Dr. Shyama Prasad Mukherjee University

DEPT. OF COMMERCE

B.COM SEM – 2

PAPER: Corporate Law

TOPIC: Red Herring Prospectus

BY: HARSHA

A Red Herring Prospectus, or offer document, is filed by a company to SEBI (Securities and Exchange Board of India) when it plans to raise money from the public by selling shares of the company to investors. The document is very useful to investors because it provides detailed information about the company's business operations, financials, promoters and the company's objective for raising funds by filing an IPOs. It also explains how the company aims to use the money that will be raised, the possible risks for investors etc.

- Red Herring prospectus (or RHP) is an initial prospectus filed by the company with the Securities and Exchange Commission (SEC). It is considered to be the first step to raising capital via Initial Public Offering (IPO).
- Though it does not disclose the details of price, the number of shares being offered, the coupon of the issue, or the size of the issue, it has the details regarding the company's operation and financial position and standing.
- A red herring prospectus after being authorized by the SEC tends to become the company's final prospectus. It can be utilized to seek investments and hence carries the same liability as that of a normal prospectus.
- Dissimilarities between the red herring prospectus and the prospectus shall be called for attention in the prospectus.
- As mentioned above, it does not contain the quantum and price of securities being offered by the company.
- The public offering of shares can be completed only after the Final prospectus would be prepared and distributed, which shall contain the price and the number of shares issued.

In short, in Red Herring prospectus, the company only mentions the total sum that it plans to raise from the market, leaving out details such as the price at which the shares are going to be issued or the number of shares the company proposes to issue to the public. Investors should look into major disclosures such as the company's operations, its financials, comparison with the competitors in the industry, various risk factors that may threaten the business, how the company aims to utilize the amount so raised, etc. It would be in the best interest of the investors to read the RHP exhaustively, understand the contents, and then conclude.

Meaning of Book Building:

Every business organisation needs funds for its business activities. It can raise funds either externally or through internal sources. When the companies want to go for the external sources, they use various means for the same. Two of the most popular means to raise money are Initial Public Offer (IPO) and Follow on Public Offer (FPO).

During the IPO or FPO, the company offers its shares to the public either at fixed price or offers a price range, so that the investors can decide on the right price. The method of offering shares by providing a price range is called book building method. This method provides an opportunity to the market to discover price for the securities which are on offer.

Book Building may be defined as a process used by companies raising capital through Public Offerings-both Initial Public Offers (IPOs) and Follow-on Public Offers (FPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional investors as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process. Book Building vs. Fixed Price Method:

The main difference between the book building method and the fixed price method is that in the former, the issue price to not decided initially. The investors have to bid for the shares within the price range given. The issue price is fixed on the basis of demand and supply of the shares. On the other hand, in the fixed price method, the price is decided right at the start. Investors cannot choose the price. They have to buy the shares at the price decided by the company. In the book building method, the demand is known every day during the offer period, but in fixed price method, the demand is known only after the issue closes.

Book Building in India:

The introduction of book-building in India was done in 1995 following the recommendations of an expert committee appointed by SEBI under Y.H. Malegam. The committee recommended and SEBI accepted in November 1995 that the book-building route should be open to issuer companies, subject to certain terms and conditions. In January 2000, SEBI came out with a compendium of guidelines, circulars and instructions to merchant bankers relating to issue of capital, including those on the book-building mechanism.

The principal intermediaries involved in a book building process are the companies, Book Running Lead Manager (BRLM) and syndicate members are the intermediaries registered with SEBI and eligible to act as underwriters. Syndicate members are appointed by the BRLM. The book building process is undertaken basically to determine investor appetite for a share at a particular price. It is undertaken before making a public offer and it helps determine the issue price and the number of shares to be issued.

The following are the important points in book building process:

1. The Issuer who is planning an offer nominates lead merchant banker(s) as ‘book runners’.

2. The Issuer specifies the number of securities to be issued and the price band for the bids.

3. The Issuer also appoints syndicate members with whom orders are to be placed by the investors.

4. The syndicate members put the orders into an ‘electronic book’. This process is called ‘bidding’ and is similar to open auction.

5. The book normally remains open for a period of 5 days.

6. Bids have to be entered within the specified price band.

7. Bids can be revised by the bidders before the book closes.

8. On the close of the book building period, the book runners evaluate the bids on the basis of the demand at various price levels.

9. The book runners and the Issuer decide the final price at which the securities shall be issued.

10. Generally, the number of shares is fixed; the issue size gets frozen based on the final price per share.

11. Allocation of securities is made to the successful bidders. The rest bidders get refund orders.

How is the Price Fixed?

All the applications received till the last dates are analyzed and a final offer price, known as the cut-off price is arrived at. The final price is the equilibrium price or the highest price at which all the shares on offer can be sold smoothly. If the price quoted by an investor is less than the final price, he will not get allotment.

If price quoted by an investor is higher than the final price, the amount in excess of the final price is refunded if he gets allotment. If the allotment is not made, full money is refunded within 15 days after the final allotment is made. If the investor does not get money or allotment in a month’s time, he can demand interest at 15 per cent per annum on the money due.