption of outstanding FCCBs' in Form 83 at the time of obtaining Loan Registration Number from the Reserve Bank; ➢ The designated AD - Category I bank should monitor the end-use of funds; ➢ ECB / FCCB beyond USD 500 million for the purpose of redemption of the existing FCCB will be considered under the approval route; and ➢ ECB / FCCB availed of for the purpose of refinancing the existing outstanding FCCB will be reckoned as part of the limit of USD 750 million available under the automatic route as per the extant norms.

Restructuring of FCCBs	Restructuring of FCCBs involving change in the existing conversion price is not permissible. Proposals for restructuring of FCCBs not involving change in conversion price will, however, be considered under the approval route depending on the merits of the proposal.

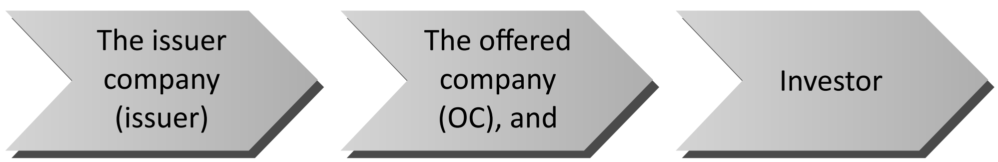
FOREIGN CURRENCY EXCHANGEABLE BONDS

Indian promoters can new raise money abroad by issuing foreign currency bonds against the value of their investments in shares of listed group company, termed as Foreign Currency Exchangeable Bonds (FCEB). The issue of these bonds helps the promoter to meet the financing requirements within the group. Issue of Foreign Currency Exchangeable Bonds (FCEB) are governed by Foreign Currency Exchangeable Bonds Scheme, 2008 issued by Ministry of Finance, Department of Economic Affairs.

What is FCEB?

According to the "Issue of Foreign Currency Exchangeable Bonds (FCEBs) Scheme, 2018, FCEB means a bond expressed in foreign currency, the principal and the interest in respect of which is payable in foreign currency, issued by an issuing company and subscribed to by a person resident outside India, exchangeable into equity shares of another company, being Offered company in any manner, either wholly or partly or on the basis of any equity related warrants attached to debt instruments. The FCEB may be denominated in any freely convertible foreign currency.

Parties of FCEB



Under this option, an issuer company may issue FCEBs in foreign currency, and these FCEBs are convertible into shares of another company (offered company) that forms part of the same promoter group as the issuer company.

Example- Company ABC Ltd. issues FCEBs, then the FCEBs will be convertible into shares of company XYZ Ltd. that are held by company ABC Ltd. and where companies ABC Ltd. and XYZ Ltd. form part of the same promoter group. Unlike FCCBs that convert into shares of issuer itself, FCEBs are exchangeable into shares of OC. Also, relatively, FCEB has an inherent advantage that it does not result in dilution of shareholding at the OC level.

Eligible Issuer	The Issuing Company shall be part of the promoter group of the Offered Company and shall hold the equity share/s being offered at the time of issuance of FCEB.
Offered Company	The Offered Company shall be a listed company, which is engaged in a sector eligible to receive Foreign Direct Investment and eligible to issue or avail of Foreign Currency Convertible Bond (FCCB) or External Commercial Borrowings (ECB).

Entities not eligible to issue FCEB	An Indian company, which is not eligible to raise funds from the Indian securities market, including a company which has been restrained from accessing the securities market by the SEBI shall not be eligible to issue FCEB.
Eligible subscriber	Entities complying with the Foreign Direct Investment policy and adhering to the sectoral caps at the time of issue of FCEB can subscribe to FCEB. Prior approval of the Foreign Investment Promotion Board, wherever required under the Foreign Direct Investment policy, should be obtained.
Entities not eligible to subscribe to FCEB	Entities prohibited to buy, sell or deal in securities by the SEBI will not be eligible to subscribe to FCEB.

End-use of FCEB proceeds:

Issuing Company	i. The proceeds of FCEB may be invested by the issuing company overseas by way of direct investment including in Joint Ventures or Wholly Owned Subsidiaries abroad, subject to the existing guidelines on overseas investment in Joint Ventures / Wholly Owned Subsidiaries. ii. The proceeds of FCEB may be invested by the issuing company in the promoter group companies.
Promoter Group Companies	Promoter group companies receiving investments out of the FCEB proceeds may utilize the amount in accordance with end-uses prescribed under the ECB policy.
End-uses not permitted	The promoter group company receiving such investments will not be permitted to utilise the proceeds for investments in the capital market or in real estate in India.
All-in-cost	The rate of interest payable on FCEB and the issue expenses incurred in foreign currency shall be within the all-in-cost ceiling as specified by Reserve Bank under the ECB policy.
Pricing of FCEB	At the time of issuance of FCEB the exchange price of the offered listed equity shares shall not be less than the higher of the following two: (i) The average of the weekly high and low of the closing prices of the shares of the offered company quoted on the stock exchange during the six months preceding the relevant date; and (ii) The average of the weekly high and low of the closing prices of the shares of the offered company quoted on a stock exchange during the two week preceding the relevant date.
Average Maturity	Minimum maturity of FCEB shall be five years. The exchange option can be exercised at any time before redemption. While exercising the exchange option, the holder of the FCEB shall take delivery of the offered shares. Cash (Net) settlement of FCEB shall not be permissible.

Parking of FCEB proceeds abroad	The proceeds of FCEB may be retained and / or deployed overseas by the issuing / promoter group companies in accordance with the policy for the ECB or repatriated to India for credit to the borrowers' Rupee accounts with AD Category I banks in India pending utilization for permissible end-uses. It shall be the responsibility of the issuing company to ensure that the proceeds of FCEB are used by the promoter group company only for the permitted end-uses prescribed under the ECB policy. The issuing company should also submit audit trail of the end-use of the proceeds by the issuing company / promoter group companies to the Reserve Bank duly certified by the designated AD bank.
Operational Procedure	Issuance of FCEB shall require prior approval of the Reserve Bank under the Approval Route for raising ECB. The Reporting arrangement for FCEB shall be as per the extant ECB policy.

FOREIGN CURRENCY EXCHANGEABLE BONDS SCHEME, 2008

Issuer Company	The Issuing Company shall be part of the promoter group of the Offered Company and shall hold the equity share/s being offered at the time of issuance of FCEB.
Offered Company	The Offered Company shall be a listed company, which is engaged in a sector eligible to receive Foreign Direct Investment (FDI) and eligible to issue or avail of Foreign Currency Convertible Bond (FCCB) or External Commercial Borrowings (ECB).
Entities not eligible to issue FCEB	An Indian company, which is not eligible to raise funds from the Indian securities market, including a company which has been restrained from accessing the securities market by the SEBI shall not be eligible to issue FCEB.
Eligible subscriber	Entities complying with the FDI policy and adhering to the sectoral caps at the time of issue of FCEB can subscribe to FCEB. Prior approval of the Foreign Investment Promotion Board (FIPB), wherever required under the FDI policy, should be obtained.
Entities not eligible to subscribe to FCEB	Entities prohibited to buy, sell or deal in securities by the SEBI will not be eligible to subscribe to FCEB.
End use of FCEB Proceeds	**Issuing Company** i. The proceeds of the FCEB may be invested in promoter group companies. ii. The proceeds of FCEB can be invested overseas by way of direct investment including in Joint Ventures or Wholly Owned Subsidiaries subject to the existing guidelines on Indian Direct Investment in Joint Ventures or Wholly Owned Subsidiaries. **Promoter Group Companies** Promoter Group Companies receiving investments out of the FCEB proceeds may utilise the amount in accordance with end-uses prescribed under the ECB policy.

End-uses not permitted	The promoter group company receiving such investments will not be permitted to utilise the proceeds for investments in the capital market or in real estate in India.
All-in-cost	The rate of interest payable on FCEB and the issue expenses incurred in foreign currency shall be within the all-in-cost ceiling as specified by Reserve Bank under the ECB policy.
Operational procedure	Issuance of FCEB shall require prior approval of the Reserve Bank under the Approval Route for raising ECB. The Reporting arrangement for FCEB shall be as per extant ECB policy.
Pricing of FCEB	At the time of issuance of FCEB the exchange price of the offered listed equity shares shall not be less than the higher of the following two: (i) The average of the weekly high and low of the closing prices of the shares of the offered company quoted on the stock exchange during the six months preceding the relevant date; and (ii) The average of the weekly high and low of the closing prices of the shares of the offered company quoted on a stock exchange during the two week preceding the relevant date.
Average Maturity	Minimum maturity of FCEB shall be five years. The exchange option can be exercised at any time before redemption. While exercising the exchange option, the holder of the FCEB shall take delivery of the offered shares. Cash (Net) settlement of FCEB shall not be permissible.
Parking of FCEB proceeds abroad	The proceeds of FCEB shall be retained and/or deployed overseas by the issuing/promoter group companies in accordance with the policy for the ECB. It shall be the responsibility of the issuing company to ensure that the proceeds of FCEB are used by the promoter group company only for the permitted end-uses prescribed under the ECB policy. The issuing company should also submit audit trail of the end-use of the proceeds by the issuing company / promoter group companies to the Reserve Bank duly certified by the designated Authorised Dealer bank.

CHECKLIST ON PRE ISSUE AND POST-ISSUE FORMALITIES FOR GDRs/ADRs/FCCBs

Pre-Issue Formalities

Documents required for granting approval under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015, for companies proposing to come out with issue of GDRs/ADRs/FCCBs:

1. Certified true copy of the resolution passed by the Board of Directors of the Company approving the issue of the GDRs/ADRs/FCCBs.
2. Copy of the notice sent to the shareholders of the company.
3. Certified true copy of the resolution passed by the shareholders of the Company in the general body meeting approving the issue of the GDRs/ADRs/FCCBs.
4. Draft offering circular for issue of the GDRs/ADRs/FCCBs.

5. Confirmation by the Managing Director and/or Company Secretary as per prescribed format by Exchange.

6. Processing fee.

Note: All pages of the documents/details provided should be serially numbered, stamped and certified by the authorized signatory of the company.

Post-Issue Formalities

Documents required for listing approval for equity shares underlying GDRs/ ADRs/ or equity shares allotted upon conversion of FCCBs issued by the Companies:

1. Letter of Application (i.e. by Listed companies applying for listing of further issue) duly completed. (In case of conversion of FCCBs only post allotment distribution schedule is requited to submitted).

2. Brief particular of the new securities issued as per prescribed format.

3. Certified true copy of the Board resolution in which the equity shares were allotted.

4. List of allottees and the number of equity shares allotted.

   In case of GDRs/ADRs, the list of GDR/ADR holders and the number of GDRs/ADRs allotted.

5. Shareholding Pattern as per the format prescribed under Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 giving details pre and post allotment.

6. Processing Fee **[Processing fee is not payable on the first conversion, where the company has paid the same at the time of obtaining prior approval under Regulation 28(1) of the SEBI (LODR), Regulations, 2015. In case prior approval obtained after 01/04/2017, the aforesaid Processing Fees is not applicable].**

7. Additional Annual Listing Fee, if applicable, on enhanced capital.

8. Confirmation by the Managing Director/ Company Secretary as per enclosed format by Exchange.

9. Certified true copy of letter issued by the overseas Stock Exchange granting listing/ trading permission to the GDRs/ADRs/FCCBs.

10. Certified true copy of the resolution in which the Board of the company or the Committee of Directors of the company decided to open the proposed issue of GDRs/ADRs/FCCBs.

11. Auditor's Certificate confirming the floor price for the proposed issue and receipt of funds against the said issue.

12. A copy of the final offering circular (printed copy as well as pdf file on CD), duly certified by the Managing Director/ Company Secretary.

13. Detailed valuation report with related workings/calculations on the basis of which company proposes to acquire the foreign company.

Note: Documents at Sr. Nos. 9 to 13 are required to be submitted only at the time of filing the first application in respect of any offer document.

All pages of the documents/details provided should be serially numbered, stamped and certified by the authorized signatory of the company.

LESSON ROUND-UP

- Capital can be raised from international capital market in foreign currency by accessing foreign capital market. Funds raised through foreign currency are called as euro equity or debt.
- Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ ADR/FCCB/FCEB.
- ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc.
- The issue of GDRs/FCCBs requires the approval of a Board of Directors, shareholders, "In principle and Final" approval of Ministry of Finance, Approval of Reserve Bank of India, In-principle consent of Stock Exchange for listing of underlying shares and In-principle consent of Financial institutions.
- FCCBs/DRs may be issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and Depository Receipts Scheme, 2014 respectively, as per the guidelines issued by the Government of India thereunder from time to time.
- The FCCBs are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company.

GLOSSARY

Bond: A negotiable certificate evidencing indebtedness a debt security or IOU, issued by a company, municipality or government agency. A bond investor lends money to the issuer and, in exchange, the issuer promises to repay the loan amount on a specified maturity date. The issuer usually pays the bondholder periodic interest payments over the life of the loan.

Eurobond: Eurobonds are issued in a specific currency outside the currency's domicile. They are not subject to withholding tax and fall outside the jurisdiction of any one country. The Eurobond market is based in London. Not to be confused with euro-denominated bonds.

CEDEL: One of the two major organizations in the Eurobond market which clears or handles the physical exchange of, securities and stores securities. Based in Luxembourg, the company is owned by several shareholding banks and operates through a network of agents.

Coupon: The interest paid on a bond expressed as a percentage of the face value. If a bond carries a fixed coupon, the interest is paid on an annual or semi-annual basis. The term also describes the detachable certificate entitling the bearer to payment of the interest.

Foreign Currency Convertible Bonds: It means bonds issued in accordance with this scheme and subscribed by a non- resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments.

Overseas Depository Bank: It means a bank authorised by the issuing company to issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What do you mean by External Commercial Borrowings (ECBs)? Describe the various forms of ECB as per RBI Guidelines.
2. State the procedure laid out for issuance of ADRs/GDRs.
3. Briefly explain the condition required to be fulfilled by a company for issue of depository receipts under the Companies (Issue and Global Depository Receipts) Rules, 2014.
4. What do you mean by Foreign Currency Exchangeable Bond (FCEB)? Explain the Pricing norms for issuing of FCEB under the Foreign Currency Exchangeable Bonds Scheme, 2008.
5. Mention the Regulatory Framework in India for issue of ADR/GDR/FCCBs/FCEBs.
6. Write short notes on :
   (a) Sponsored ADR/GDR issue
   (b) Two Way Fungibility Scheme.

LIST OF FURTHER READINGS

- FAQs on External Commercial Borrowings available at https://m.rbi.org.in/Scripts/FAQView.aspx?Id=120
- Master Direction - External Commercial Borrowings, Trade Credits and Structured Obligations https://m.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510
- FAQs on Funding Option available at https://www.investindia.gov.in/faq-pdf/27/en

Role of Intermediaries in Fund Raising

Lesson 17

KEY CONCEPTS

■ Intermediaries ■ Investment Adviser ■ Financial Planning ■ Risk Profiling ■ Suitability ■ Merchant Banker ■ Portfolio Manager ■ Disclosure Document

Learning Objectives

To understand:

- Various Intermediaries associated with the Primary Market
- Role and Responsibilities of Investment Adviser, Merchant Banker and Portfolio Manager
- Regulatory framework governing Investment Adviser, Merchant Banker, Portfolio Manager
- Role of a Company Secretary

Lesson Outline

- Introduction
- Investment Advisers (IAs)
- SEBI (Investment Advisers) Regulations, 2013
- Responsibilities of an Investment Adviser
- Disclosure to clients
- Administration and Supervision of IAs
- Exemptions from registration under IA Regulations
- Major Developments/Amendments to be considered by Investment Advisers
- Liability for action in case of default
- Summary of the provisions of SEBI (IA) Regulations
- Merchant Bankers
- SEBI (Merchant Bankers) Regulations, 1992
- Role of Merchant banker in an IPO
- Responsibilities of Merchant bankers
- General Obligations and Responsibilities of Merchant Banker
- Activities and Timelines – IPO
- Portfolio Managers
- SEBI (Portfolio Managers) Regulations, 2020
- General responsibilities of a Portfolio Manager
- Role of a Company Secretary
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- SEBI (Investment Adviser) Regulations, 2013
- SEBI (Merchant Bankers) Regulations, 1992
- SEBI (Portfolio Managers) Regulations, 2020
- SEBI (Intermediaries) Regulations, 2008

INTRODUCTION

Intermediaries are an integral part of securities market. They are the facilitators ensuring seamless functioning of securities market. SEBI regulates various intermediaries in the primary markets through Regulations for these intermediaries. These Regulations allow SEBI to inspect the functioning of these intermediaries and to ensure that their conduct is market appropriate and fair.

Market intermediaries, being a vital link between regulators, issuers and investors, constitute one of the various components of the financial market. They play a very important role in development of the market by providing a variety of services. SEBI is responsible for the registration, supervision, compliance monitoring and inspections of all market intermediaries in respect of all segments of the markets viz. equity, equity derivatives, currency derivatives, debt and debt related derivatives and commodity derivatives.

Regulation of market intermediaries has following objectives:

i. To ensure regulation of the segment

ii. To protect investors

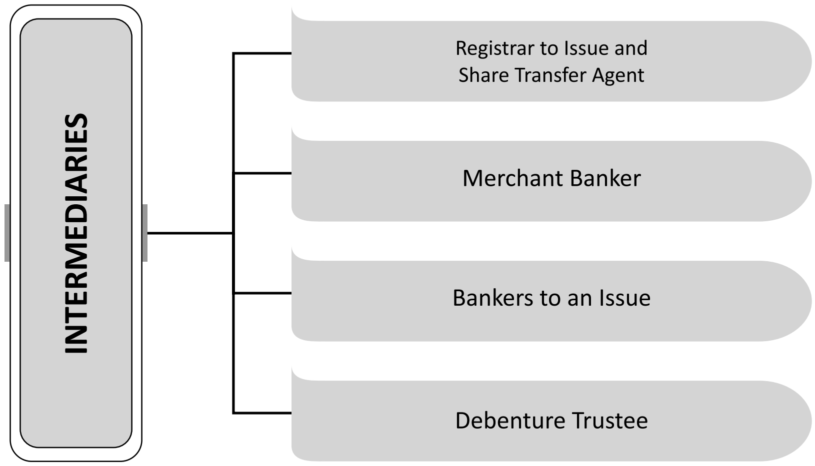
iii. To protect client assets from insolvency of the intermediaries and guarding against defaults as well as sudden disruption in the market;

iv. To ensure that the intermediaries are fair and diligent in dealing with their clients; and

To reduce conflict of interest.

The regulation sets qualifying standards, prudential standards, internal controls and risk management standards and enforces a code of conduct. In order to enhance investor confidence, it is necessary that all the intermediaries maintain high standards of integrity and fairness and also act with due skill, care and diligence in conducting their business with high levels of compliance. The various intermediaries' regulations have been framed under the SEBI Act, 1992 and the Depositories Act, 1996 for registration and regulation of all market intermediaries. Under these acts, the government and SEBI issue notifications, guidelines and circulars that market intermediaries need to comply with. SEBI's regulations aim to ensure that intermediaries offer quality services to stakeholders, besides fair and sound conduct and compliance practices.

The Intermediaries associated with the Primary Market are:



INVESTMENT ADVISERS

Who is an Investment Adviser?

In terms of the IA Regulations, **Investment Adviser (IA)** is a person who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out as an investment adviser, by whatever name called.

Investment Advice means advice relating to investing in, purchasing, selling or otherwise dealing in securities or investment products, and advice on investment portfolio containing securities or investment products, whether written, oral or through any other means of communication for the benefit of the client and includes financial planning.

Advice exclusively relating to non-securities market which is regulated by sectoral regulators through registration etc. is outside the scope of these regulations. However, advice on the portfolio which contains securities or investment products is covered within the scope of these regulations and includes financial planning.

Advice given through newspaper, magazines, any electronic or broadcasting or telecommunications media, which is widely available to the public shall not be considered as investment advice for the purpose of these regulations.

SEBI (Investment Advisers) Regulations, 2013

Since there was a proliferation of investment advisors in the country, there arose a need to regulate them. In order to regulate the entities who for consideration, are engaged in the business of providing investment advice to investors, SEBI came up with SEBI (Investment Advisers) Regulations, 2013 **('IA Regulations')**.

In terms of the IA Regulations, a person shall not act as an investment adviser or hold itself out as an investment adviser unless he has obtained a certificate of registration from SEBI on and from the commencement of IA Regulations unless an exemption specifically applies.

953 Investment Advisers are registered with SEBI as on May 21, 2024

If any person found to be engaged in providing investment advisory services without getting registered with SEBI, appropriate action as deemed fit, under the Investment Advisers Regulations and the SEBI Act, 1992 may be initiated.

Question 1: Whether insurance agent or insurance broker is exempted from obtaining registration under IA Regulations?

Answer: Insurance Agents or Insurance Brokers registered with IRDA who provide advice in various insurance products across manufacturers shall be regulated by IRDA only. If such Insurance Agents or Insurance Brokers expand their activities to include investment advice on other financial products, then they shall be register and be regulated under the IA Regulations for financial products other than insurance products.

Question 2: Whether a person acting in multiple capacities such as insurance agent, pension advisor, mutual fund distributor, etc. is exempted from obtaining registration under IA Regulations?

Answer: A person acting in multiple capacities such as insurance agent, pension advisor, mutual fund distributor, etc. planning to expand his/her scope of activities to include investment advice on other financial products or engaged in the financial planning of the clients may be registered and regulated under IA Regulations for advising on such other financial products or financial planning of the clients.

Responsibilities of an Investment Adviser

- An investment adviser shall act in a fiduciary capacity towards its clients and shall disclose all conflicts of interests as and when they arise.
- An investment adviser shall not receive any consideration by way of remuneration or compensation or in any other form from any person other than the client being advised, in respect of the underlying products or securities for which advice is provided.
- An investment adviser shall maintain an arms-length relationship between its activities as an investment adviser and other activities.
- An investment adviser which is also engaged in activities other than investment advisory services shall ensure that its investment advisory services are clearly segregated from all its other activities, in the manner as prescribed hereunder.
- An investment adviser shall ensure that in case of any conflict of interest of the investment advisory activities with other activities, such conflict of interest shall be disclosed to the client.
- An investment adviser shall not divulge any confidential information about its client, which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.
- An investment advisor shall not enter into transactions on its own account which is contrary to its advice given to clients for a period of 15 days from the day of such advice.
- An investment advisor shall follow Know Your Client procedure as specified by SEBI from time to time.
- An investment adviser shall abide by Code of Conduct as specified in Third Schedule of the SEBI (IA) Regulations, 2013.
- An investment adviser shall not act on its own account, knowingly to sell securities or investment products to or purchase securities or investment product from a client.
- In case of change in control of the investment adviser, prior approval from the SEBI shall be taken.
- Investment advisers shall furnish to the SEBI information and reports as may be specified by the SEBI from time to time.
- It shall be the responsibility of the investment adviser to ensure compliance with the certification and qualification requirements at all times.

Redressal of client grievances

- An investment adviser shall redress client grievances promptly but not later than twenty-one calendar days from the date of receipt of the grievance.
- An investment adviser shall have adequate procedure for expeditious grievance redressal.
- Client grievances pertaining to financial products in which investments have been made based on investment advice, shall fall within the purview of the regulator of such financial product.
- Any dispute between the investment adviser and his client shall be submitted to a dispute resolution mechanism that includes mediation and/or conciliation and/or arbitration in accordance with the procedure specified by SEBI or through Ombudsman authorized or appointed for the purpose by any regulatory authority, as applicable. .

In its continuous pursuit of protection of interests of investors in the securities market, SEBI has launched the new version of the SEBI Complaint Redress System (SCORES 2.0) on April 1, 2024. The new version of SCORES strengthens the investor complaint redress mechanism in the securities market by making the process more efficient through auto-routing, auto-escalation, monitoring by the 'Designated Bodies and reduction of timelines. The new SCORES system has also been made more user friendly. SCORES is an online system where investors in securities market can lodge their complaints through web URL and an App.

The website URL for SCORES 2.0 from April 01, 2024 is *https://scores.sebi.gov.in.* The salient features of SCORES 2.0 are as follows:

i. Reduced and uniform timelines for redressal of investor complaints across the Securities Market i.e. 21 Calendar days from date of receipt of complaint.

ii. Introduction of auto- routing of complaints to the concerned regulated entity so as to eliminate time lapses, if any, in the flow of complaints.

iii. Monitoring of the timely redress of the investors' complaints by the 'Designated Bodies'.

iv. Providing two levels of review: First review by the 'Designated Body' if the investor is dissatisfied with the resolution provided by the concerned regulated entity. Second review by SEBI if the investor is still dissatisfied after the first review.

v. Introduction of auto-escalation of complaint to the next level in case of non- adherence to the prescribed timelines by the regulated entity or the Designated Body as the case may be.

vi. Integration with KYC Registration Agency database for easy registration of the investor on to SCORES

Key Parameters

A. Risk Profiling

Investment adviser shall ensure that it obtains from the client, such information as is necessary for the purpose of giving investment advice, including the following :

- age;
- investment objectives including time for which they wish to stay invested, the purposes of the investment;
- income details;
- existing investments/ assets;
- risk appetite/ tolerance;
- liability/borrowing details.

The Investment adviser ought to have a process for assessing the risk a client is willing and able to take, including assessing a client's capacity for absorbing loss, identifying whether client is unwilling or unable to accept the risk of loss of capital and appropriately interpreting client responses to questions and not attributing inappropriate weight to certain answers.

B. Suitability

An Investment adviser shall ensure that -

- All investments on which investment advice is provided is appropriate to the risk profile of the client;
- It has a documented process for selecting investments based on client's investment objectives and financial situation;
- It understands the nature and risks of products or assets selected for clients;
- It has a reasonable basis for believing that a recommendation or transaction entered into:
  - o meets the client's investment objectives;
  - o is such that the client is able to bear any related investment risks consistent with its investment objectives and risk tolerance;
  - o is such that the client has the necessary experience and knowledge to understand the risks involved in the transaction.

Whenever a recommendation is given to a client to purchase of a particular complex financial product, such recommendation or advice is based upon a reasonable assessment that the structure and risk reward profile of financial product is consistent with client's experience, knowledge, investment objectives, risk appetite and capacity for absorbing loss.

C. Disclosure to clients

An investment adviser shall :

- disclose to a prospective client, all material information about itself including its business, disciplinary history, the terms and conditions on which it offers advisory services, affiliations with other intermediaries and such other information as is necessary to take an informed decision on whether or not to avail its services.
- disclose to the client its holding or position, if any, in the financial products or securities which are subject matter of advice.

- disclose to the client any actual or potential conflicts of interest arising from any connection to or association with any issuer of products/ securities, including any material information or facts that might compromise its objectivity or independence in the carrying on of investment advisory services.
- disclose all material facts relating to the key features of the products or securities, particularly, performance track record.
- draw the client's attention to the warnings, disclaimers in documents, advertising materials relating to an investment product which it is recommending to the client.

Administration and Supervision of IAs

SEBI IA Regulations provide that SEBI may appoint a Self-Regulatory Organisation (SRO) for the purpose of administration and supervision of Investment Advisors. Accordingly, SEBI vide circular dated June 18, 2021 has provided the framework for administration and supervision of Investment Advisers under IA Regulations and has recognised BSE Administration & Supervision Limited (BASL), a wholly owned subsidiary of BSE Limited as "*Investment Adviser Administration and Supervisory Body*" ("IAASB"). IAASB shall also be responsible for grievance redressal of clients and IAs, taking administrative actions against IAs, monitoring activities of IAs through periodic reporting, maintenance of database of IAs and submission of periodic reports to SEBI.

Exemptions from registration under IA Regulations

The following entities have been *inter alia* provided exemptions from registration under the SEBI IA Regulations:

a) Any person who gives general comments in good faith in regard to trends in the financial or securities market or the economic situation where such comments do not specify any particular securities or investment product;

b) Entities which are providing advice/incidental advice to their primary activity and are regulated by the respective regulator/self-regulatory body/institute. These include-

   i. Insurance agent or insurance broker;

   ii. Any pension advisor;

   iii. Any distributor of mutual funds;

   iv. Any advocate, solicitor or law firm;

   v. Any member of Institute of Chartered Accountants of India, Institute of Company Secretaries of India, Institute of Cost and Works Accountants of India, Actuarial Society of India or any other professional body;

   vi. Any stock broker, portfolio manager or merchant banker registered under respective SEBI Regulations, who provides any investment advice to its clients incidental to their primary activity:

   However, such intermediaries shall comply with the general obligation(s) and responsibilities as specified in Chapter III of these regulations.

   vii. Any fund manager of a mutual fund, alternative investment fund or any other intermediary, by whatever name called.

c) Any person who provides investment advice exclusively to clients based out of India (except Non-Resident Indian or Person of Indian Origin).

Mandate for periodic reporting – latest reform on monitoring of Investment Advisors:

On May 7, 2024, SEBI issued a circular mandating periodic reporting for Investment Advisers. SEBI has recognized Investment Advisers Administration and Supervisory Body ("IAASB") for the purpose of administration and supervision of Investment Advisers ("IAs") under regulation 14 of the IA Regulations.

To improve transparency and protect investors from misleading financial advice circulating on social media, SEBI, in a new directive on May 7,2024, mandated investment advisors to disclose details of their social media presence twice a year. This move comes amidst growing concerns about unregistered influencers and even registered advisors misusing social media platforms to provide unauthorized or misleading investment tips.

The IAASB has to be provided information on:

a. accounts, pages, channels, or other social media platforms used by the advisors.

b. detailed information regarding various aspects of their operations.

c. details about bank accounts established for receiving advisory fees, disclose their office addresses, share information about their shareholding patterns, and provide information about any advertisements they have issued.

d. half-yearly reports on September 30 and March 31 of every financial year.

SEBI's move aims to enhance transparency and accountability in the financial advisory sector, ensuring that investors are protected from unsolicited or unverified advice on social media platforms.

Major Developments/Amendments to be considered by Investment Advisers

In order to strengthen the IA Regulations further, SEBI made certain amendments to the IA Regulations vide SEBI (Investment Advisers) (Amendment) Regulations, 2020 with effect from September 30, 2020. It includes strengthening of educational and experience criteria, Net worth requirements, fees charged by IAs, compliance with respect to Audit requirements etc. In this regard, SEBI vide circular dated September 23, 2020 issued guidelines to Investment Advisers. These amendments are intended to strengthen the regulatory framework for investment advisers.

Some of the key regulatory changes include:

A. Segregation of Advisory & Distribution Activities

- Segregation of Advisory & Distribution Activities at client level to avoid conflict of interest.
- An individual investment adviser shall not provide distribution services.
- A non-individual investment adviser shall have client level segregation at group level for investment advisory and distribution services and maintain an arm's length relationship between its activities as investment adviser and distributor by providing advisory services through a separately identifiable department or division.

B. Implementation services

Investment Advisers are allowed to provide implementation services (Execution) through direct schemes/ products in the securities market. However, no consideration can be received directly or indirectly, at investment adviser's group or family level for these services.

C. Agreement between Investment Adviser and client

Mandatory agreement to be entered between Investment Adviser and the client or ensuring greater transparency with reference to advisory activities.

D. Fees

The fee charged by the Investment Adviser for providing Investment Advice from a client shall be in the manner as specified by SEBI.

E. Eligibility Criteria for IAs

- Enhanced eligibility criteria for registration as an Investment Adviser including net worth of Rs.50 lakhs for non-individuals and Rs.5 lakhs for individuals.
- Individual investment adviser or a principal officer of a non-individual investment adviser to have enhanced professional or post-graduate qualification in relevant subjects and relevant experience of five years while grandfathering existing Individual Investment Advisers from complying with the enhanced qualification and experience as specified by SEBI.
- Individuals registered as investment advisers whose number of clients exceed 150 in total, shall apply for registration with SEBI as non-individual investment adviser.

SEBI had issued a Consultation Paper, in January 2020, on Review of Regulatory Framework for Investment Advisers and sought comments from the public on the proposals. After considering the public comments received, the SEBI Board had approved the proposals on regulatory changes including amendments to SEBI (Investment Advisers) Regulations, 2013. To give effect to these proposals the Securities and Exchange Board of India (Investment Advisers) (Amendment) Regulations, 2020 have been notified. The guidelines dealing with various other issues like key terms and conditions of Investment Advisory Services agreement, modes of charging fee, periodicity etc. were separately specified through a Circular.

Mandate for periodic reporting –SEBI reform on monitoring of Investment Advisors:

On May 7, 2024, SEBI issued a circular mandating periodic reporting for Investment Advisers. SEBI has recognized Investment Advisers Administration and Supervisory Body (“IAASB”) for the purpose of administration and supervision of Investment Advisers (“IAs”) under regulation 14 of the IA Regulations.

To improve transparency and protect investors from misleading financial advice circulating on social media, SEBI, in a new directive on May 7,2024, mandated investment advisors to disclose details of their social media presence twice a year. This move comes amidst growing concerns about unregistered influencers and even registered advisors misusing social media platforms to provide unauthorized or misleading investment tips.

The IAASB has to be provided information on:

a. accounts, pages, channels, or other social media platforms used by the advisors.

b. detailed information regarding various aspects of their operations.

c. details about bank accounts established for receiving advisory fees, disclose their office addresses, share information about their shareholding patterns, and provide information about any advertisements they have issued.

d. half-yearly reports on September 30 and March 31 of every financial year.

SEBI’s move aims to enhance transparency and accountability in the financial advisory sector, ensuring that investors are protected from unsolicited or unverified advice on social media platforms.

Dealing in unregulated products by SEBI registered Investment Advisers

SEBI took note that some registered Investment Advisers are engaged in unregulated activity by providing platform for buying/ selling/ dealing in unregulated products including digital gold.

Hence SEBI issued a caution on October 21, 2021, stating that undertaking such unregulated activity including dealing (i.e., advisory, distribution and execution/ implementation services) in digital gold by Investment Advisers is not in accordance with the provisions of Section 12(1) of the SEBI Act, 1992 read with the SEBI (Investment Advisers) Regulations, 2013.

Investment Advisers were advised to refrain from undertaking such unregulated activities. SEBI has said that dealing in any unregulated activity by Investment Advisers may entail action as deemed appropriate under the SEBI Act, 1992 and regulations framed thereunder.

Liability for action in case of default

An investment adviser who –

- contravenes any of the provisions of the Act or any regulations or circulars issued thereunder;
- fails to furnish any information relating to its activity as an investment adviser as required by the SEBI;
- furnishes to the Board information which is false or misleading in any material particular;
- does not submit periodic returns or reports as required by the SEBI;
- does not co-operate in any enquiry, inspection or investigation conducted by the SEBI;
- fails to resolve the complaints of investors or fails to give a satisfactory reply to the SEBI in this behalf,

shall be dealt with in the manner provided under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

Summary of the provisions of SEBI (Investment Advisers) Regulations, 2013

Summary of the provisions of SEBI IA Regulations is given below for easy reference:

Area	***Provisions of IA regulation***
Who can seek registration	Individuals, partnership firms, Corporates, LLP
What role is performed	Advice relating to investing in, **purchasing, selling or otherwise dealing in securities or investment products**, and advice on investment portfolio containing securities or investment products, whether written, oral or through any other means of communication for the benefit of the client and shall include financial planning.
Qualification Experience and Certifications	Post Graduate+5 years+ NISM certification on Financial Planning or any other Certification as recognised.
Net worth	Individual -INR 5 lakh Non-Individual -INR 50 lakh
Cap on Fees	Fixed fee of INR 1.25 lacs p.a. or 2.5% of Assets under Advice (AUA) per client per annum.
Agreements	Compulsory
Risk profiling and suitability	Required

Area	*Provisions of IA regulation*
Execution Services	IA can provide execution services without taking any consideration.
Handling of Investor Grievances	Yes, Regulation 21 deals with Investor Grievances.
Client Level Segregation requirement	Yes, Segregation of clients on Family/Group Level.
Restriction on enrolling number of clients under Individual License	Yes, 150 clients for individual IAs
Free trials	Not allowed
Receiving Fees in advance	Allowed, only up to 2 quarters
Receipt of fees in Cash	Not allowed, only accept payment through payee crossed cheque/ DD or by way of direct credit into their bank account through NEFT/ RTGS/IMPS/UPI.
Display of complaints status on website	Required to display status of complaints on website
Requirement of Principal officer in non-individual entity and Person associated with Advice/ Research	Yes
Maintenance of record of client interactions	Required

MERCHANT BANKERS

Who is a Merchant Banker?

Merchant Banker means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management.

SEBI (Merchant Bankers) Regulations, 1992

SEBI notified SEBI (Merchant Bankers) Regulations, 1992 to regulate the activities of Merchant Bankers. Any person may make an application to SEBI for grant of a certificate of registration to act as Merchant Banker in Form A which shall be accompanied by a non-refundable application fee. **The Capital adequacy requirement to register as a Merchant Banker is a net worth of not less than 5 crore rupees.**

221 Merchant Bankers are registered with SEBI as on May 21, 2024

The application shall be made for any one of the following categories of the merchant banker namely:—

(a) Category I, that is—

- to carry on any activity of the issue management, which will, inter alia, consist of preparation of prospectus and other information relating to the issue, determining financial structure, tie up of financiers and final allotment and refund of the subscriptions; and
- to act as adviser, consultant, manager, underwriter, portfolio manager.

(b) Category II, that is to act as adviser, consultant, co-manager, underwriter, portfolio manager.

(c) Category III, that is to act as underwriter, adviser, consultant to an issue.

(d) Category IV, that is to act only as adviser or consultant to an issue.

As per Section 6(a) of SEBI (Merchant Bankers) Regulations, 1992 a Merchant Banker should be a body corporate as defined in Section 2(11) of the Companies Act, 2013. Applicants which are LLPs are also considered as Body Corporates, and hence are eligible to make an application as Merchant Banker. However, a sole proprietor is not eligible to be a Merchant Banker.

As per regulation 9A, registrations granted under regulation 8 of SEBI (Merchant Bankers) Regulations, 1992, shall be subject to the condition that where the merchant banker proposes change in control, it shall obtain prior approval of SEBI for continuing to act as such after the change.

Role of Merchant banker in an IPO

A merchant banker or the investment banker plays a pivotal role in any public issue. A merchant banker has to be registered with SEBI. In a book built IPO, Merchant bankers are known as Book Running Lead Managers (BRLMs).

A Merchant Banker manages the entire IPO / FPO/ right issue from beginning to end, right from getting the prospectus filed and approved by SEBI to determining the price range to making the selling and market plan for the IPO as well as post listing support is all handled by the merchant bankers. A merchant banker is the nodal contact point for everything pertaining to the issue.

The past track record and credibility of the merchant bankers matters a lot since most investors tend to invest in IPOs based on the reputation of merchant bankers. SEBI has stipulated that the same also be disclosed in the offer document as well as in the advertisement. Investors normally prefer merchant bankers with a strong pedigree, who have handled many IPOs successfully in the past as well as those merchant bankers whose IPOs have generally done well post listing.

Responsibilities of Merchant bankers

1. A Merchant Banker has the following responsibilities

- Overall transaction management responsibility.
- Navigating transaction strategy including structuring, timeline and execution.
- Conducting due diligence and Participating in Drafting sessions.
- Co-ordination with all parties involved in the transaction; Liaison with SEBI and Stock Exchanges.
- Coordinating Research Briefing, Pre-marketing, Management Roadshows and Marketing the Issue.

- Managing the Book of Demand, Advising on Pricing and Allocation.
- Assisting in managing post issue formalities.

2. Co-ordination with other intermediaries – IPO

A Merchant Banker has to coordinate with all intermediaries to ensure the success of IPO.

3. Issuer's Domestic Counsel

- Advising Company for compliance with domestic regulations applicable to them.
- Drafting and coordinating approvals relating to offering as applicable.
- Conducting due diligence and drafting of certain sections of DRHP/RHP/Prospectus.
- Drafting of Escrow and Syndicate Agreement.
- Providing legal opinion to Issuer and Underwriters and assisting in 'Closing' an issue.

4. Underwriters Domestic Counsel

- Conducting due diligence and reviewing of DRHP/RHP/Prospectus.
- Advising Underwriters on compliance with domestic regulations.
- Drafting Underwriting Agreement; Provide legal opinion and assisting in 'Closing'.

5. International Counsel

- Conducting due diligence and drafting of primarily Business, MD&A and Risk Factors for the DRHP / RHP / Prospectus.
- Primary responsibility for compliance with international regulations relating to offering and selling restrictions and preparation of "International Wraps".
- Drafting Underwriting Agreement; Negotiating Comfort Letter and Co-ordination with Auditors.
- Provide legal opinion and assisting in 'Closing'.

6. Statutory Auditors

- Provide Auditors Report and requisite certificates.
- Provide comfort letter.
- Provide inputs on certain sections of DRHP, relating to financials.

7. Printers

- Printing of DRHP / RHP, Prospectus, application forms and other stationery.

8. Registrar to the Issue

- Analysis of e-book.
- Coordinating with Escrow Bankers/SCSBs, BRLMs for submitting reports to SEBI.
- Prepare documents for finalizing Basis of Allotment post weeding out technical rejections.
- Arranging for refunds, Demat credit etc.

9. Advertising / PR Agency

- Corporate and Issue advertising.
- Public relations.
- Managing logistics for roadshows.

10. Depository

- Tripartite Agreement.
- Dematerialization of the company's shares.
- Demat transfers of shares.
- Credit of shares to allottees.

11. Escrow collection Banks

- Collection of application moneys from Anchor Investors.
- Provide final certificates.
- Assist in post-issue.

12. Self-Certified Syndicate Bank(s) or SCSB(s)

- To receive bids and block bid amount in the investor's bank account based on applications submitted.
- To provide FC on account transfer/ unblock funds post finalization of basis of allotment.
- To address investor grievances on account of ASBA bids.

General Obligations and Responsibilities

- Every merchant banker shall abide by the Code of Conduct as specified in Schedule III.
- Merchant banker not to associate with any business other than that of the securities market.
- Every merchant banker shall keep and maintain books of account, records and documents namely copy of balance sheet, profit and loss account, auditor's report etc. and shall preserve the books of account and other records and documents maintained for a minimum period of 5 years.
- Every merchant banker shall furnish to the SEBI half-yearly unaudited financial results when required by the SEBI with a view to monitor the capital adequacy of the merchant banker.
- Every merchant banker acting as an underwriter shall enter into an agreement with each body corporate on whose behalf it is acting as an underwriter.
- A merchant banker acting as an underwriter shall not derive any direct or indirect benefit from underwriting the issue other than the commission or brokerage payable under the agreement for underwriting entered with client.
- A merchant banker shall disclose to the SEBI his responsibilities, change in the information or particulars previously furnished, names of the body corporate whose issues he has managed or has been associated with.

- The merchant banker shall submit a periodic report in such manner as may be specified by the SEBI from time to time.

Activities and Timeline – IPO

Largely, the Book Running Lead Managers role will include the following:

(a) providing advice on financial aspects of the Offering including, inter alia, advice as to the pricing, timing and structure of the Offering, and the allocation of shares to investors and acting as bookrunners of the Offering;

(b) advising on the appointment of other professional advisers necessary and appropriate for the Offering;

(c) co-ordinating the activities of other members of the Syndicate;

(d) together with legal counsel and other professional advisers appointed for the Offering by the Selling Shareholders, the Promoter Selling Shareholders and the Company, advising on and assisting in the preparation, printing and distribution of a detailed prospectus (the "Prospectus") in connection with the Offering;

(e) advising the Selling Shareholders, the Promoter Selling Shareholders and the Company on determining the price range and pricing for the Offering;

(f) co-ordinating the work of the Selling Shareholders, the Promoter Selling Shareholders and the Company's other advisers in the Offering;

(g) advising on marketing strategy and development of an equity story and an appropriate marketing campaign in respect of both the institutional and retail offerings;

(h) assisting, together with other advisors and legal counsel, as appropriate, the Selling Shareholders, the Promoter Selling Shareholders and the Company in making an application for the listing of its Securities on the NSE and the BSE;

(i) assisting, together with other advisors and legal counsel, as appropriate, the Selling Shareholders, the Promoter Selling Shareholders and the Company in furnishing reports, certificates and other information as may be required by the Securities and Exchange Board of India ("SEBI") and any other governmental or regulatory authority in connection with the Offering;

(j) assisting, together with other advisors and legal counsel, as appropriate, with the completion of the necessary due diligence exercise.

A granular, indicative list of activities with the necessary timeline for an IPO and the role of the Merchant banker is as follows:

Activity	***Indicative Timeline***	***Merchant Banker to co-ordinate with***
Board Meeting approves IPO	X	Issuer
Appointment of Merchant Banker (MB)	X	Issuer
Commence preparation of information as per MBs request list	X+1	Issuer

Activity	***Indicative Timeline***	***Merchant Banker to co-ordinate with***
Commence work with Auditors on preparing information as per SEBI requirements	X+1	Issuer/Auditor/MB
Zero draft (rough skeleton) of the draft RHP circulated	X+2	lawyers
Mail the notice of AGM to shareholders	X+4	Issuer
Appointment of Registrar, Banker, Advertising Agency and Registrar to the Issue	X+5	Issuer
Submit copy of the memorandum and articles of association of the company for stock exchange clearance	X+5	Issuer
Commence work on descriptive information on business, operations etc.	X+7	Issuer
Data Room ready for Due-diligence	X+7	Issuer
Finalize business plans and outlook	X+7	Issuer
Presentation from key business heads for Offer Document preparation and due diligence interviews (2 days)	X+9	Issuer
1st draft of draft Red Herring Prospectus circulated	X+13	MB
Circulate the pending/additional information request list	X+13	MB
Issuer to provide comments on draft Red Herring Prospectus	X+20	Issuer
1st Drafting Session (2 days)	X+22	Issuer / Lawyer
Additional information to be provided by Issuer	X+23	Issuer
2nd draft of draft Red Herring Prospectus circulated	X+26	Issuer, Lawyer
Issuer to provide comments on 2nd draft of the Red Herring Prospectus	X+28	Issuer
2nd Drafting Session (2 days)	X+30	Issuer, Lawyer
AGM for shareholder approval of IPO and increase in authorised capital	X+30	Issuer
Stock exchange to provide comments, if any, on the Memorandum & Articles	X+30	Stock Exchanges
Complete Appointment of other Intermediaries	X+31	Issuer
Any additional information for draft Red Herring Prospectus	X+32	Issuer
File applications to FIPB and RBI	X+32	Issuer/ Lawyer
Draft Red Herring Prospectus finalised	X+35	Issuer / Lawyer

Activity	***Indicative Timeline***	***Merchant Banker to co-ordinate with***
Issue of Comfort Letter by Auditors and Legal Counsel	X+35	Auditor / Legal Counsel
Adoption and signing of Draft Red Herring by Issuer's Board	X+36	Issuer
Filing of Draft RHP with SEBI / Stock Exchanges	X+37	Issuer
Commence type setting of the draft RHP	X+38	MB/Printer
Complete first draft of Management Roadshow presentation and Q&A	X+40	MB / Issuer
Receive in-principle approval from the stock exchanges and submit to SEBI	X+52	Stock Exchanges
SEBI Comments on draft Red Herring Received	X+58	SEBI
Pre-marketing commences	X+60	Issuer
Obtain FIPB and RBI approvals	X+65	Issuer
Pre-marketing ends	X+67	Issuer
Finalise Bidding Centers	X+67	Issuer
Communicate to SEBI of any updates to draft Red Herring	X+72	MB / Issuer
Final SEBI Clearance Received	X+75	SEBI
Draft Bid-cum application form	X+75	Issuer
Discussion of Pre-Marketing feedback with company and finalizing floor price	X+76	MB / Issuer
Make arrangements with NSE/BSE for Book Building	X+76	Stock Exchanges
Finalise Underwriting Agreement, Escrow Agreement and Syndicate Agreement	X+76	Issuer
Finalise Management Roadshow Presentation and Q&A	X+77	Issuer
Filing of the Red Herring (including latest Results) with ROC and SEBI	X+77	Issuer
ROC Acknowledgement	X+79	Issuer
Commence Printing of Red Herrings & Application Forms	X+80	Issuer
Commence dispatch of forms	X+81	Printer
Management Roadshows Begins	X+82	Issuer
Submit RHP and Forms to SEBI	X+85	SEBI
Publish Statutory Advertisement	X+87	Issuer/Ad Agency

Activity	***Indicative Timeline***	***Merchant Banker to co-ordinate with***
Sign Syndicate agreement and Escrow Agreement and submit Syndicate agreement with SEBI	X+87	Issuer
Book Opens	X+90	Issuer
Management Roadshows End	X+95	Issuer
Finalise CAN form	X+96	Lawyer
Book Closes	X+97	Issuer
Submission of all forms to the Banker by Syndicate	X+98	Banker
Final bid handed over to the Registrar	X+98	Registrar
Pricing and allocation to QIBs; Underwriting Agreement Signed	X+98	Issuer
Update the Prospectus and file with SEBI	X+99	Issuer
Submit three-day report to SEBI	X+101	Issuer/Registrar
Obtain SEBI approval if there are significant developments included in Prospectus	X+100	SEBI
File Prospectus with RoC along with Underwriting agreement after signing by Board of Directors	X+101	Issuer
Obtain RoC Approval	X+102/3	Issuer
Distribution of CAN to QIB	X+102/3	MB/Registrar
Publish Statutory Advertisement	X+101	Issuer/Ad Agency
Bankers to hand over all the Bid forms to Registrar	X+104	Bankers/Registrar
Registrar to complete Date entry	X+108	Registrar
Bankers to submit final certificate along with cheque return summary	X+106	Bankers
Registrar to complete reconcilliation	X+108	Registrar/Bankers
Registrar draws the Basis of Allocation	X+110	MB / Issuer
Submit basis of allocation to Stock Exchange for approval	X+110	Registrar/Issuer/Stock Exchanges
Request BSE for arranging draw of lots by public representative	X+110	Registrar/Stock Exchange
Basis of Allocation approved by the Stock Exchanges	X+111	Issuer
Pay-in for QIBs	X+111	Issuer

Activity	*Indicative Timeline*	*Merchant Banker to co-ordinate with*
Committee approval/ BoD approval for adopting the basis of allotment	X+111	Issuer
Allotment of Shares / Corporate Action	X+111	Bankers
Designated date	X+112	Issuer
Transfer of funds for refunds - instructions from LMs/Registrar	X+112	Issuer
Transfer of funds from Escrow to Public Offer Account	X+112	Registrar/Banker
Corporate action for credit of allottees account (equity shares)	X+113	Registrar
Closing Date - receive all the required certifications and opinions	X+113	Legal counsel/ Auditors/Issuer
Confirm compliance with Corporate Governance code	X+113	Issuer
Retail and Non-Institutional CANs and refunds dispatch completed	X+113	Registrar
Submit the allotment details to BSE and NSE and complete all documentation	X+113	Issuer/Registrar
Basis of Allotment advertisement	X+113	
Receive listing approval	X+115	Stock Exchanges
Receive notice of trading	X+115	Stock Exchanges
Submit post issue report	X+120	Registrar

PORTFOLIO MANAGERS

Who is a Portfolio Manager?

A portfolio manager is a body corporate, which, pursuant to a contract with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or goods or funds of the client.

Discretionary portfolio manager means a portfolio manager who under a contract relating to portfolio management, exercises or may exercise, any degree of discretion as to the investment of funds or management of the portfolio of securities of the client.

In **discretionary** portfolio management service, the portfolio manager individually and independently manages the funds and securities of each client in accordance with the needs of the client. Under the **non-discretionary** portfolio management service, the portfolio manager manages the funds in accordance with the directions of the client.

SEBI (Portfolio Managers) Regulations, 2020

I. **Registration as portfolio manager.**

A portfolio manager has to obtain registration from SEBI under the SEBI (Portfolio managers) Regulations, 2020.

428 Portfolio Managers are registered with SEBI as on May 21, 2024.

II. **Networth requirement of a portfolio manager**

The portfolio manager is required to have a minimum networth of INR 5 crore.

III. **Fees for services rendered by a Portfolio Manager**

SEBI (Portfolio Managers) Regulations, 2020 provide that the portfolio manager shall charge a fee as per the agreement with the client for rendering portfolio management services. The fee so charged may be a fixed amount or a performance-based fee or a combination of both. However, no upfront fees shall be charged by the portfolio manager directly or indirectly to the clients.

The agreement between the portfolio manager and the client shall, *inter-alia,* also include the quantum and the manner of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly.

IV. **Investment rules for Portfolio Manager – for investment of clients' funds**

1. The portfolio manager shall, before taking up an assignment of management of funds and portfolio on behalf of a client, enter into an agreement in writing with such client that clearly defines the inter se relationship and sets out their mutual rights, liabilities and obligations relating to management of portfolio. However, this shall not apply to the agreement between the portfolio managers and the large value accredited investors.
2. The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client.
3. The portfolio manager may make investments in the securities of its related parties or its associates only after obtaining the prior consent of the client in such manner as may be specified by the SEBI.
4. Under Discretionary Portfolio Management Service (DPMS), Portfolio Managers shall invest funds of his clients in the securities listed or traded on a recognized stock exchange, money market instruments, units of Mutual Funds through direct plan and other securities as specified by SEBI from time to time.
5. Under Non-Discretionary Portfolio Management Service (NDPMS), Portfolio Managers may invest up to 25% of the assets under management (AUM) of a client in unlisted securities, in addition to the securities permitted for discretionary portfolio management.

   However, the portfolio manager may offer discretionary or non-discretionary or advisory services for investment up to hundred percent of the assets under management of the large value accredited investors in unlisted securities, subject to appropriate disclosures in the disclosure document and the terms agreed between the client and the portfolio manager.
6. A Portfolio manager shall also ensure that an existing client of Non-Discretionary PMS, who has already invested in certain unlisted securities, does not subscribe to rights issue of such unlisted securities, which may result in breach of the 25% limit. An active breach due to investor action,

subsequent to corporate actions like subscription to rights issue, which results in breach of 25% limit applicable to Non-Discretionary portfolios, shall be considered as non-compliance. However, a passive breach due to corporate actions like bonus with respect to value of unlisted securities will not be considered as non-compliance.

7. The portfolio manager is required to accept as a mandate, a minimum INR 50 Lacs or securities having a minimum worth of INR 50 Lacs from the client. The requirement of minimum investment amount per client shall not apply to an accredited investor.

8. Clients of Portfolio Managers on-boarded before January 21, 2020 shall, in case of any top-up, comply with the requirement of the minimum investment amount and top up their accounts to minimum INR 50 Lacs.

9. The client may withdraw partial amounts from his portfolio, in accordance with the terms of the agreement between the client and the Portfolio Manager. However, the value of investment in the portfolio after such withdrawal shall not be less than the applicable minimum investment amount.

10. A client need not top up his account if the portfolio value falls below the minimum investment amount as provided in the SEBI (Portfolio Managers) Regulations, 2020 as a result of valuation of portfolio.

V. **Management or administration of clients' portfolio:** The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client.

VI. **Appointment of custodian**: Every portfolio manager shall appoint a custodian in respect of securities managed or administered by it.

VII. **Maintenance of books of accounts, records, etc.:** Every portfolio manager shall keep and maintain the books of accounts, records and documents namely a copy of balance sheet at the end of each accounting period, a copy of the profit and loss account for each accounting period, a copy of the auditor's report, a statement of financial position etc. The portfolio manager shall preserve the books of account and other records and documents mentioned under this chapter for a minimum period of five years.

VIII. **Basis for calculation of performance of the portfolio manager**

The performance of a discretionary portfolio manager is calculated using **Time Weighted Rate of Return (TWRR)** method for the immediately preceding three years and in such cases performance indicators shall also be disclosed.

SEBI Circular No. SEBI/HO/IMD/DF1/CIR/P/2020/26 dated February 13, 2020, *inter-alia*, provides information on reporting of performance by Portfolio Managers and also a client reporting format which includes information on the performance of the client account, portfolio manager and the appropriate benchmark.

IX. **Reports provided the portfolio manager**

The portfolio manager shall furnish periodically a report to the client, as per the agreement, but not exceeding a period of three months and such report shall contain the following details, namely:

- the composition and the value of the portfolio, description of securities and goods, number of securities, value of each security held in the portfolio, units of goods, value of goods, cash balance and aggregate value of the portfolio as on the date of report;

- transactions undertaken during the period of report including date of transaction and details of purchases and sales;
- beneficial interest received during that period in the form of interest, dividend, bonus shares, rights shares, etc;
- expenses incurred in managing the portfolio of the client;
- details of risk foreseen by the portfolio manager and the risk relating to the securities recommended by the portfolio manager for investment or disinvestment;
- default in payment of coupons or any other default in payments in the underlying debt security and downgrading to default rating by the rating agencies, if any;
- details of commission paid to distributor(s) for the particular client.

X. **Disclosure mechanism of the portfolio managers to their clients**

The portfolio manager provides the client, a Disclosure Document prior to entering into an agreement with the client.

The Disclosure Document contains the quantum and manner of payment of fees payable by the client for each activity, portfolio risks, complete disclosures in respect of transactions with related parties, the performance of the portfolio manager and the audited financial statements of the portfolio manager for the immediately preceding three years.

It is relevant to note that SEBI does not approve any of the services offered by the Portfolio Manager. An investor has to invest in the services based on the terms and conditions laid out in the disclosure document and the agreement between the portfolio manager and the investor.

SEBI also does not certify the accuracy or adequacy of the contents of the Disclosure Document provided by the Portfolio Manager.

The portfolio manager shall file with the SEBI, a copy of the Disclosure Document after grant of certificate of registration before circulating it to any client or whenever any material change including change in the investment approach is effected. The portfolio manager shall file the disclosure document with the material change within 7 working days from the date of the change.

XI. **Rules governing services of a Portfolio Manager**

1. The services of a Portfolio Manager are governed by the agreement between the portfolio manager and the investor. The agreement should cover the minimum details as specified in the SEBI Portfolio Manager Regulations. However, additional requirements can be specified by the Portfolio Manager in the agreement with the client. Hence, an investor is advised to read the agreement carefully before signing it.
2. Portfolio managers cannot impose a lock-in on the investment of their clients. However, a portfolio manager can charge applicable exit fees from the client for early exit, as laid down in the agreement subject to provision of SEBI Circular No. SEBI/HO/IMD/DF1/CIR/P/2020/26.
3. A Portfolio Manager cannot offer indicative or guaranteed returns.

XII. **Sources of information for investors – about portfolio managers**

Investors can log on to the website of SEBI www.sebi.gov.in for information on SEBI regulations and circulars pertaining to portfolio managers. Addresses of the registered portfolio managers are also available on the SEBI website. Information on monthly reports submitted by Portfolio Managers to SEBI can be accessed at *https://www.sebi.gov.in/sebiweb/other/OtherAction.do?doPmr=yes.*

XIII. **Complaints by investors**

The Portfolio Manager shall redress investor grievances promptly but not later than twenty-one calendar days from the date of receipt of the grievance and in such manner as may be specified by the SEBI. The SEBI may also recognize a body corporate for handling and monitoring the process of grievance redressal within such time and in such manner as may be specified

SMART ODR Portal

All claims, differences or disputes between investors and the portfolio manager arising out of or in relation to the activities of the portfolio manager in the securities market shall be submitted to a dispute resolution mechanism that includes mediation and/or conciliation and/or arbitration, in accordance with the procedure specified by the SEBI.

GENERAL RESPONSIBILITIES OF A PORTFOLIO MANAGER

- Every portfolio manager shall abide by the Code of Conduct as specified in Schedule III of the SEBi (Portfolio Managers) Regulations, 2020.
- The discretionary portfolio manager shall individually and independently manage the funds of each client in accordance with the needs of the client, in a manner which does not partake character of a Mutual Fund, whereas the non-discretionary portfolio manager shall manage the funds in accordance with the directions of the client.
- The portfolio manager shall act in a fiduciary capacity with regard to the client's funds.
- The portfolio manager shall segregate each client's holding in securities in separate accounts.
- The portfolio manager shall keep the funds of all clients in a separate account to be maintained by it in a Scheduled Commercial Bank.
- The portfolio manager shall transact in securities within the limitation placed by the client himself with regard to dealing in securities under the provisions of the Reserve Bank of India Act, 1934.
- The portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities.
- The portfolio manager shall not borrow funds or securities on behalf of the client.

- The portfolio manager shall not lend securities held on behalf of the clients to a third person except as provided under these regulations.

- The portfolio manager shall ensure proper and timely handling of complaints from his clients and take appropriate action immediately.

- The portfolio manager shall ensure that any person or entity involved in the distribution of its services is carrying out the distribution activities in compliance with these regulations.

ROLE OF A COMPANY SECRETARY

Importance of a Company Secretary to a company desirous of getting listed

Company Secretary of a to-be listed entity as well as a listed entity that proposes a further public offer (FPO) or a rights issue is pivotal in as much that there are a lot of tasks including co-ordination with various regulators, intermediaries for the success of the IPO.

The tasks that a Company Secretary has to undertake as far as an issue of securities on a public or rights basis is concerned is given in the following paragraphs.

Under regulation 6 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, a company Secretary has to be appointed as the compliance officer of a listed entity. Hence, when a company decides to go for an IPO, the first step is to appoint a Company Secretary.

Co-ordination with intermediaries

An issue, from an idea to fruition requires co-ordination with a number of intermediaries, SEBI registered and otherwise. While a merchant banker is the fulcrum around which the due diligence for an issue revolves, there is a need to co-ordinate with various intermediaries and the Company Secretary has to do such co-ordination. Specifically, the intermediaries with whom the Company Secretary has to co-ordinate are as under:

- Merchant Banker/Book Running Lead Manager (in case of book-built issues)
- Statutory Auditors of the Issuer company
- Lawyers / Legal Counsel
- Credit Rating Agency/ Industry Report
- Debenture Trustee, if applicable
- Banker to the issue - Escrow Account
- Registrar to the Issue
- Printers
- Syndicated brokers
- Advertisement agencies / newspapers.

During the course of due diligence, various laws need to be referenced like the Companies Act, 2013, the Depositories Act, 1996, the Securities Contracts (Regulation) Act, 1956 and Rules, the Securities and Exchange

Board of India Act, 1992, the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, SEBI (Intermediaries) Regulations, 2008 related SEBI Regulations on Share Based Employee Benefits, ESOPs, Insider Trading Regulations and respective Intermediaries Regulations etc. There are relevant acts like the Income Tax Act that also need to be mentioned. Further, sector specific acts like Factories Act, Workmen's compensation Act etc. are also important. These are important from the perspective of disclosure of litigation under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

A Company Secretary has to ensure that activities involved while performing the role of Investment Adviser, Merchant Banker and Portfolio Manager are complied with and are in accordance with the respective intermediaries regulations.

LESSON ROUND-UP

- Intermediaries are an integral part of securities market. They are the connecting links or the facilitators ensuring seamless functioning of securities market. SEBI regulates various intermediaries in the primary markets through its Regulations for these intermediaries.
- Investment Adviser (IA) is a person who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.
- In order to regulate the entities who for consideration, are engaged in the business of providing investment advice to investors, SEBI came up with SEBI (Investment Advisers) Regulations, 2013 ('IA Regulations').
- Investment adviser has a process for assessing the risk a client is willing and able to take, including assessing a client's capacity for absorbing loss, identifying whether client is unwilling or unable to accept the risk of loss of capital and appropriately interpreting client responses to questions and not attributing inappropriate weight to certain answers.
- SEBI IA Regulations provide that SEBI may appoint a Self-Regulatory Organisation (SRO) for the purpose of administration and supervision of Investment Advisors.
- Merchant Banker means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management.
- A Merchant Banker manages the entire IPO / FPO/ right issue from beginning to end, right from getting the prospectus filed and approved by SEBI to determining the price range to making the selling and market plan for the IPO as well as post listing support is all handled by the merchant bankers. A merchant banker is the nodal contact point for everything pertaining to the issue.
- A portfolio manager is a body corporate, which, pursuant to a contract with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or goods or funds of the client.
- The portfolio manager shall, before taking up an assignment of management of funds and portfolio on behalf of a client, enter into an agreement in writing with such client that clearly defines the inter se relationship and sets out their mutual rights, liabilities and obligations relating to management of portfolio.

- The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client.
- The portfolio manager shall furnish periodically a report to the client, as per the agreement, but not exceeding a period of three months.
- The portfolio manager provides to the client the Disclosure Document prior to entering into an agreement with the client.
- Company Secretary of a to-be listed entity as well as a listed entity that proposes a further public offer (FPO) or a rights issue is pivotal in as much that there are a lot of tasks including co-ordination with various regulators, intermediaries for the success of the IPO.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Investment Advice means advice relating to investing in, purchasing, selling or otherwise dealing in securities. In light of the same, define the term Investment advise and Investment adviser.
2. Who is Merchant Banker? State the responsibilities & obligations of Merchant Banker.
3. Will advice given through newspaper, which is widely available to the public be considered as investment advice for the purpose of IA regulations?
4. Which entities are exempted from registration under the IA Regulations? Explain Briefly.
5. What is the role of Merchant banker in an IPO?
6. What is the difference between discretionary portfolio manager and non-discretionary portfolio manager?
7. The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client. Briefly explain investment rules for Portfolio Manager for investment of clients' funds.

LIST OF FURTHER READINGS

- SEBI Manual
- Regulations/Rules/Guidelines/Circulars issued by SEBI, RBI, MCA etc. from time-to-time
- SEBI Annual Reports
- SEBI Monthly Bulletin

OTHER REFERENCES

- www.sebi.gov.in
- www.mca.gov.in
- www.icsi.edu
- www.nseindia.com
- www.bseindia.com

Project Evaluation

Lesson 18

KEY CONCEPTS

■ Project Finance ■ Project Evaluation ■ Project Appraisal ■ Feasibility Study ■ Due Diligence ■ Risk Assessment ■ Risk Mitigation ■ Credit Risk Management (CMS) ■ Project Report

Learning Objectives

To understand:

- The concept of Project Evaluation
- Factors affecting the cost of Project
- Importance of Project Appraisal
- Due Diligence in Project Finance
- Project Appraisal through Feasibility and Due Diligence (Technical, Financial, and Legal) and Role of Company Secretary
- The concept of Risk Assessment and Mitigation
- Credit Risk Management in Project Finance
- Steps involved in preparation of Detailed Project Report (DPR)

Lesson Outline

- Introduction
- Factors affecting the Cost of Project
- Project Appraisal through Feasibility and Due Diligence (Technical, Financial, and Legal)
- Legal Feasibility and Due Diligence
- Technical Feasibility and Due Diligence
- Financial Feasibility and Due Diligence
- Role of a Company Secretary
- Project Viability and Research on Innovation
- Regulatory Authorities/Agencies
- Risk Assessment and Mitigation
- Credit Risk Management in Project Finance
- Preparation of detailed Project Report (DPR)
- Importance of the Project Report
- Contents of the Project Report
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

INTRODUCTION

Project evaluation is a systematic and objective assessment of an ongoing or completed project. The aim is to determine the relevance and level of achievement of project objectives, development effectiveness, efficiency, impact and sustainability. Evaluations also feed lessons learned into the decision-making process of the project stakeholders, including donors and national partners

Evaluation assesses how well planning and managing for future impact is being done during the project cycle. Because projects are collaborative efforts, partners have co-responsibility for achieving outcomes and, ultimately, impact.

As a Company Secretary, it is important to understand the concept of project evaluation, appraisal process, feasibility studies, factors affecting cost of project etc. The organization raises funds for the various new and undergoing projects. Company Secretary as a Key Managerial Personnel can advise the Board on the optimum utilization of funds raised by the organization for the said purposes.

FACTORS AFFECTING THE COST OF PROJECT

Cost estimation in project management is the process of forecasting the financial and other resources needed to complete a project within a defined scope. Cost estimation accounts for each and every element required for the project like materials, labor, construction equipments, design of the project, time overrun etc. and calculates a total amount that determines a project's budget from the beginning till end. A brief on various cost incurred in a construction project is placed below:

a) **Material Cost-** Many factors can impact the cost of a construction project, and one of them is the materials used. Some materials, like concrete and steel, are very expensive and required in bulk, while others, like wood, are relatively affordable. The type of materials used can have a significant impact on the overall cost of a project. For example, a concrete foundation will be much more expensive than a wooden one. The cost of materials is just one factor to consider when planning a construction project, but it is an important one.

b) **Impact of Labor Wage on Project Cost-** The impact of labor wages on project cost is an important consideration for any business or organization. Labor costs can have a significant impact on the overall cost of a project, and this needs to be taken into account when budgeting for a project. Several factors can impact the cost of labor, including the type of work being done, the skills required, and the location of the work.

c) **Impact of Method of Construction on Project Cost-** The method of construction is how the project is built, and it can have a significant impact on the overall cost. For example, traditional methods of construction tend to be more expensive than newer methods such as modular construction. This is because traditional methods often require more materials and labor, and they are often slower and more complicated. Other factors that can impact the cost of a construction project include the size and scope of the project, the location, and the type of materials used.

d) **Impact of Variation Orders on Project Cost-** Projects are often subject to change which modify the scope of work that is requested by the client after the commencement of construction. These changes can be minor, such as adding an extra light fixture to a room, or major, such as adding a floor to a building. Change orders can have a significant impact on the cost of a construction project. It is important for construction managers to be aware of the potential impact of change orders on the cost and schedule of their projects, and to factor that into their planning.

e) **Impact of Delay on Cost Overrun in Project cost-** Construction projects are often delayed due to a variety of factors, including bad weather, material shortages, and problems with the construction crew. While delays can be frustrating, they can also have a significant impact on the overall cost of the project. Cost overruns are common in construction, and they are often the result of delays. When a project is delayed, the contractor may need to pay overtime to the construction crew, and they may also need to pay for storage fees if the project site is not ready to receive materials. In addition, delays can lead to cost overruns by causing the contractor to miss their deadline for completing the project. This can result in a penalty from the client, which can add to the overall cost of the project.

f) **Nature of Construction site-** The project site can heavily influence the construction cost of the project. Site conditions such as poor soil, presence of pipes, uneven land, archaeological site, water bodies and environmentally hazardous spaces could increase the cost of the project manifold. Thus, they must be essentially covered in the project cost.

g) **Nature of Structure-** The type of structure and its structural form significantly influence the project cost. Simpler the structure, the lesser the cost will be. For example, if we have a simple grid, the structural design will be simple. Accordingly, the cost would be lesser comparatively.

h) **Project quality-** The quality of the project massively influences the cost. Whether you plan to incorporate modern amenities or wish to keep it simple, the project quality considerably influences the development cost of a house. Besides, high-quality projects involve the use of high-quality raw materials.

i) **Regulator and insurance requirements-** Approvals from the different regulatory authorities could be both costly and time-consuming. Also, it is crucial to consider the home insurance cost in advance as it can seriously blow your budget out of proportion.

j) **Size of the project-** A large-sized project requires a large workforce and more materials. Thus, the construction cost would enormously differ based on the size of the project. For instance, a project on 1,000 sq. ft. will entail lower development cost compared to a project on 5,000 sq. ft.

Determination of the Project Cost

It is of utmost importance to know the investment to be made on the different heads of the assets, to arrive at the total capital outlay on the project. The different heads under which investments are to be made for a manufacturing plant may be presented as under:

S. No	***Particulars of assets***	***Cost already incurred***	***To be incurred***	***Total Cost***
i	Land			
ii	Site Development			
iii	Civil Construction Work (Factory, Office and other civil structure) including building electrification)			
iv	Plant and Machineries (Giving break up for indigenous and imported separately)			
v	Plant Erection and installation expenses			
vi	Plant Electrification including cost of captive power plant			
vii	Other manufacturing assets like dies, moulds, materials handling equipment, Effluent Treatment Plant, etc.			

viii	Technical Know-how fees, if any			
ix	Deposits			
x	Other assets like furniture, office equipment, computers, vehicles, etc.			
xi	Preliminary Expenses			
xii	Preoperative Expenses			
xiii	Contingencies			
	Total Capital Cost			
xiv	Margin money for Working Capital			
xv	Total Project Cost			

The investment on each and every item mentioned above is appraised in detail and as such the report should provide complete information.

PROJECT APPRAISAL THROUGH FEASIBILITY AND DUE DILIGENCE (TECHNICAL, FINANCIAL AND LEGAL)

In narrow sense, project appraisal means comparing or assessing the project's credibility and viability to know the authenticity of a project. It is an important activity to evaluate the key factors of the project to check the viability of a project proposal.

In broader sense, Project Appraisal is a consistent process of reviewing a given project and evaluating its content to approve or reject this project, through analyzing the problem or need to be addressed by the project, generating solution options (alternatives) for solving the problem, selecting the most feasible option, conducting a feasibility analysis of that option, creating the solution statement, and identifying all people and organizations concerned with or affected by the project and its expected outcomes. It is an attempt to justify the project through analysis, which is a way to determine project feasibility and cost-effectiveness.

Project appraisal is an essential stage of any project, regardless of its nature, type and size. This stage represents the first point of the pre-planning or initiation phase. Without having appraised a project, it is financial and technically unreasonable to proceed with further planning and development.

Importance of Project Appraisal

Project appraisal is an important intellectual and systematic exercise carried out by the Financial Institutions/ Banks to consider the:

- Credit worthiness of the proposal;
- Critically analyse various assumptions made in the project report with respect to the cost and profitability; and
- Other factors affecting the viability of the project such as plant capacity, location of the business unit, proximity to raw materials, manpower, power and other utilities covered under both external and internal economies of scale.

Project report also serves as a benchmark for evaluating and monitoring the project during the implementation period. Based on the information furnished in the project report and considering the various external factors, appraisal is done to ascertain feasibility/viability of the project. The lender generally satisfies on the following key parameters before giving sanction for project funding:

- ***Management Appraisal***: Whether promoters can manage the Project successfully and infuse the required equity capital into the project.
- ***Technical Appraisal***: Whether the necessary resources are available for the manufacturing of products.
- ***Marketing Appraisal***: Whether products can be sold in the market and can surmount the competition.
- ***Financial Appraisal***: Whether a project can make profit to meet the financial obligations without any default.
- ***Social Benefit Appraisal***: Whether it is in line with societal expectations.

To access the above key parameters, FIs/Banks focus on the following crucial aspects:

- Promoter's background, experience and their managerial skills.
- Technology adopted and its suitability to the local environment.
- Availability of raw materials and other resources.
- Scope of market for the product.
- Cost structure and expected profits in light of the cost structure.
- Impact of the project on the society in terms of employment generation, use of local resources and environmental impact, etc.
- Impact on foreign exchange reserves of the country due to export of the finished products and/or import of raw materials.
- Compliance of the Government policies and regulations.
- Acceptability of the risk level with reference to political, social, economic, technological and legal environment.
- Greenfield / Brown field / ESG impact and consequent Tax holidays / implications.

The detailed appraisal of all the above factors will help lenders to ascertain the risk involved in the project and shall help in forming opinion whether to extend the financial support or to decline.

Feasibility Study

There are five types of feasibility studies mentioned as under:

S. No	***Type of feasibility***	***Reason for conducting study***
1.	Legal Feasibility	Performed to understand if the proposed plan conforms to the legal and ethical requirements.
2.	Economic Feasibility	Involves a cost benefits analysis to identify how well, or how poorly, a project will be concluded.
3.	Technical Feasibility	Process of validating the technical resources and capabilities to convert the ideas into working systems.

4.	Operational Feasibility	Performed to understand well a proposed system solves the problems.
5.	Scheduling Feasibility	Measure of how reasonable the project duration is.

DUE DILIGENCE IN PROJECT FINANCE

Due diligence in project finance is a process that consists of multiple steps to ensure the most comprehensive analysis:

1. Assessment of promoter history and background;
2. Evaluation of the company and project business model;
3. Legal due diligence;
4. Detailed Analysis of financial statements of the project and its and capital structure;
5. Determine major risks associated with the project;
6. Analysis of tax effects;
7. Credit analysis and evaluation of loan terms;
8. Project valuation.

A. Legal Feasibility and Due Diligence

The due diligence process should ensure that the project is procured in accordance with current legal requirements, both in domestic and international terms, and that key aspects of the project have been analyzed from a legal perspective. In order to assess the legal feasibility of the project, legal due diligence should include following three important steps:

1. **Analysis of the applicable legal framework***:* This includes the identification and analysis of pertinent laws and regulations that may affect the project. Some of the legal and regulatory aspects that need to be reviewed are as under:

   - The enabling Project legislations, especially looking for particular requirements imposed on projects, such as minimum capital value and maximum contractual duration;
   - The public procurement law which may be partially applicable, especially in search of general contractual and procurement guidelines;
   - Legislation referring to foreign investment, property, and labor issues;
   - Legislation related to land use planning and environmental laws;
   - Legal aspects of dispute resolution and intellectual property;
   - Legislation relating to the granting of ownership/control of public assets or of responsibility for the delivery of public services to third parties;
   - Legal treatment of revenue sources associated with the concession.

   These reviews need to provide, firstly, a comprehensive list of requirements applied to the project that feed other feasibility exercises, such as the technical requirements and the commercial feasibility analysis. Secondly, they should indicate, whenever appropriate, the need for any change in law or regulation and, should it be the case, identify the process through which this change can be enacted and assess the time and resources needed to promote the change.

2. **Assessment of the legal readiness of the procuring authority.** Although this particular issue may have already been checked, it is important to review at this stage whether the promoting authority and other institutions involved have the legal authority to launch the project or proceed with the approval as needed. The legal empowerment issues also apply, in some countries, to the formal responsibility for the appraisal exercises. Some countries require official feasibility exercises to be conducted. In this case, there can be requirements about which governmental bodies should be included and how. Therefore, the legal due diligence must clearly conclude which authorities should be involved and to what extent in each case.

3. **In-depth legal analysis of the main project issues**. Large infrastructure projects often have particularities with significant legal implications. It is thus very important during appraisal to assess the adherence of several aspects of the project to the general legal framework. Particular attention should be given to the legal feasibility of:

   - The financial aspects of the project;
   - Issues considered relevant to commercial viability, including the bankability of the project;
   - The use of land and existing assets;
   - Potential alternative ownership claims on the land (common in countries with complex or undocumented systems of property ownership);
   - Rights of other users (for example, a state oil company that owns pipes buried under the land, a road route crossing under electricity transmission wires etc.);
   - Employment issues;
   - Tax and accounting issues considered in the financial model.

Category	*Example of Legal Issues*
Financial aspects	• Legal feasibility of the selected type of public support or guarantees where needed. • Approval process for public support and authorities involved. • Legal restrictions and limitations for charging private sector end-users if applicable. • Legal ability to develop collateral businesses (advertising, retail, leisure, and so on).
Commercial feasibility	• Possibility of granting step-in rights to lenders. • Possibility of taking security over assets, current and future income streams, shares, and insurance policies under the current law. • Possibility of being named on insurance policies as lender and beneficiary.
Foreign investment and currency exchange	• Restrictions on foreign direct investment (FDI) and currency exchange controls. • Limitations on repatriation of dividends and capital invested. • Limitations on foreign staff.
Employment issues	• Consequences for public sector employees if existing assets are to be taken over by the private sector.

Category	***Example of Legal Issues***
Environmental issues	• Are specific environmental clearances required by law for the particular site or project type, or are there exemptions that are applicable to the site/project?
Taxation and accountancy	• Regime applicable to the project. • Regime applicable to imports (when significant equipment is included in the project Capex). • Provision of tax exemptions and potential specific tax benefits for FDI. • Other questions to be considered in the financial model.
Land and property assets issues	• Type of rights that can be assigned to the private sector. • The country specific issues surrounding land availability (which can take the form of right of way or clearance for Transportation projects and/or site ownership for facilities). • Rules regarding ownership of assets. • Responsibility for relocating people living in the right of way.

One important assessment required during the analysis of the main issues is the legal classification of the land and any existing assets. Even if the assets are already held by the procuring authority, they may not be ready to be transferred to the concessionaire. In some countries, there is a requirement for a change in the type of use of the asset, from "public use" to "disposable use". Other countries require legal authorization to transfer the control of public assets to the private sector. In any case, the availability of the land or asset needs to be fully acknowledged and the issues surrounding it identified.

B. Technical Feasibility and Due Diligence

A technical feasibility study can serve as a great planning tool by providing an overview of how the project can evolve during the course of its development. The results of the study also require to troubleshoot potential problems and track the progress of project from concept to reality.

Technical due diligence requires to evaluate the viability of architecture and design ideas required to execute a project and its successful completion.

Generally the following types of technical due diligence is undertaken:

- Infrastructure functionality and performance
- Architectural peer review process for functionality
- Compliance with industry standards and regulations
- Equipment capabilities and performance
- Proof of concept testing
- Facilities that support project needs
- Data that supports the implementation of the technology
- Operational risk assessments
- Systems and applications Integration.

The broad purpose of the technical analysis is to ensure that the project is technically feasible to manufacture the finished products with the available inputs and resources. An in-depth appraisal is done to ensure that a project is:

1. Properly designed, taking into consideration the pertinent variables,
2. Appropriately engineered, and
3. Follow the accepted standards.

Many a time especially for large project, Banks insist for the techno viability study to be carried by their approved consultant. The aspects which are normally find place in technical details are as follows:

i. Manufacturing Process and Technology: The manufacturing process is basically a sequence of activities intended to achieve the desired product/service. In manufacturing, the process converts inputs like raw materials, labour, etc. into desired output with the help of various machines and equipment.

While elaborating the manufacturing process, it should ensure that the process covers the use of all the machines to be installed. FIs/Banks will certainly verify whether machines mentioned in the project report are required for carrying out the manufacturing activities to justify the investment in the plant and machines. Drawing a flow chart will help in understanding the process easily.

If any manufacturing activity is outsourced in the process, for which no machines are proposed, the same should be specifically mentioned and cost of such outsourcing is to be included in the expenses in the profitability estimates.

Further the level of technology and automation is proposed, will determine the investment in the machines and manufacturing process. In case the technical know-how is acquired from outside, the credentials of the technology provider, its suitability to local condition along with name of the units where such technology is used is insisted by the lenders.

ii. Installed Capacity: Taking into consideration the actual working days, number of shifts to be operated and the machines proposed to be installed. The installed capacity of the unit is to be determined very carefully and precisely.

All profitability estimates depend upon capacity to produce. It should also be ensured that the installed capacity so arrived at, matches with the plant capacity mentioned by the supplier in the quotation/offer. In case of unit is manufacturing multi products, product mix has also to be ascertained. It is desirable to work out the gross revenue at the full capacity.

It is observed that it takes time to achieve optimum capacity utilisation and therefore it increases gradually over a period of time. The year wise capacity utilisation should be mentioned in this para to know the production and sales at different capacity utilisation. It may be depicted as under:

Sl. No.	***Year***	***Capacity Utilisation***	***Production (Units)***	***Sales (Units)***
1		%		
2		%		
3		%		
4		%		

The revenue at different capacity utilisation will be reflected in the profitability estimates and correspondingly the other cost elements to arrive at the net profit/loss.

iii. Location: The choice of location is influenced by the factors like:

- Proximity to the raw materials.
- Proximity to the market for end product.
- Availability of other infrastructure like rail, road, air connectivity, power, labour, water, communications etc.
- Government policies and the special incentives declared by the various State Governments for the promotion of any location for development.

It is an irreversible decision and affects the profitability in long term. Taking into consideration the above factors, a location is selected.

Whether it is the proximity to the source of raw material or to the centre of consumption, the decision should be taken considering the relative transportation cost in the overall costing.

iv. Raw Material availability and sources: The report should mention the types of raw materials required for the manufacturing of the finished products and its total requirement at 100% capacity. It may be provided as under:

Sl. No.	*Name of the Raw Materials*	*Imported/ Indigenous*	*Quantity Required*	*Rate*	*Total Cost*
1					
2					
3					
4					
	Total				
	Add Wastage		%		
	Total Cost				

It is expected that report should contain the details on:

- All such raw materials which are more than the 10% of the value of the total consumption.
- The source of the major raw materials supply.
- Quotations from the suppliers should also be obtained to support the raw material cost.
- Separate details should be provided for indigenous and imported raw materials. This will help FIs/Banks to assess the dependency on the imported raw materials and the country of export. A brief mention is also desirable about the import policy of the Government.

v. Power and Utilities: A broad assessment of utilities like power, water, steam, fuel etc. should be made properly.

Power: Power requirement should always be based on the machines installed and for general purpose. There are many industries which require initial heating load to charge the machines. It should also be taken care while working out the total power requirement.

It is also observed that all the machines are not required to operate simultaneously at all times and hence the maximum demand may be less than the connected load. It is to be noted that power connection cost and security deposit amount increases with the high-power demand. Therefore, power requirement is to be worked out very precisely to reduce the cost of the power connection.

If the company propose to install its own power generating unit for captive consumption, the same should be mentioned in the report and the capital cost to be incurred for such captive power plant is to be included in the project cost. And cost benefit analysis should be kept ready, if required by the FIs/Banks.

Other utilities: In addition, many units require water, steam and fuel (like coal, oil, etc.) for their manufacturing process. The requirement of such utilities and the sources are equally important and should to be mentioned in the report.

Cost of the power and other utilities is to be worked out at 100% capacity as well as at different capacity utilisation which will be reflected in the profitability estimates.

vi. Manpower Requirements:

The human factor in the projects is very vital for the smooth running of the unit. Report should contain the information on total manpower requirement. It is desirable that information should be classified and be given as under:

Sl. No.	***Particulars of employees***	***Salary Per Month***	***Total Cost***
1	Managerial		
2	Technical		
3	Supervisory		
4	Skilled		
5	Semi-skilled		
6	Unskilled		
7	Contractual and/or seasonal labour, if any		
	Total		
8	Add Fringe Benefits like PF and other statutory contributions.		
	Total Cost		

The bifurcation of the employees may be modified as per the nature of the enterprise. It should be ensured that the cost covers the minimum wages, prevailing salary and incentives, fringe benefits (like PF, ESIC, Bonus etc.) and should be taken into consideration while working out the total manpower cost.

vii. Environment clearance

The Government is now much more concerned about the environment protection and safety. A project may cause environmental pollution in various ways, such as:

- Water pollution
- Air pollution
- Noise pollution

Hence the environmental aspect of the project should be properly dealt with and all the necessary equipment must be provided in the project cost to control the pollution. It is observed that Government has issued notices to many industries for violation of environmental norms and suspended the operations due to non-compliance.

State Pollution Control Board/ Central Pollution Control Board are the authorities to give the consent and put the necessary conditions to be complied with for running any manufacturing plants.

The unit is required to obtain:

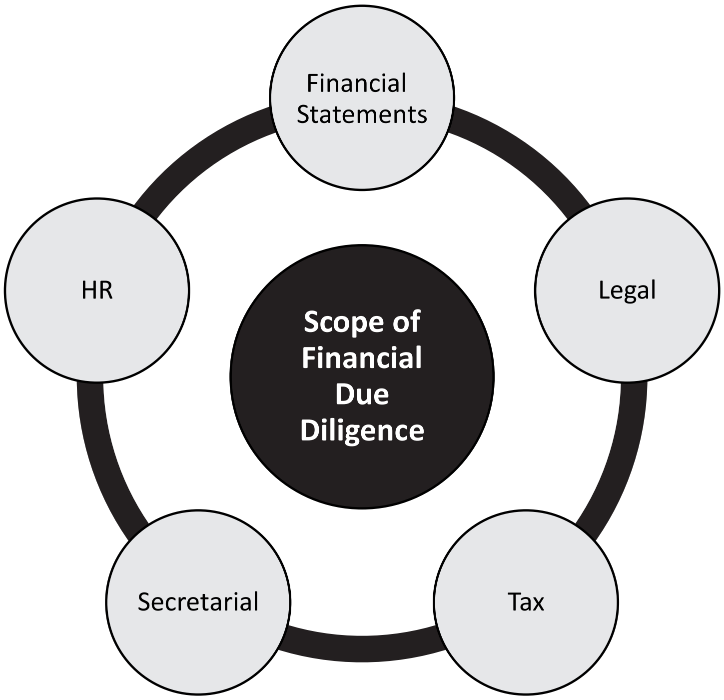
1. **Consent to Establish** before starting the unit and it is required to install necessary pollution control mechanism during implementation.
2. **Consent to Operate** is required to be obtained from the concerned authorities when the plant is ready for operation. The Consent to Establish is valid up to the implementation period and the validity of the Consent to Operate is given in the certificate.

viii. Others

- Carbon credits / Recycling/Upcycling Sustainability – all are given due weightage at the time of project evaluation
- Input costs on account of industry standard certifications e.g., ISO or ISI and other relevant substantial costs would need to be factored
- Cost of Patents, Licenses, Import of Technical manpower / Transfer Pricing Tax implications would need to be mentioned too as CS students are aware of all these aspects.

Financial Feasibility and Due Diligence

A very important investigative analysis of the financial performance of a company, somewhat similar to an audit, financial due diligence is conducted by outsiders looking to gain a better understanding of the financial situation that the company finds itself in, and its prospects for the future.



Checklist for Financial Due Diligence Report

It's the common and best practice to include all the important points of the financial health of an enterprise into the financial due diligence report. Some of them are mentioned below:

a) **Detailed Information on the Company Finances-** It includes tax returns, accounts receivable records, and financial statements for prior years also along with current one.

b) **Particulars of the Company Assets-** Comprising the details about the company's various buildings, equipment, and intangible assets like IPRs.

c) **Data on Clients, Partners, and Suppliers-** Detailed information on the many players in the company's supply chain and their interactions with one another has to be given here.

d) **Statistics on the employees of the Business-** It provides the information about the individuals who occupy key positions inside the business with their professional backgrounds. It might also provide information about previous ones also.

The basic object of making any business proposal is to make profit to meet business obligations and to remain financially viable at all times. Financial feasibility is determined by taking into consideration various technical parameters like plant capacity, product mix, cost of inputs, employees cost, other manufacturing expenses, interest, depreciation and administrative expenses. Within these parameters the financial estimates/projections need to be submitted to the FIs/Banks for their appraisal.

The following information may be included:

I. Determination of the Project Cost

II. Means or sources of Finance

III. Profitability Estimates

IV. Projected Balance Sheet

V. Projected Cash Flow/Fund Flow

VI. Financial Risk assessment.

I. Determination of the Project Cost:

It is of utmost importance to know the investment to be made on the different heads of the assets, to arrive at the total capital outlay on the project.

The different heads under which investments are to be made may be presented as under:

S. No	***Particulars of assets***	***Cost already incurred***	***To be incurred***	***Total Cost***
i	Land			
ii	Site Development			
iii	Civil Construction Work (Factory, Office and other civil structure) including building electrification)			
iv	Plant and Machineries (Giving break up for indigenous and imported separately)			

S. No	*Particulars of assets*	*Cost already incurred*	*To be incurred*	*Total Cost*
v	Plant Erection and installation expenses			
vi	Plant Electrification including cost of captive power plant			
vii	Other manufacturing assets like dies, moulds, materials handling equipment, Effluent Treatment Plant, etc.			
viii	Technical Know-how fees, if any			
ix	Deposits			
x	Other assets like furniture, office equipment, computers, vehicles, etc.			
xi	Preliminary Expenses			
xii	Preoperative Expenses			
xiii	Contingencies			
	Total Capital Cost			
xiv	Margin money for Working Capital			
xv	Total Project Cost			

The investments on each and every item mentioned above are appraised in detail and as such the report should provide complete information.

II. Means of Finance

After arriving at the total project cost as discussed earlier, sources from which these are to be funded should be considered. There are various alternatives and sources available to finance the project cost. According to the repayment capacity and profit generated by the unit, term loan component is determined. The finance may come from the following sources:

i. **Equity-** It is promoters' contribution by way of equity in the project. Being capital in nature, no interest can be provided and it cannot be withdrawn during the currency of the loan. In case of limited company, there is no provision in the Companies Act 2013 to provide any interest on equity and it cannot be reduced without the statutory compliances. However, in case of partnership firm, interest on capital is allowed under the Income Tax Act. FIs/Banks put strict conditions to ensure that capital is not withdrawn. Normally FIs/Banks desire that promoters should bring not less than 25% of the project cost by way of equity.

ii. **Internal Accruals-** In case the project is undertaken by an existing entity, the necessary equity for the project may come by way of internal accrual from their retained earnings and promoters need not to bring fresh capital. `It may be combination of partly from the internal accruals and partly from the infusion of fresh capital or unsecured loans.

iii. **Interest free Unsecured Loans/Deposits/Debentures (Quasi Equity) -** It is observed that out of the total promoters' contribution, promoters propose to bring their contribution partly in equity and partly as unsecured loans. FIs/Banks normally allow this arrangement subject to the condition that such type of unsecured loans should remain interest free and should not be withdrawn during the currency of loans. This is being treated as quasi equity and FIs/Banks may allow such quasi equity up to 15% to 25% of the total promoters' contribution. However, such policy may vary from bank to bank.

iv. **Government Subsidy/Incentives-** Central and various State Governments declare incentives schemes to promote the under-developed areas and offers various incentives including capital subsidy. This capital subsidy should also be considered as means of finance, if it is available during the implementation period of the project. Otherwise, it should not be considered a part of the means of finance. However, a reference should be made in the report about its entitlement to claim it.

v. **Term Loans-** Term loan is a part of the finance that is funded by FIs/Banks. It is interest bearing loan repayable in instalments over a long period of time depending upon the project. Normally repayment tenure is between 5-10 years. FIs/Banks allow moratorium period in repayment where the borrower is not required to pay any instalment of term loans. However, interest is to be serviced regularly. Depending upon the gestation period and generation of the earnings, repayment schedule is fixed.

vi. **Deferral Payment Scheme (imported machines)-** Machines manufacturers of some countries offer machines on Deferred Payment Scheme (three years) on attractive terms to the importing country. In case it is proposed to be availed, the term loan on those machines shall be reduced.

Whatever may be sources, the following two criteria is normally applied while determining the financial pattern:

(a) Debt Equity Norms (D/E)

It is the ratio of debt to the equity. Lower the equity, higher the debt equity ratio or vice versa. Earlier D/E ratio of 3:1 was considered reasonable. The fast-changing technology and economic scenario, high D/E ratio is being considered risky. However, for mega project, high D/E ratios are still considered on case to case basis.

Today D/E ratio between 2:1 to 1:1 is considered by the FIs/Banks. Debt Equity ratio of 2:1 means debt is two times of the equity from the promoters and in case of D/E ratio of 1:1, promoters bring equal contribution.

(b) Margin Concept

Under this method, FIs/Banks keep certain pre-determined margin say 25% to 40% depending upon the nature of assets to arrive at the loan component and rest is the promoters' contribution in the project.

III. Profitability Estimates:

After the project cost and means of finance are finalised, based on the technical parameters, profitability estimates at different capacity utilisation are prepared till the repayment of the term loan.

The profitability estimates prepared under the following heads:

a. Capacity Utilisation

b. Sales and other Income

c. Cost of Production:

- Raw Material Cost, Indigenous and Import
- Power and Fuel Cost
- Manpower Cost
- Stores and Spare Consumed
- Other Manufacturing Expenses including Repairs & Maintenance
- Depreciation and Amortisation (specify Straight Line Method/ Written Down Value Method)
- Administrative Expenses like Travelling & Conveyance, Rent and Taxes, Insurance, Telephone and Communication Expenses, Stationary, Audit Fees, Legal and Consultation Fees, Office Electricity, Bank Commission and Charges, Office Expenses, Security Charges, etc.
- Selling Expenses including Sales Commission, Brokerage, Advertisement and Publicity Expenses etc.
- Interest on Term Loan
- Interest on Working Capital Loan
- Interest on Other Loans
- Profit Before Tax
- Provision of Income Tax computed as per the provisions of Income Tax Act, 1961 including payment of Minimum Alternate Tax. If any.
- Net Profit After Tax.

The detailed profitability estimates are normally prepared in the Credit Monitoring Arrangement (CMA) format prescribed till the repayment of term loans and should be attached to the report. However, the key points of the profitability estimate should always be given in project report, which may be as under:

Year	***1***	***2***	***3***	***4***	***5***	***6***	***Till Repayment***
Capacity Utilisation							
Gross Revenue							
Net Revenue							
Profit before Interest and Depreciation							
Depreciation							
Interest							
Income Tax							
Net Profit							
Add Depreciation							
Cash Profit							
Repayment of Term Loan							
DSCR							

The details of each of the items of expenditure are to be given in the report by way of annexure so that FIs/Banks can verify the correctness of the figures.

Regarding the depreciation, The Companies Act, 2013 prescribes the depreciation rate in Schedule II based on the useful life of the assets. These rates are based on the depreciation method followed i.e. SLM/WDV. These rates are different from the rates prescribed under the Income Tax Act. Hence while calculating the Income Tax liabilities; it is to be ensured that depreciation allowable under the Income Tax Act only should be considered for IT liability including MAT. Sometime a reconciliation statement due to different rates of depreciation is attached to the report.

IV. Projected Balance Sheet

The projected balance sheet showing assets and liabilities of the borrower is prepared in CMA format prescribed to understand the financial position. It is prepared till the repayment of the term loans. However, the key points should always be given in the project report itself, which may be as under:

Year	***1***	***2***	***3***	***4***	***5***	***6***	***Till Repayment***
Capital and Liabilities							
Capital							
Reserve and Surplus							
Net Worth							
Long Term Liabilities							
Short Term Liabilities incl. TL instalment due within one year							
Total Liabilities							
Assets							
Gross Fixed Asset							
Net Fixed Assets							
Investments							
Current Assets							
Non-Tangible Assets							
Total Assets							
Current Ratio							
TOL/Net Worth							
Net Working Capital Margin							

V. Cash flow/Fund flow Statement

Based on the profitability and balance sheet, cash flow/fund flow statement is also prepared. This will help to understand that sufficient cash flow is generated to meet all short term and long-term liabilities and financial obligation in time. It also helps in understanding that long term surplus is available to meet the short-term liabilities. Vice versa, FIs/Banks may ask for explanation for utilising the short-term sources for long term purpose. Not all the times it is viewed negative. If the enterprise has sufficient liquid assets above the normal requirement to meet the current liability i.e., current ratio above 1.33, funds can be diverted for expansion. The detailed fund flow is to be given in the CMA format prescribed.

May provide the format covering expected cash flows from operating, investing and financing activities.

VI. Financial Risk Assessment

Risk is inherent in all the business as their performance is based on future projection, which cannot be predicted precisely. Risk assessment is very complex process and it is becoming a vital function in evaluation and appraisal of the project by FIs/Banks. Therefore, in FIs/Banks, now a days, a separate department with team of experts has been set up to assess the risk associated with the project. Prior to the sanction of any financial limits, risk assessment is carried out. There are several risks in a project, i.e., industry risk, market risk, international risk, financial risk, etc. Financial risk assessment plays an important role in appraisal. There is no single yardstick to assess it.

However, the following analysis may help to understand it better.

(a) Ratio Analysis

Ratio analysis is very simple and easy technique to understand critical components of the profitability estimate and projected balance sheet.

Profitability Ratio: In this ratio, each component of cost with respect to profitability estimates is critically analysed. Cost of the product consists of raw materials, power and fuel, manpower, interest, administrative expenses etc. The analysis of the various elements of cost gives the indication about which cost/expenses is more crucial in the project, which further requires management attention.

Balance Sheet Ratio: In Projected Balance Sheet, which shows financial position of the project; the ratio like Current Ratio, Outside Liability to Net worth etc. are widely analysed to know the financial soundness of the project.

Current Ratio which is useful to understand the current liquidity is calculated by dividing the current assets by current liability and ratio of1.33 is normally considered reasonable. In case of micro and small enterprises, ratio of 1.20 to 1.25 may be accepted. Higher the current ratio greater is the liquidity and financial soundness in short term.

The ratio of Total outside Liability (long term and short term both) to Net Worth (capital plus reserve and quasi capital) indicates how many times the borrowings are as compared to net worth. Normally FIs/Banks consider this ratio below 4 as reasonable. Lower ratio indicates higher commitment of promoters in the project and is viewed very positive.

(b) Debt Service Coverage Ratio (DSCR)

The Debt Service Coverage Ratio (DSCR) is the ratio of operating income available for debt servicing to repay the interest and principal of term loans. It is popular bench mark to measure the ability to repay loan.

$$\text{DSCR} = \frac{\text{Profit after Tax + Depreciation + Interest on Term Loans}}{\text{Interest on Term Loans + Principal of Term Loan}}$$

It is calculated for each year of profitability till the repayment of term loan. If the average DSCR is 2 and above, it will find favour with the FIs/Banks. Any proposal giving average DSCR below 1.5 is considered risky and promoters are asked to reduce the term loan and bring more equity. If it is between 1.5 to 2, it may be considered depending upon the promoters' background, type of project and collateral security offered. Higher DSCR sometimes result in reduction in repayment period.

(c) Break Even Analysis

Break-even analysis is done to understand at what capacity utilisation the unit achieves the break-even sales i.e., a point of sales where company makes no profit no loss. It recovers all expenses, fixed and variables. Break -even point may change with the change in the composition of the fixed and variable expenses and the realisable value of the products. Therefore, to calculate the breakeven is not an easy exercise and it requires understanding of the cost behaviour into fixed & variables expenses and that of the sale price. None the less analysis of BEP is very relevant in many decision makings like make or buy, to accept special order at low price, etc. Lower the breakeven point, higher the margin of safety or vice versa.

(d) Sensitivity Analysis

The behaviour of the various cost elements is never constant. It keeps on changing from situation to situation. Since the future is uncertain, it is important to know the impact of the changes in the various input cost and the realisable value on the profitability. Such analysis is called 'sensitivity analyses. The impact is always calculated negatively on the profitability. For example:

1. What, if raw material price is increased by ....%
2. What, if the power and fuel cost is increased by ....%
3. What, if the employees' cost is increased by ....%
4. What, if the selling priced is decreased by ....%

Such analysis helps to understand the extent of vulnerability of the project to certain input cost or price variability. FIs/Banks invariably calculate this analysis for the risk assessment purpose.

(e) Payback Period

Payback period is the time within which the initial outlay on the project is expected to be recovered through the cash inflows generated by the operations of the unit. It is one of the simplest and important investment appraisal techniques. Earlier the recovery more is the safety. However, it does not take into account the time value of money and also it does not take into account the cash flows post payback period. Some projects may generate higher cash flows in the later life of the project. This limitation can be resolved using the net present value of the earnings over a period of time. The discounting factor to be used to calculate the net present value may be the cost of capital.

(f) Internal Rate of Return (IRR)

Under IRR, future cash inflows are discounted at present value of cash inflows equal to the outflows on the project. This IRR is compared with the expected IRR and accordingly decisions are taken.

(g) SWOT Analysis

A SWOT analysis is an exercise to identify Strengths, Weaknesses, Opportunities and Threats to assist in making strategic plans and decisions.

A SWOT analysis also reveals the positive forces that work together and potential problems that need to be recognized and addressed.

Strengths and Weaknesses are considered to be internal factors over which enterprises have some measure of control whereas Opportunities and Threats are considered to be external factors over which enterprise have little or no control.

The overview of these four factors is necessary and should find place in the project report.

(a) **Strengths** - Strengths are positive aspects which help and support to accomplish mission and growth in the business. It may be good financial strength, good marketing network, easy access to the raw materials, etc.

(b) **Weaknesses** - Weaknesses are those negative factors that prevent in achieving full potential, however they can be controlled and mitigated by proper strategy. For example, dependency on the few customers for sale or on few suppliers for raw materials availability may be taken into consideration if such weakness observed in the proposal.

(c) **Opportunities**–Opportunities may arise from market, competition, technological changes, deregulation by Government, import restrictions, etc. An enterprise should be careful and recognize the opportunities and grasp them whenever they arise.

(d) **Threats** - Threats challenge the stability and survival of the enterprise. It may come from change in technology, product obsolescence, increase in cut-throat competition, development of substitutes, Government regulations, etc. They compound the vulnerability of the business and management should always be alert to such situation.

Strength, Weakness, Opportunity and Threat are relative terms and interchanges from time to time depending upon the situation. When writing the weakness and threat, it is also desirable to mention about measures to mitigate.

ROLE OF A COMPANY SECRETARY

The feasibility report is always prepared based on the information supplied by the promoters of the entity. As a professional consultant, when the work of the project report preparation, feasibility study, funding of the project and other incidental matters are assigned, it is desirable to seek the information from the promoters, which are required to be incorporated in the project report. The required information is to be framed in the questionnaire format, which is to be furnished by the promoters. The information required may be classified as:

- General Information
- Information of Management and Promoters Background
- Information on Technical details
- Information on Marketing Strategy
- Information of revenue and cost estimates
- Project Implementation Schedule
- Risk Associated with the Project.

At this stage, the promoters may be advised to disclose all the relevant information regarding the project, whether positive or negative. The unfavourable points, if any, can be addressed and dealt appropriately in the report at this stage without hiding it.

The Practicing Company Secretary plays an important role in the entire process of project report preparation, appraisal, and funding and project implementation. Due to expertise in corporate funding, compliances, governance and legal understanding and due diligence, Company Secretaries can provide professional services in the following areas:

Area of Practice*	***Professional services***
In Formation	1. To obtain DIN of proposed directors of the project 2. To ascertain the availability of name for the new company 3. To prepare the Memorandum and Articles of Association 4. To incorporate the Company/LLP
In Registration & Licence	1. To obtaining Udyam Registration for MSME status 2. To obtain Industrial Entrepreneurs Memorandum from Ministry of Commerce and Industry, Government of India for large scale registration 3. To obtain industrial licence from Government of India
In Raising Fund	1. To Prepare feasibility report for financial assistance from FIs/Banks 2. Representing case before the FIs/Bank and doing Liaison and follow up win FIs/ Banks 3. To obtain Credit ratings from external rating agencies 4. To raise the capital from capital market or Venture Capital
Other Corporate Services	1. To draft collaboration agreement and/or Shareholders Agreement, if required 2. To provide FEMA related advice on FDA and ECB guidelines 3. To carry on due diligence 4. To obtain Environment Clearance from the Concerned department
Corporate Compliances	1. To increase the authorised capital and comply with the statutory requirement for further issue of shares 2. To comply with the statutory requirement of accepting the unsecured loans and deposits and issue of debentures 3. To suggest proper capital structure 4. To allot shares and to issue share certificates 5. To help in executing the loan and other legal documents 6. To create/satisfy charge with MCA 7. To take search of the company's record and issue necessary certificate

** This is an indicative list for information purpose only.*

Activity Flow Chart for Company Secretary

The activities involved in the entire process of execution of professional assignment are illustrated as under:

➢ Initial discussion with the promoters on the project
➢ Understanding the scope of the work and discuss about the professional charges
➢ To apprise the broad about financing norms
➢ Obtain the assignment in writing specifying the scope of work and payment terms of professional fees
➢ Send the questionnaire format to furnish the information about the project and promoters
➢ Prepare the draft report based on the information received and discuss the report point to point with promoters and incorporate their suggestion before the final report
➢ Advise the promoters to read the entire project report very carefully so that during the discussion with the FIs/Banks, they do not make any such statement which is not in conformity with what is stated in the project report, unless revised or modified
➢ Submit the proposal to more than one FI/Bank and try to obtain the in-principle clearance to avoid the rejection at later stage
➢ Arrange the meeting of the promoters with bankers
➢ Remain in touch with bankers during the preparation of their appraisal note for sanctioning authority and also on the likely terms and conditions being stipulated. At this stage we can discuss on the change in terms and conditions which are not favourable to the borrowers
➢ Try to arrange the discussion with the higher authority sanctioning the proposal. This will always help in easy sanction.
➢ If the loan proposal is sanctioned by the FI/Bank, read the terms and conditions for disbursement of the loan
➢ Pay processing fee
➢ Express thanks to all involved in the sanction process, formally or informally
➢ Comply with the terms and conditions of the sanction and execute the loan agreement and other legal document

Feasibility and Due Diligence- Some examples

1. **Feasibility study for the Expansion of Healthcare facility**

   If the healthcare facility wants to expand its area of a building, then it may conduct the feasibility study, which will help it in determining whether a hospital should go ahead with the project of expansion or not.

   Different criteria which should be taken into account, like in the present case. Following are the factors that will include:

   - Labor and material cost that will be incurred for the expansion.

- What will be the change in the revenue to the organization if the expansion is done?
- How disruptive it will be for the staff and its patients?
- What is the public opinion with respect to the new extension, i.e., whether the local community is in favor of such a project or they are against it?
- What is the response of the various stakeholders of the organization as the stakeholders play an important role in any organization as they are the people who have a major interest in a project or business?
- A detailed evaluation of all the project's pros and cons while conducting the study and then allotting the ranks to them with respect to each other. All the responses should be gathered properly and analyzed on different parameters as applicable. Based on that, it will be determined that the organization go ahead with the project expansion or not.

2. Setting up a New Food Outlet

A detailed and thorough feasibility study before opening the outlet will help the owner in saving time and money as, with the help of a study, he can make an informed decision regarding the chance of success of the venture.

Following are the different factors that may be focused on:

- *Preparing Market Statistics:* Feasibility study should include studying the demographic characteristics like age and income to know the size of the potential market. In the case of the family restaurant, one should know the number of families residing in the area as singles or students will not count for the potential share.
- *Potential Locations:* The location for the family restaurant should be the area having high-traffic. Parking and other factors should also be considered to make sure that the place is easily accessible to customers.
- *Level of Competition:* At the time of the Feasibility study, one should gather information about the total number of nearby restaurants and the style of those restaurants. The area should not already be saturated with a similar concept as planned. Thus one should properly analyze the strengths and weaknesses of all major competitors.
- *Extensive Industry Analysis*: For studying the feasibility, one should join the various organizations of the same industry and attend their meetings to know more about the health and growth of the industry.
- *Recent Economic Environment:* Decide whether as per the current economic environment launching a new restaurant is advisable or not. Whether any restaurants were closed in the past few years or not and their reasons thereof.
- *In depth Cost Structure:* One should break down the cost of each item on the menu and determine the major suppliers in the future and prices offered by them. Also, there should be a proper cost projection of the food cost projections.
- In the feasibility study, one should evaluate management capability, i.e., whether an entrepreneur has the required skill and experience to make a venture successful. He should also have the capability to manage the staff and to understand properly about kitchen operation.

These are some of the important parameters that one should evaluate to conduct a feasibility study on starting a new family restaurant. Apart from these, other factors like laws and regulations, logistics, and other factors as applicable should also be considered before making the decisions.

All the facts and figures should be evaluated deeply with their positive and negative aspects to take a sound decision.

PROJECT VIABILITY AND RESEARCH ON INNOVATION

The viability of the project can be understood in terms whether it can be completed successfully given the time, money, and other resources that are available with the Organization.

This is very important aspect in Project Management which qualitatively and quantitatively evaluates the strength of the projects, identifies gaps in practices, and advises upon the actions to take to minimize project risk in later stages.

Factors that can impact the viability of a project, including its scope, complexity, and the skill level of the team working on it along with the availability of resources can also play a role in determining whether or not a project is viable to undertake further.

The assessment of a project viability is based on a review of the status and plans for key Project activities like financing, permitting, engineering, procurement, construction, interconnection, start-up and testing, operations, fuel supply, water supply, wastewater discharge, labor agreements, site control, commissioning of the project, civil work etc.

Economic viability of the project is considered positive if the economic benefits of the project exceed its economic costs, when analyzed for society as a whole. The economic costs of the project are not the same as its financial costs—externalities and environmental impacts should be considered. This concept is also known as SCBA i.e. Social Cost Benefit Analysis.

Steps for Viability Check

- Define the scope of the project: This will include project's goals, objectives, and deliverables and any restrictions or limitations.
- Conduct a market analysis: This entails investigating and evaluating the project target market, identifying possible clients, Competitors, and recent market trends.
- Preparing a financial plan: It will include making a budget for the project, projected income and costs, and calculating the payback period.
- Risk assessment and understanding uncertainties: This includes locating and assessing any potential risks or uncertainties that may affect the project in any way, such as governmental changes or market conditions.
- Report Preparation: The data collected above should be compiled into a report that explains the viability study results and offers options for continuing the project.
- Review and feedback: Presenting the report to all the stakeholders to get their input, and make any necessary adjustments.

Project viability in financial terms

Financial viability should be analyzed in present value terms, which means **the costs and revenues over the life of the project are expressed in terms of today's money**. This is essential for making meaningful comparisons of benefits and costs that occur at different times and for comparing different projects.

Financial Viability Analysis of a Construction Project- An Illustration

- Project is expected to cost Rs. 5000 crores. It is planned to be financed by equity and borrowing.
- The net cash flow during the construction period (2016-2019) is negative as there will not be any inflow but fixed interest on loan is to be paid. It is positive during the operation period (2019-2039).

- It is agreed that the SPV will be started with an equity of Rs. 2000 crores to be provided by the sponsors and rest would be borrowed form a leading financial institutions. This arrangement will make debt equity ratio to be 3:2. Interest on loan is expected to be 12% p.a. to be paid semi-annually at the end of September and March. Loan is taken on 1st April 2016.
- The loan is to be repaid in five equal installments starting from 16th year of the project (reckoned from the date of operation). It is expected that the project would generate enough cash flows in the latter phase so as to repay lender from 16th year of the project.
- Annual Operation and Maintenance cost is expected to be 2.5% p.a. of project cost. In addition to this, there will a periodic maintenance at the end of every five years starting from 5th year of operation. The annual operation and maintenance cost is expected to increase 2% annually in next 5 years and thereafter it will increase by 1%.
- After the completion of construction on 31st march, 2019, revenue is generated from toll from vehicles during the operation period, which is fixed based on technical viability of the project. Toll revenue is expected to be 8% of project cost in first year i.e. by the end of March, 2020. It is also supposed to increase 10% annually over previous year up to 2028 and thereafter it will increase by 5%.
- Depreciation means allocation of project cost over the life of the project. It only reduces taxable income and provides an annual tax advantage equal to the product of depreciation and the (marginal) tax rate, but it does not lead to a cash outflow from the company. The most common method for depreciation is straight-line depreciation. Under this method, annual depreciation equals a constant proportion of the initial investment. It is assumed that the project cost of Rs. 5000 crores is to be written off over the 20 years which is the life of the project.
- Corporate Tax rate is 34%.

A project can be considered as financially viable, if the following conditions are satisfied:

- The Net Present Value (NPV) for the project should be positive. The discount rate for financial analysis may sometimes include a premium for risk over the current commercial lending rate.
- The financial IRR should have a value greater than the discount rate.
- The cash flow (liquidity position) in each year of the concession period should be satisfactory. That means the cash balance at the end of every year should be positive.
- Payback period/Breakdown year should be less than the concession period.

Questions for discussion

Q. 1. Comment on the financial viability of the project by taking into account the following measures assuming a discount rate of 12%:

a. NPV

b. Payback period

c. Discounted payback period

d. Profitability Index

e. Project IRR

f. Equity IRR

Q. 2. If the maintenance cost goes up by 50% from 1st year and expected revenue is 6%, how would these affect the financial viability of the project?

Cash Flow of the Project from 2017-2024

	2017	2018	2019	2020	2021	2022	2023	2024
Toll Revenue				400.00	440.00	484.00	532.40	585.64
Less: Operation & Maintenance				125.00	127.50	130.05	132.65	135.30
Interest on Loan	360.00	360.00	360.00	360.00	360.00	360.00	360.00	360.00
Depreciation				250.00	250.00	250.00	250.00	250.00
PBT	-360.00	-360.00	-360.00	-335.00	-297.50	-256.05	-210.25	-159.66
Less: Tax	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
PAT	-360.00	-360.00	-360.00	-335.00	-297.50	-256.05	-210.25	-159.66
Repayment of loan								
Project Cash Flow	-360.00	-360.00	-360.00	-85.00	-47.50	-6.05	39.75	90.34
Equity Cash Flow	-597.60	-597.60	-597.60	-322.60	-285.10	-243.65	-197.85	-147.26

Cash Flow of the Project from 2025-2033

	2025	2026	2027	2028	2029	2030	2031	2032	2033
Toll Revenue	644.20	708.62	779.49	857.44	900.31	945.32	992.59	1042.22	1094.33
Less: Operation & Maintenance	138.01	139.39	140.78	142.19	143.61	145.05	146.50	147.97	149.45
Interest on Loan	360.00	360.00	360.00	360.00	360.00	360.00	360.00	360.00	360.00
Depreciation	250.00	250.00	250.00	250.00	250.00	250.00	250.00	250.00	250.00
PBT	-103.81	-40.77	28.70	105.24	146.69	190.27	236.09	284.25	334.88
Less: Tax	0.00	0.00	9.76	35.78	49.88	64.69	80.27	96.65	113.86
PAT	-103.81	-40.77	28.70	105.24	146.69	180.51	200.31	234.38	270.19
Repayment of loan									
Project Cash Flow	146.19	209.23	278.70	355.24	396.69	430.51	450.31	484.38	520.19
Equity Cash Flow	-91.41	-28.37	41.10	117.64	159.09	192.91	212.71	246.78	282.59

Cash Flow of the Project from 2034-2039

	2034	2035	2036	2037	2038	2039
Toll Revenue	1149.05	1206.50	1266.82	1330.16	1396.67	1466.51
Less: Operation & Maintenance	150.94	152.45	153.97	155.51	157.07	158.64
	2034	2035	2036	2037	2038	2039
Interest on Loan	360.00	360.00	288.00	216.00	144.00	72.00
Depreciation	250.00	250.00	250.00	250.00	250.00	250.00

PBT	388.11	444.05	574.85	708.65	845.60	985.87
Less: Tax	131.96	150.98	195.45	240.94	287.51	335.19
PAT	307.84	347.40	460.99	576.69	694.63	790.42
Repayment of loan		960.00	888.00	816.00	744.00	672.00
Project Cash Flow	557.84	597.40	710.99	826.69	944.63	1040.42
Equity Cash Flow	320.24	-600.20	-367.09	-131.87	105.59	320.90

Solution to Question No. 1

a. Net Present Value (NPV) is the difference between present value of Future Cash Flow (FCF) and the initial cash outlay. For this, we are considering project cash flow calculated in the previous page.

Present value of FCF	(INR 1,519.25)
Initial Outlay	INR 5,000.00
NPV	(INR 6,519.25)

Net present value is negative. Hence, it can be said that the project will not be profitable for the company. Under the present forecasts, the project does not look financially viable.

b. Payback period is the time taken to recover initial investment. For this, we need to calculate cumulative cash flow and identify the time where the initial investment gets recovered. The project will recover the initial investment between 2038 and 2039.

Payback period 21.87 Years
If we consider concession period only, then it will break even in between 18 and 19 years.

c. Discounted payback period considers time value of money. If we consider time value of money, then this project will never be able to recover its initial investment of Rs. 2500 crores.

d.

Profitability index = Present value of cash inflows/ initial outlay	
Present value of cash inflow	130.09
Initial outlay	5000
Profitability Index	2.60%

So, the above calculation shows that for every 100 rupees investment in the project, cost recovered is only Rs. 2.6.

e.

Project IRR	1.53%	IRR is calculated using IRR function in excel

f. Equity IRR is negative. It cannot be calculated.

Based on the above estimates, we can that the project is not very viable financially.

Solution to Question No. 2

If maintenance cost goes up by 20% and projected revenue is 6% instead of 8%, then project will not be financially viable at all.

REGULATORY AUTHORITIES/AGENCIES

These are the independent governmental bodies established by legislative act in order to set standards in a specific field of activity, or operations, in the private sector of the economy and then to enforce those standards. Regulatory agencies function outside direct executive supervision.

Philosophy behind the regulatory framework

- Checking the anti-competitive practices
- Taking steps to prevent market failure
- Focusing on the public interest
- Ensuring the flawless running of industrial development

The following are Regulators in Indian Financial system:

- SEBI: The apex regulator in the Indian capital market is the Securities and Exchange Board of India (SEBI).
- IRDAI: The Insurance Regulatory and Development Authority of India (IRDA) is the regulatory authority for the insurance sector.
- RBI: Reserve Bank of India (RBI) is the apex regulator for banking sector.
- PFRDA: Pension Funds Regulatory and Development Authority (PFRDA) regulate pensions.
- MCA: Ministry of Corporate Affairs (MCA) regulates the functioning of corporate sector in accordance with law.
- AMFI: Association of Mutual Funds in India is a non-statutory body. It is a body to control mutual fund industry in the country.

Approvals/clearances required for doing business and corresponding agencies granting the same in India

Approvals/Clearances required	***Department/Agencies to be approached and consulted***
Incorporation of Company	Registrar of Companies, Ministry of Corporate Affairs
Registration/IEM/Industrial license	DIC for SSI/SIA, Department of Industrial Policy & Promotion for large and Medium industries
Allotment of land	Concerned State DI/SIDC/Infrastructure Corporation/ SSIDC
Permission for land use (In case industry is located outside an approved industrial area)	State DI Department of Town and Country Planning Local authority/ District Collector
Consent under Water and Air Pollution Control Acts Environment Impact Assessment	State Pollution Control Board Ministry of Environment and Forests, Government of India

Approvals/Clearances required	*Department/Agencies to be approached and consulted*
Approval of construction activity and building plan	a. Town and country planning b. Municipal and local authorities c. Chief Inspector of Factories d. Pollution Control Board
Sanction of Power and power safety	State Electricity Board/Companies and state electricity inspector
Use and storage of explosives	Chief Controller of Explosives
Manufacturing pharmaceutical products.	Drugs Inspectorate
Boiler Inspection	Chief Inspector of Boilers
Finance	SFC/ State Industrial Development Corporation for term loans For loans higher than Rs. 15 million, all India financial institutions like IDBI, ICICI, IFCI etc.
Registration under State Sales Tax Act State Excise Act Central Excise Act	i. Sales Tax Department ii. State Excise Department iii. Central Excise Department.
Extraction of Minerals	State Director of Mines and Geology
ISI (Quality) Marking	Regional Office of the Bureau of Indian Standards (BIS)
Quality Marking Certificate	Quality Marking Centre of the State Government
Labour Act	Labour Department
Weights and Measures	Inspector of Weights and Measures
Code Number for Export and Import	Regional Office of Director General of Foreign Trade.

Source: https://www.oecd.org/gov/regulatory-policy/44925979.pdf

RISK ASSESSMENT AND MITIGATION

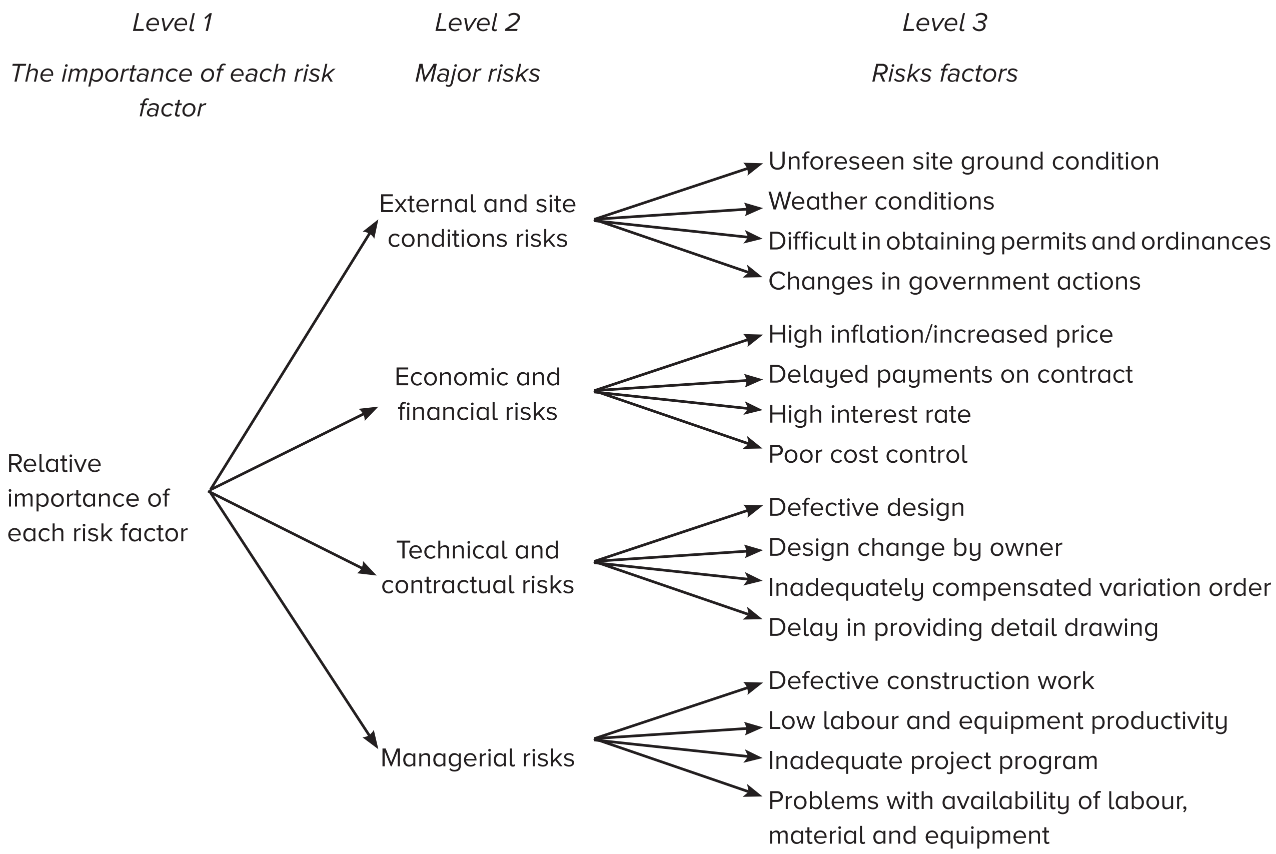
A risk is generally defined as an elaboration of unfortunate consequences of certain events. Risk can be managed properly if it is assessed and identified timely. So the Risk management refers to the problems that may occur which are only in term of probability, at the same time in the actual time of occurrence there can be a number of other events happening which are unknown but predicable generally.

In the Projects, risk usually refers to the factors that may hamper the objective of the project regarding time, cost and quality. Risk Identification that can be faced is important for the contractor to get alert and prepare in advance for the uncertainties that arises.

Risk level = Risk probability × Risk impact

Risk Types/Attributes in Project Management

- General, dynamic or static Risk;
- Internal or external risks;
- Financial risk;
- Time risk;
- Physical risk;
- Personnel risk;
- Design and technical risk;
- Contractual risk;
- Political and regulation risk;
- Safety risk;
- Economic Risk;
- Legal Risk and Managerial Risk.



Majorly Risk analysis, also known as risk assessment, begins from the identifying the risk before the project is carried out. It is very important to identify all potential hazards in a project well in advance. The whole process of Risk Management can be understood from the following images, which are very clearly explaining what and How of the Risk.

CASE STUDY

The Project is estimated to cost Rs. 382.12 crores and is proposed to be funded by way of Rs. 69.00 crores of equity, Rs. 191.03 crores of Debt and Rs. 122.09 crores grant from Government.

Detailed Project Description

As per the concession agreement, the scope of the Project would include the following Core Construction Requirements: Design, Build, Finance, Operate and Transfer [DBFOT] basis and maintenance during construction period and functions associated with the construction of the Project Highway and roadside facilities. The Project Highway is to be widened to have a 4 lane divided carriageway facility.

Project Facilities:

Toll Plaza(s): There are three toll plaza(s) to be erected 1st Km 43/600 on SH10, 2nd Km 125/000 on SH70 3rd in Km 80/200 on SH70 of the project highway for the purpose of regulating the entry and exit of vehicles.

Road side Furniture: To be provided for the entire length of the project highway. Viz., sign board, overhead portal with sign boards etc.

Pedestrian facilities: Facilities of safe and unhindered movement of pedestrian and cyclist shall be provided on the project highway.

Landscaping and Tree plantation: All along the road, tree shall be planted as per standards; tree shall be planted in rows and on either side of project highway as per standards. The plantations in the median shall comprise of shrubs and flowing plants. Tree plantation shall also be taken to environmental balance and loss due to cutting of trees for road widening.

The scheme for landscaping shall be part of overall environmental mitigation plan (EMP). The area around toll plaza and check post shall be properly landscaped. All depressed/scraped area shall be properly landscaped all along project road.

Bus-bays and passenger shelter: These shall be provided in accordance with CA and places mentioned therein.

Cattle crossing: Facilities for crossing highway at busy intersection is proposed through vehicular underpass.

Highway Lighting: The lighting shall comply with the provisions of standards and specifications, the project Highway shall also be provided with adequate lighting system in Urban /built up areas, Under Passes/ Cattle Passes, at grade intersections, Toll plaza, Bus Stop etc.

Administrative: Operation and Maintenance Base Camp: A minimum of 300 Sqm of covered area for functional base camp shall be provided. The base camp shall be located near the plazas location.

The proposed facilities available at base camp are described here under:-

Toll plaza /collection centre, Main collection centre administrative block, Equipment and machinery required for operation and maintenance and Storage space for equipment and material for traffic signs and marking, Workshop, General Garage and repair shop, Testing laboratory and First Aid Box.

Bridges & Other Structures: The Project includes **c**onstruction of 8 major bridges widened for four lanes, widening of 20 minor bridges, one Road over bridge.

Risks Identification of Project of Highway Construction

❖ Vital Risks of this Project

- **Traffic Risk-**Traffic during the construction process. Inconvenience for the commuters to travel.

- **Toll Risk-**Due to the lower traffic density, the collection of toll reduced. Toll risk lead to the failure in recovery of construction cost. Total construction cost increased.
- **Constructional Risk-**The project is implemented by the way of fixed price and time. So the risk in the increase of material cost increased.
- **Operational and Maintenance Risk-**Due to the delay of the project, the Operational and Maintenance cost increased which affected the commencement of operation to cover the estimated maintenance expenditure.
- **Land Acquisition-**Delay in the project due to land acquisition leading to increase in the estimated construction cost.

❖ Slight Risks in this project

- **Utilities-** Non availability of fuel, electricity and utilities not relocated at time delays the work of the day.
- **Noise-** Repetitive, excessive noise causes long term hearing problems in labour and can be a dangerous distraction.
- **Material & Manual Handling-** Materials and equipment is being constantly lifted and moved around on a construction site, whether manually or by the use of lifting equipment. Different trades will involve greater demands, but all may involve some degree of risk.

❖ Corrective Steps

- **Traffic Risk-** The base, Toll able Traffic had been considered based on the Independent Traffic report given by Executive Engineer Public Works Department. However, considering a fall in the base traffic number by 5 % in the process of working out sensitivity analysis, the Min DSCR and Avg DSCR are at acceptable levels.
- **Toll Risk-** Financial indicators of the project are highly sensitive to tariff growth assumptions. In the model it is considered with an average traffic growth of 5%, though there is enough potential due to anticipated industrial growth.

A reduction in the traffic growth to 4% found that the DSCRs are at acceptable levels.

There is no risk perceived on the WPI factor, since the toll fee given by Government if for the total concession period and the revised toll fee numbers are also mentioned.

Constructional Risk- The Project is implemented by way of a fixed price fixed time EPC contract. Hence the risk on account of price increase in material cost is mitigated.

Operational and Maintenance Risk- O&M contract for periodic maintenance is likely to be awarded to IVRCL. IVRCL has substantial experience in implementing road contracts. It is also proposed to have a major Maintenance Reserve (MMR) to be built up through internal accruals from commencement of operation to cover the estimated major maintenance expenditure.

Utilities- There should be adequate amount of fuel in backup inn case of emergency, electricity backup should be there in case of power cuts for completion of project on time without any delay.

Noise- Using simple ear plugs does not necessarily offer total protection against hearing damage – employers are required to carry out and document a comprehensive noise risk assessment.

Material & Manual Handling- Where employee's duties involve manual handling, then adequate training must be carried out. Where lifting equipment is used, then adequate training must also be carried out, but may involve some form of test, to confirm competency. Records of training must be maintained for verification.

Result:-

- Initial base traffic reduced by 5%.
- Traffic growth rate reduced from 5% to 4%.
- Interest rate increased by 1%, both during construction and operation period.
- Increase in O & M expenses by 10% during operation period.

Conclusion from the case study was drawn that the flow chart of the different activity for better planning of risk management is necessary. Effective risk management process encourages the construction companies to identify and mitigate the risks and later if those risks managed effectively, they can efficiently enjoy financial savings, and greater productivity, improved success rates of new projects and better decision making. The risk management in any project is very essential. It identifies the factors that cause uncertain risks in a Toll project and a possible process of mitigating them timely.

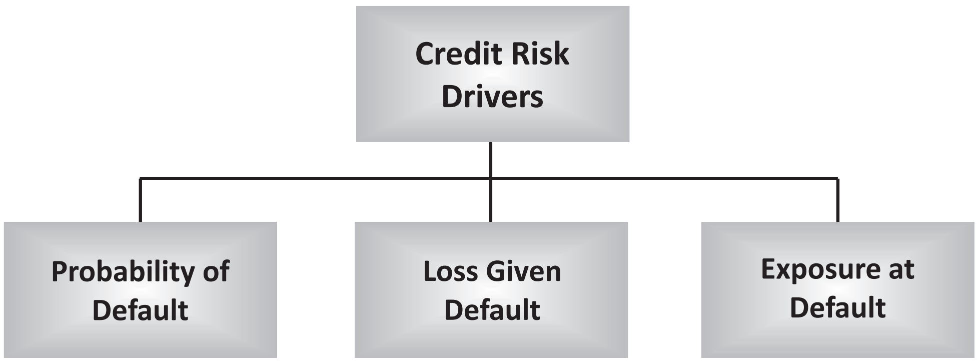
CREDIT RISK MANAGEMENT IN PROJECT FINANCE

The risk management is project finance, is all about identifying the various type of risks associated with a project and the appropriate allocation of these risks among the different parties engaged in the concerned project as to mitigate it. The project finance risk can be categorized into different categories like credit, construction, operations, financing, volume risk etc.

Credit risk which is the risk of loss that may occur from the failure of any party to make required payments on loans**.**

According to RBI, credit risk is "The possibility of losses associated with diminution in the credit quality of borrowers or counterparties.

Lenders face different types of credit risks—**default risk, concentration risk, country risk, downgrade risk, and institutional risk**. Institutions can have a check on the credit worthiness by using the "5 Cs" of credit risk—credit history, capacity to repay, capital, conditions of the loan, and collateral.



Credit risk management refers to measuring and mitigating the risks associated with the amount given as loan to the projects and preparing the organization to cope up with this risk.

Managing Credit Risk helps lending authorities to understand the credit worthiness of the borrowers, thereby helping them decide whether or not to approve their loan applications.

Certain specific strategies to manage credit risks may include:

– Efficient data aggregation

– Apt credit-scoring model
– Realistic credit limits
– Streamlined on boarding of customers
– Clear contracts
– Advanced automated systems.

Financial Institutions focus on the credit rating while financing a project. All FIs/Banks invariably carry out credit rating of the proposals. It may be:

- Internal Credit Rating
- External Credit Rating.

Internal Credit Rating: Each FI/Bank has its own credit rating model and credit risk committee which weigh the proposal considering various parameters and assign the marks for each parameter. If the proposal scores the marks above the investment grade, the proposal is considered for sanction and project scoring high marks are often offered lower rate of interest.

S. No.	***Rating (Long term)***	***Degree of safety/default on Long term Scale***	***Rating (short term)***	***Degree of safety/default on Short term scale***
1	AAA	Highest safety	A 1	Very strong
2	AA	High safety	A 2	Strong
3	A	Adequate safety	A 3	Moderate
4	BBB	Moderate safety	A 4	Minimal
5	BB	Moderate risk of default	D	Defaulter or expected to be defaulter
6	B	High risk of default		
7	C	Very high risk of default		
8	D	Defaulter or expected to be defaulter		

External Credit Rating: Apart from the internal rating done by the FIs/Banks while appraising the project, they may insist for the credit rating from external agency in case the loan amount is exceeding the prescribed limit. Few important agencies are CRISIL, CARE, ICRA, FITCH, SMERA, BRICKWORK, etc. They evaluate the project and assign the rating according to risk perception. Higher rating increases the negotiating power for the better terms from the FIs/Banks.

There is uniformity between the various Credit Rating Agencies regarding assignment of credit rating. The following chart indicates rating model being followed by Credit Rating Agencies:

(i) Due Diligence

The present economic scenario increases the importance of due diligence to ensure the compliances of the various statutes and systems. The due diligence may be in the following areas:

- Market due diligence
- Technical due diligence

- Legal due diligence
- System due diligence
- Financial and Accounting due diligence
- Tax due diligence
- Environmental due diligence, etc.

Depending upon the nature and size of project and purpose of the financial assistance, due diligence may be insisted upon by FIs/Banks.

(ii) Collateral Security

Apart from the first charge on the assets of the project, FIs/Banks insist on the additional collateral security from the borrower to increase the security coverage and the comfort level. There is no yardstick for such collaterals. The quantum of the collateral securities depends upon the risk perception and borrowers profile.

It is be worthwhile to mention that Government of India and SIDBI had set up the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). Under this scheme, Micro and Small industries are eligible for collateral free credit facilities up to Rs. 200 lakhs from any FIs/Banks.

Personal Guarantees of Directors and Major Shareholders

Personal guarantees of the proprietor, partners, and directors are invariably provided for the loans taken. If the promoter of any project is a corporate entity, the FIs/Banks will insist on the corporate guarantee also.

It is also observed that personal guarantees of the major shareholders (Holding 10% and above) are being asked by the lenders, if they belong to promoters' family. If investment is made as an investor only, depending upon the situation, personal guarantee may not be insisted upon. However, FIs/Banks normally insist on the guarantee of shareholders holding not less than 51% shares.

Corporate Guarantees.

As explained in preceding paragraph, if the promoter of the project is a corporate entity or one of the major shareholders is a corporate entity belonging to promoter family, corporate guarantee may be insisted upon.

(iii) Execution of Legal Documents

After sanction of loan, FIs/Banks issue detailed sanction letter incorporating the various terms and conditions of the sanction which may include loan amount, interest rate, repayment schedule, securities, guarantees, margin, promoters' equity contribution etc. These conditions may be stipulated for pre disbursement and post disbursement. After complying with all the terms of the pre disbursement conditions, Loan documents are executed. During this process, FIs/Banks may take the search of the properties, valuation of the properties, legal due diligence, search on MCA site, etc. All documents are to be properly stamped as per local Acts. In case of corporate borrowers, charge is to be created on MCA site.

PREPARATION OF DETAILED PROJECT REPORT (DPR)

A Project Report is a written document relating to any investment containing the data on the basis of which the project has been appraised and found feasible. The information on economic, technical, financial, managerial and production aspects of the Project are shown as the part of Project Report**.**

The concept of Detailed Project Reports (DPRs) is quite demanding which are the outputs of planning and design phase of a project. DPR is a very detailed and elaborate plan for a project indicating overall programme, different roles and responsibilities, activities and resources required for the project. It can be called a blueprint of the project plan.

Importance of the Project Report

Project report is a blueprint of future trajectory of any business organisation. A well drafted Project Report plays a pivotal role in strengthening the investment proposal which in turn assist immensely in obtaining financial assistance from Financial Institutions/Banks (FIs/Banks) or any other stakeholder, i.e. equity shareholder, preference shareholder, debenture holder etc. of the business. A project report contains the information and data on the basis of which project is appraised to study its feasibility. Project Report submitted at the beginning to the FIs/Banks mainly contains the information about the business ideas and its promoters.

It is worthwhile to mention that while preparing the project report, as far as possible, all relevant information as mentioned above should be given in the report itself instead of giving by way of annexure. Giving information in annexure requires the appraising officer to switch between annexure and main report which distracts the attention and continuity. If annexure is necessary, then gist of the contents of the annexure is to be incorporated in the project report itself.

Many a times, it is observed that sanctioning authority does not meet and interact with the promoters in person but take decisions based on the information given in the project report. Therefore, it is advisable to give complete information about the project and its promoters along with supporting data. A SWOT (S-Strengths, W-Weaknesses, O- Opportunities and T-Threats) analysis of the project proposal in the report with appropriate solution is well appreciated by the FIs/Banks. The proper presentation provides confidence to the sanctioning authority to consider the proposal favourably. Furnishing the information “as and when asked for” should always be avoided. It delays the processing and sometimes adversely affects the decision.

The necessity of detailed project report can be understood from the fact that it is an extensive document that gives intricate details about the proposed business idea focusing on the information about the business proposal and different strategies that would be taken into account in order to implement the plan. It provides a sound base for investing in a project. If a good DPR is prepared, it can result into benefits like:

- Managing the budget of the Project
- Risk Minimization
- Efficient Project progress follow up
- Holdover the project by the concerned Authorities.

Contents of the Project Report

The project report should provide all the necessary relevant information so as to enable FIs/Banks to appraise the project in a systematic way. In view of this, it should contain the following information:

- General Information
- Management and Promoters Background

- Technical Feasibility
- Marketing Strategy
- Financial Feasibility
- Social Cost -Benefits Analysis
- Project Implementation Schedule
- Risk Assessment.

The information to be incorporated under each of the above heads are elaborated and discussed in the respective chapters of this book. These information are normally required by FIs/Banks and are indicative in nature. Each FI/Bank has its own appraisal system and policy. They may ask more information/clarification to satisfy themselves before committing any type of funding. Previous exposure of funding in the similar line of activity and experience of FI/Banks may sometimes have impact on the funding decision.

General Information

This is the first part of the project report which gives general information about the project. The information may include:

i. **Name of the entity**

ii. **Address**

iii. **Constitution** of the entity i.e Sole Proprietorship, Partnership, Society, Trust, Limited Liability Partnership, Private or Public Limited Company.

iv. **Date of Incorporation and Registration Authority**

v. **Status/Size of the Project**

vi. **Registration Number and Issuing Authority**

vii. **Licensing Requirement:**

There are certain products which require compulsory licence to manufacture. The enterprise should obtain the same from the Government before taking any effective steps. These items are specified in the Industrial Policy of the Government of India.

i. **Nature of Activity and Products to be manufactured:**

   The report should mention the details of the products to be manufactured and its use in brief. If the production process gives rise to any by products, it should also be mentioned in the report since in many cases, by products are important source of the revenue. For example, Sugar industry gives rise to molasses as by products which has substantial realisable value in the sugar industry.

ii. **Plant Capacity:**

   The report should mention in brief the installed capacity for all the products to be manufactured.

iii. **Nature and Amount of Financial Assistance:**

   The financial assistance requested from the FIs/Banks should mentioned in brief i.e. the amount of:

   - Term Loan (Rupee loan and loan in foreign currency)
   - Working Capital Loan (fund based)

- Non-Fund Based Limits (Letter of Credit/Bank Guarantee limit)
- One time LC limit for import of machines, if any.
- BG for duty free import of machines, if any.
- BG/LC for raw material purchase, performance, tender etc. for working capital.

Management and Promoters Background and their Appraisal

This is one of the most important part of the project report which is being read very carefully by financial institutions/banks and many a time it determines the fate of the proposal. Therefore drafting the promoter's background needs special attention and care. The appraisal of the management is very subjective and there is no yardstick to measure it. Following factors are considered while appraising Management and Promoters' background:

i) Past track record and technical qualification and industry specific skills

ii) Business competence and experience (especially in the proposed activity)

iii) Performance of the associate concerns

iv) Bankers Report

v) Financial Resources

vi) Existing organizational setup & degree of professionalism

vii) Achievements and Recognitions received from any Government or Trade and Industry Association or Professional Bodies.

It should be ensured that none of promoters name and their associate concerns are appearing as defaulter in the RBI defaulters list/CIBIL Report.

The promoters' background may be divided into two parts:

A. Promoter's individual profile

Detailed Profile of each of the promoter such as:

- Name
- Address
- Age
- Educational Qualification
- Experience

Some FIs/Banks expect that in this part, promoters should give details of their experience after finishing their education and entering into the business/job. This helps them to understand their growth and achievements.

B. Details of Associate Concerns

Details of all the associate concerns in which promoters are interested as proprietor/partners/director are to be provided. The detail should contain the following information:

- Name of the Associate Concern
- Address of the Concern

- Names of Proprietor/Partners/Directors
- Year of Establishment
- Nature of Activity/Business
- Name and address of the Bankers
- Financial Limits enjoyed:
  (a) Term Loans
  (b) Working Capital Loans
- Past performance and financial position for the last three years indicating turnover, profits, net worth and outside liabilities. The presentation may be as under:

S. No	*Particulars*	*Year*	*Year*	*Year*
A. Financial Performance				
1	Sales and other income			
2	Profit before depreciation, interest and tax			
3	Depreciation			
4	Interest			
5	Income Tax			
6	Profit after Tax			
7	Net Cash Accruals			
B. Financial Position				
1	Capital			
2	Reserve & Surplus			
3	Term Liabilities			
4	Current Liabilities			
5	Net Fixed Assets			
6	Current Assets			

The performance of the associate concerns or subsidiary companies is equally important to consider the proposal favourably. All the above information helps the lenders to understand the promoters 'future achievements and their growth.

A new entrepreneur with no business background, having service experience should mention about the name of the employer/s, nature of job and responsibility undertaken.

Things to consider while writing a DPR

An ideal DPR should be clear, concise, accurate and well organized with clear section headings. It must be easy for the audience to understand. Presentation of the facts and figures report writing is quite crucial. Formatting, revising and proof reading is very important process for good report writing that must be well focused.

A **detailed project report** must include the following information:

- Brief information about the project
- Experience and skills of the people involved in the promotion of the project
- Details and practical results of the industrial concerns of the promoters of the project
- Project finance and sources of financing
- Government approvals
- Raw material requirement
- Details of the requisite securities to be given to various financial organizations
- Other important details of the proffered project idea include information about management teams for the project, details about the building, plant, machinery, etc.

The DPR needs to provide information covering the following areas:

1. **Sectoral Background and the broad objective of the Project**
   - Existing status of the physical infrastructure (brief description)
   - Base line information in terms of user coverage & access (by different user categories/segments)
   - List of various projects proposed for the sector
   - List of other capital expenditure projects supported by other schemes for the sector
   - Existing tariff and cost recovery methods and extent of cost recovery for past 5 years
   - Any other qualitative information e.g. list of key issues related to that sector.
2. **Definition of the Project and its Scope**

   The project is needed to be clearly defined in terms of Land
   - Total quantum of land required and being provided for the project
   - Confirmation that the required land is owned /already purchased
   - Land title should be clear and unencumbered
   - Physical infrastructure components.

   Environmental compliance/protection measures/improvement measures
   - Environment impact assessment
   - Environment management plan.

   Other information
   - Details of surveys and investigations required

- Assessment of requirements related to utilities shifting
- List of clearances and agencies from which these are to be obtained
- Disaster related risk assessment and broad countermeasures (including earthquake/other natural disaster resistant design of structures).

3. Project Cost

The project (construction) cost should cover major elements, including but not limited to these specific components listed here:

- Land acquisition/site development
- Physical infrastructure component-wise cost
- Environmental compliance cost
- Cost of surveys & investigations
- Cost of shifting utilities
- Cost of consultancy services:
  - (a) Design
  - (b) Supervision
  - (c) Quality Assurance
- Other statutory compliance costs if applicable
- Finance/interest cost during construction
- Contingency
- Any other.

For all cost elements, assumptions (rates, methods of calculations etc.) are to be clearly given either in the main text or as an attached appendix of the DPR.

Note:

- All cost heads are to be provided for in the DPR; if an element is not applicable, "0" may be put against it when entering actual figures. O&M costs are covered in a separate section; this section covers only capital cost.
- if survey cost is included in design cost , this may be clearly specified to avoid double counting
- The project, for implementation purposes, can be broken into contract packages for tendering. This perspective of cost is being covered separately in the section on Project Institutional framework.

4. Institutional Framework of the Project

Roles of different institutions involved in the construction phase of the project

- A Roles/responsibility matrix could be a convenient option to present this information.
- The relationship between SPV and the state government agencies on the other are to be made explicit. Innovative approaches to provide for improved coordination and/or working arrangements can be highlighted.

Areas of involvement of the private sector in the construction phase (tick mark as appropriate):

i	Project Feasibility Study	
ii	Project Engineering Design	
iii	Specialized Surveys	
iv	Construction Works	
v	Supervision Consultants	
vi	Quality Assurance Consultants	
vii	Any Other Please Specify (example: Equipment Lease)	

Additional information regarding the above can be provided. (In brief) if required.

5. Financial Structure of the Project

Overall Financial Structuring of the project which can involve a combination of equity, grant, debt and finance from private participation (and in some cases, contribution from user communities)

Review of options for

- Institutional debt and/or
- Private sector participation

The Debt Component can be from:

(a) general bank finance: however banks are unlikely to accord long tenure finance (these could typically be around eight years at a stretch)

(b) specially issued bonds

(c) term loan from financial intermediary such as HUDCO, LIC, IL&FS, IDFC, SBI Caps ICICI bank; state level financial institutions (including those specific to development of urban infrastructure) etc.

The ideal debt component is dependent upon a number of factors including the status, nature and sector of the project, project cash-flows as well as the financial condition of the economy along with availability of finance.

Private sector participation can be through

- a separate legal entity created specifically for this purpose (SPV)
- a direct BOT/BOOT arrangement and its variant models with or without an SPV arrangement
- a simple management contract or lease based contract.

All variants involve payment to the private entity to enable them cost recovery of construction (and also for O&M). This could be in the form of:

- Private party being allowed direct recovery of user charges for a specified long term duration (say, for illustrative purposes only, 15-25 years)
- Private party being paid a fixed annuity (or on a fixed rate per unit quantity for service delivery undertaken) for its services over the specified term duration.

6. **Phasing of the Project**

It refers to a collection of activities within a project and also called structuring of projects into stages. Phasing can be done as for following activities:-

a) Schedule for tendering/selection for procurement of services

   (i) Construction contractors

   (ii) Consultants / firms for supervision and quality assurance

   (iii) Consultants for any other activity required.

b) Schedule for obtaining all clearances (along with list of major clearances)

c) Schedule for shifting utilities.

The implementation schedules/work plan can be presented in a simple bar chart on weekly, fortnightly or quarterly basis, as shown below by adding the columns according to the convenience.

7. **Operation & Maintenance Planning of the Project**

The DPR is to incorporate/include information relating to the following five areas:

(i) The institution to be engaged in the O&M of the created infrastructure asset/enhanced infrastructure assets.

(ii) Brief outline of the existing method of billing & collection (including user/customer-segment wise differentiated strategy, if any).

(iii) Select performance metrics in regard to billing & collections (for the most recent completed financial year, and if possible, for the current quarter of the ongoing financial year).

(iv) The scope for private entity/community /NGO to be involved in defined aspects of O&M for any specific/all components of the infrastructure asset.

(v) The DPR should clearly define the requirements of manpower, energy, spares and consumables etc. for O&M on an annual basis giving details of existing usage, norms and proposed additional requirements.

In regard to tariff and user cost recovery, the DPR is to provide:

(i) The tariff (revenue) model for each customer/user group for the sector (including underlying assumptions) and forecast growth of customer/ user groups over the next 20 years.

(ii) Unit cost of service and unit price (existing year and forecast for next 20 years).

(iii) Outline plan to restructure tariff system to any or all categories of user groups to comply with MoA requirement.

8. **Assessment of Financial Viability of the Project**

- NPV & IRR (overall): examines overall project viability, including finance cost and asset replacement cost.
- NPV & IRR (O&M): examines only O&M viability.

The complete supporting project cash flow projections along with underlying assumptions have to be presented.

It should clearly explain the cost of capital considered and calculation method to arrive at the same for the project.

DPR should provide:-

Cash Flows - Detailed cash flow covering the last 5 years on an actual basis and projections for the next 20 years. (The underlying assumptions for the projections also need to be mentioned)

An assessment of the annual impact of the project on the finances (i.e. revenue receipts, revenue expenditure, capital receipts and capital expenditure).

Debt situation assessment

- Debt schedules and terms for all debt taken
- Debt service coverage ratio (DSCR)
- Debt-equity ratio for the project.

In case of Special Purpose Vehicle (SPV) or Joint Venture (JV) as a separate legal project implementation entity, the Profit & Loss (P&L) Statement and Balance Sheet forecasts for the next 20 years shall be provided.

9. Social Cost Benefit Analysis of the Project (SCBA)

Along with the financial perspective, SCBA is very important covering a list of benefits from societal perspective (both social and economic) supported by:

- Explanation or description in qualitative terms.
- Quantification of these benefits to the extent possible (or wherever possible) along with underlying assumptions.

Social benefits must be assessed as compared to the project outlays verses project benefits for the society.

- access	- supply continuity	-time savings
- coverage	- safety	-environment improvement
- service quality	- cost savings	-employment
- improved efficiency	- improved efficiency	- improved quality of life, etc.

Negative impacts must also be stated in terms of:-

- Explanation or description in qualitative terms
- Quantification of these negative/adverse impacts to the extent possible (or wherever possible) along with underlying assumptions. Examples of negative/adverse impacts include:

– Pollution; environmental distortions
– Reduced green cover
– Reduced access to any specific user segments
– Supply interruptions (especially during project construction phases) etc.
– Displacement of inhabitants
– Disruption in livelihood /reduced employment/ labour redundancy
– Possible haphazard development around/adjacent project site areas

SCBA can be done in the following format:-

S.No	***Benefits Description***	***Comments***	***Quantitative Impacts & Underlying Assumptions***
	Societal Benefits		
1			
2			
3.			
	Societal adverse impacts		
1			
2			
3			

Limitations of the Project Report

As mentioned earlier, project report is a written document pertaining to any investment proposal. It contains relevant data, on the basis of which the project is prepared and appraised. A project Report is prepared by the expert after detailed study and analysis of the various aspects of a project. However, there are certain constraints and limitations of the project report. They are:

- There is no uniform loan application form prescribed for the loan application by FIs/Banks
- There is no uniform format for project report prescribed by FIs/Banks
- There is no uniform appraisal process. Each bank has its own appraisal System
- The report is prepared on assumptions, which are likely to change when implemented. As the project evolves, assumptions may come prove correct or wrong. Changing circumstances may compel to modify previously identified assumptions.

In either case, the project must be prepared to considering the contingent factors.

LESSON ROUND-UP

- Project evaluation is a systematic and objective assessment of an ongoing or completed project. The aim is to determine the relevance and level of achievement of project objectives, development effectiveness, efficiency, impact and sustainability.
- Cost estimation in project management is the process of forecasting the financial and other resources needed to complete a project within a defined scope.
- Project Appraisal is a consistent process of reviewing a given project and evaluating its content to approve or reject this project, through analyzing the problem or need to be addressed by the project, generating solution options (alternatives) for solving the problem, selecting the most feasible option, conducting a feasibility analysis of that option, creating the solution statement, and identifying all people and organizations concerned with or affected by the project and its expected outcomes.

- The due diligence process should ensure that the project is procured in accordance with current legal requirements, both in domestic and international terms, and that key aspects of the project have been analyzed from a legal perspective.
- Technical due diligence requires to evaluate the viability of architecture and design ideas required to execute a project and its successful completion.
- Financial feasibility is determined by taking into consideration various technical parameters like plant capacity, product mix, cost of inputs, employees cost, other manufacturing expenses, interest, depreciation and administrative expenses.
- The Practicing Company Secretary plays an important role in the entire process of project report preparation, appraisal, and funding and project implementation. Due to expertise in corporate funding, compliances, governance and legal understanding and due diligence, Company Secretaries can provide professional services in the various areas.
- The viability of the project can be understood in terms whether it can be completed successfully given the time, money, and other resources that are available with the Organization.
- Risk management refers to the problems that may occur which are only in term of probability, at the same time in the actual time of occurrence there can be a number of other events happening which are unknown but predicable generally.
- Credit risk is the risk of loss that may occur from the failure of any party to make required payments on loans.
- Detailed Project Report is a very detailed and elaborate plan for a project indicating overall programme, different roles and responsibilities, activities and resources required for the project. It can be called a blueprint of the project plan.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What do you mean by Project Evaluation? What are factors which affect the cost of a Project?
2. Explain the project appraisal through Technical, Legal and Financial feasibility study.
3. Elaborate the concept of risk assessment and mitigation. Also, define the role of credit risk management in Project Finance?
4. How to prepare a Detailed Project Report (DPR)?
5. Explain the role of Company Secretary in project appraisal and due diligence?

LIST OF FURTHER READINGS

- Approach to Project Finance and Understanding Financial Statements, ICSI-CCGRT Publication
- Project Finance for Business Development by John E. Triantis
- Introduction to Project Finance by Andrew Fight

OTHER REFERENCES

- https://www.oecd.org/gov/regulatory-policy/44925979.pdf
- https://www.structuralguide.com/factors-affecting-project-cost/
- https://www.sketchbubble.com/en/presentation-feasibility-study.html
- https://alcorfund.com/insight/how-to-determine-the-feasibility-of-a-business-idea/

WARNING

Regulation 27 of the Company Secretaries Regulations, 1982

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo-moto or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as a student, or debar him from re-registration as a student, or take such action as may be deemed fit.

It may be noted that according to regulation 2(ia) of the Company Secretaries Regulations, 1982, 'misconduct' in relation to a registered student or a candidate enrolled for any examination conducted by the Institute means behaviour in disorderly manner in relation to the Institute or in or around an examination centre or premises, or breach of any provision of the Act, rule, regulation, notification, condition, guideline, direction, advisory, circular of the Institute, or adoption of malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with writing of any examination conducted by the Institute, or tampering with the Institute's record or database, writing or sharing information about the Institute on public forums, social networking or any print or electronic media which is defamatory or any other act which may harm, damage, hamper or challenge the secrecy, decorum or sanctity of examination or training or any policy of the Institute.

PROFESSIONAL PROGRAMME
STRATEGIC MANAGEMENT & CORPORATE FINANCE
GROUP 2 • PAPER 5

(*This test paper is for practice and self-study only and not to be sent to the Institute*)

Time allowed: 3 hours *Maximum Mark: 100*

Answer all Questions

PART I - STRATEGIC MANAGEMENT (40 MARKS)

Question No. 1

Case Study:

About the Company

White Silver Limited (WSL) is a public limited company in Country-X engaged in mining and production of coal and coal products. The mission of the company is "to be a partner in the economy by producing and fulfilling the energy demand of the country by providing quality coal in economical and sustainable manner". The company is listed on a stock exchange of the Country X. Shares of the company are held by the Govt. of Country-X, Mutual funds & FII and general public in proportion of 78%, 10% and 12% respectively. During the financial year 2022-23, the company has produced and dispatched 1000 million tonnes of coal. Of this 82% to power plants, 4% to steel plant and rest to other sectors.

Coal is the prime source of energy and fulfills approx. Approx. 80% of energy demand of the country B. The thermal power plants, steel manufacturing plants, cement and fertilizer plants are the major consumers of coal.

The country-B has a large reserve of coal but the quality and cost are major concern. In the last few years there has been increase in import of coal by steel and power plants. The steel plants import coal due to quality and cost advantage over domestic coal. As per a study report conducted by the WSL, good quality of coal can be produced only through deep and underground mining. Underground mining requires highly automated technology.

Challenges before WSL

For adopting deep underground mining the WSL is required to acquire land for new mines and latest automated machines for mining. Land acquisition in country-X has been a hard task due to land acquisition related laws and protests by the local community and NGOs as WSL has acres of idle land in the form of used abandoned mines which cannot be used for agricultural activities or human rehabilitation due to the risk of landslides. WSL is a labour intensive company with low productivity. Employee cost is the major cost of WSL which accounts for 60% of total cost. WSL is second largest employer in country X.

Till recent past, the WSL was the only company which was allowed for mining and marketing of the coal in the country but with the changing economic scenario and to meet the growing energy demand the Govt. of Country-X is mulling to allot coal blocks to steel plant and thermal power plant for captive consumption.

The Govt. of the Country X is committed to boost manufacturing and industrial infrastructure of the country in next 10 years. Power and steel sector would be witnessing a multifold increase in demand not only from Government schemes but also from private and domestic consumers.

To meet the energy demand, the Government has reduced the duty on imported coal. The Government being a signatory of Paris agreement on climate change, is committed for sustainable development by reducing carbon emission caused by usage of fossil fuels. It has entered into various technological MoUs to install clean energy sources like nuclear, solar and wind in near future.

Required:

(i) Identify and describe the five forces of Porter with respect to WSL.

(ii) Identify the stakeholders in WSL. Discuss the strategy which WSL should adopt to prioritize the stakeholders.

(iii) Explain the strategy WSL should adopt to survive and gain competitive advantage.

(iv) If WSL wants to change itself from a labour intensive organization to a modern technology driven organization, state how WSL can manage the resistance to change from employees related unions?

(5 Marks each)

Question No. 2

a) A company is finding difficult to adapt itself in the changing environment. A strategic consultant has advised it to go for an environmental scanning to deal with the current problem.

Being company's consultant, submit a report stating the strategic fit between external and internal environment so as to enable the company to regain its previous sustainable market position.

(5 Marks)

b) Two firms X and Y are belonging to the FMCG sector. They are identical except growth rate and market share because of location and other external reasons. Firm X has high market share and high growth rate while firm Y has a high market share with a low business growth rate.

You need to identify the category of firm X and Y to which they belong referring to the BCG matrix and advise them right strategy so as to remain competitive in the market.

(5 Marks)

Question No. 3

a) A startup company is thinking of launching a low cost detergent powder in the market. The market for the said product is already dominated by big FMCG players. As a strategic professional, suggest the Company Management for adopting the best business level strategy.

(5 Marks)

b) Logistics strategy plan is an important part of formulation of strategy'. What are the major elements of Strategic Plan?

(5 Marks)

PART II – CORPORATE FINANCE (60 MARKS)

Question No. 4

(i) Sri Foods Ltd. wants to issue 10000 shares through a book built offer within a Price Band of Rs. 140 to Rs. 160. Bids are received as follows:

Bid Price	***No. of Shares***	***Total Demand***
Rs. 160	2000	2000
Rs. 150	3000	5000

Bid Price	*No. of Shares*	*Total Demand*
Rs. 148	5000	10000
Rs. 140	10000	20000

(a) What is the cut off price in this offer? Can the company decide the cut off at a lower price at which the issue is subscribed? Can the company allot the shares to the retail investors at a price that is at a discount to the cut off price?

(b) What would be the allocation pattern, presuming the company fulfils the eligibility criteria regarding net tangible assets, average operating profit, net worth etc.?

(c) What would be allocation pattern, if the company does not meet the criteria as mentioned above in part (b)?

(5 Marks each)

(ii) Following is the extract from the Balance Sheet of M/s of Shaktikant Industries Limited as on 31 March 2023:

Current Liabilities	*Amount (Rs. in Lakh)*	*Current Assets*	*Amount (Rs. in Lakh)*
Bank Borrowings	870	Inventories	700
Trade Payables	230	Financial Assets	
Other Current Liabilities	200	Investment	300
		Trade Receivables	75
		Cash and Cash Equivalents	125
		Bank Balance other than (iii) above	150
		Other Financial Assets	350

Shaktikant Industries Limited has bank borrowings of Rs. 870 Lakhs which includes bills discounted with the bank. It wishes to avail loan for its working capital and approaches your bank for financing.

While maintaining the minimum current ratio of 1.33, calculate the Maximum Permissible Bank Finance (MPBF) as per methodology suggested by Tondon Committee. Should the bank sanction the loan request or not ?

(5 Marks)

Question No. 5

a) Alpha Ltd. would like to issue US $ 1000 million Global Depository Receipts (GDRs) for setting up cloud computing services. Managing Director of the company requests you as a Company Secretary to prepare a checklist for the issue of Depository Receipts. Prepare a checklist considering conditions to be fulfilled by a company as per the provisions of Companies (Issue of Global Depository Receipts) Rules, 2014.

(*5 Marks*)

b) Gamma Ltd. makes an application for Bank Guarantee Limit for the Financial Year 2022-23 with following data to Kuber Bank Ltd:

(i) Outstanding Bank Guarantee as per the last Audited Balance Sheet: Rs. 1.05 Crore

(ii) Bank Guarantee required for the Financial Year 2022-23: Rs. 1.25 crore

(iii) Estimated maturity or Cancellation during the period: Rs. 80 lakhs

Compute the Bank Guarantee limit of Gamma Ltd. for the Financial Year 2022-23.

(5 Marks)

Question No. 6

a) The provisions relating to "Special Situation Fund (SSF)" has been notified by SEBI vide SEBI (Alternative Investment Funds) (Amendment) Regulations, 2022. Explain the above referred provision in view of requirement with regard to minimum corpus funds for each scheme of SSF and minimum investment required by different types of investors of SSF.

(5 Marks)

b) Distinguish between Real Estate Investment Trusts (REITs) and Infrastructure Investment Trust (InvITs) with reference to brief concept, growth prospect, income stability and associated risks.

(5 Marks)

Question No. 7

Jasmine Ltd. is a newly incorporated company and it would like to purchase raw materials from domestic sources as well as from other countries under Letter of Credit (LC). On the basis of the following information, calculate the limit for Letter of Credit (LC) for the Financial Year 2022-23:

a)	Estimated Raw Material purchase for FY 2022-23		Rs. 300 crore
b)	Estimated purchase under Letter of Credit (LC) for FY 2022-23 (90%)		Rs. 270 crore
c)	Of which import of Raw Material under Letter of Credit (30%)		Rs. 81 crore
d)	Lead Time	- Domestic - Import	1 Month 45 days
e)	Transit Time	- Domestic - Import	1 Month 45 days
f)	Credit (Usance) Period available	- Domestic - Import	1 Month 90 days

(5 Marks)

Question No. 8

a) Explain the provisions of the Companies Act, 2013 for issue of Sweat Equity Shares. To what extent the Sweat Equity Shares can be issued to an Independent Director?

(7 Marks)

b) How to prepare a Detailed Project Report (DPR)? Also, explain the role of Company Secretary in project appraisal and due diligence?

(8 Marks)

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