

[CS] CS-Professional

TAXMANN'S
CRACKER[®]

PREVIOUS EXAMS SOLVED PAPERS

monna8074@digity.com 26-07-2024
09:32

monna8074@digity.com 26-07-2024

Strategic Management & Corporate Finance

**CS N.S. Zad
CS Divya Bajpai**

Taxmann®

© All rights reserved

ISBN : 978-93-577-8946-2

ISBN : 978-9-357-78592-1 (ebook)

Price : ₹ 695

First Published : July 2024

Published by : www.taxmann.com 26-07-2024

Taxmann Publications (P.) Ltd.

Sales & Marketing :

59/32, New Rohtak Road, New Delhi-110 005 India

Phone : +91-11-45562222

Website : www.taxmann.com

E-mail : sales@taxmann.com

Regd. Office :

21/35, West Punjabi Bagh, New Delhi-110 026 India

Printed at :

Tan Prints (India) Pvt. Ltd.

44 Km. Mile Stone, National Highway, Rohtak Road

Village Rohad, Distt. Jhajjar (Haryana) India

E-mail : sales@tanprints.com

Disclaimer

Every effort has been made to avoid errors or omissions in this publication. In spite of this, errors may creep in. Any mistake, error or discrepancy noted may be brought to our notice which shall be taken care of in the next edition. It is notified that neither the publisher nor the author or seller will be responsible for any damage or loss of action to any one, of any kind, in any manner, therefrom.

No part of this book may be reproduced or copied in any form or by any means [graphic, electronic or mechanical, including photocopying, recording, taping, or information retrieval systems] or reproduced on any disc, tape, perforated media or other information storage device, etc., without the written permission of the publishers. Breach of this condition is liable for legal action.

For binding mistake, misprints or for missing pages, etc., the publisher's liability is limited to replacement within seven days of purchase by similar edition. All expenses in this connection are to be borne by the purchaser.

All disputes are subject to Delhi jurisdiction only.

Chapter-wise Marks Distribution

Ch. No.	Chapter	June 2024
1	Introduction to Strategic Management	15
2	Analyzing External & Internal Environment	5
3	Business Policy & Formulation of Functional Strategy	10
4	Strategic Analysis & Planning	10
5	Competitive Positioning	10
6	Managing Multi-Business Firm & Analyzing Strategic Edge	10
7	Sources of Corporate Funding	5
8	Raising of Funds from Equity & Procedural Aspects – Public Funding	25
9	Real Estate Investment Trusts	-
10	Infrastructure Investment Trusts	5
11	Raising of Funds – Private Funding	10
12	Raising of Funds – Non-Fund Based	5
13	An Overview on Listing & Issuance of Securities in International Financial Services Centre	5
14	Raising of Funds from Debt & Procedural Aspects	15
15	Foreign Funding – Institutions	-
16	Foreign Funding – Instruments, Laws & Procedures	-
17	Role of Intermediaries in Fund Raising	5
18	Project Evaluation	-

morena074@digdy.com 26-07-2024
09:33

TAXMANN

Previous Exam Trend Analysis

Year	Que. No.	Chapter Name	Marks	Category
June 2024	1(a)	Introduction to Strategic Management	5	Practical
	1(b)	Introduction to Strategic Management	5	Practical
	1(c)	Introduction to Strategic Management	5	Practical
	2(a)	Business Policy & Formulation of Functional Strategy	5	Practical
	2(b)	Competitive Positioning	5	Practical
	2(c)	Strategic Analysis & Planning	5	Practical
	2(d)	Managing Multi-Business Firm & Analyzing Strategic Edge	5	Descriptive
	2A(a)	Managing Multi-Business Firm & Analyzing Strategic Edge	5	Descriptive
	2A(b)	Analyzing External & Internal Environment	5	Practical
	2A(c)	Competitive Positioning	5	Practical
	2A(d)	Strategic Analysis & Planning	5	Descriptive
	3(a)	Raising of Funds from Equity & Procedural Aspects – Public Funding	5	Practical
	3(b)	Raising of Funds from Equity & Procedural Aspects – Public Funding	5	Descriptive
	3(c)	Raising of Funds from Equity & Procedural Aspects – Public Funding	5	Descriptive
	4(a)	Sources of Corporate Funding	5	Descriptive
	4(b)	Role of Intermediaries in Fund Raising	5	Descriptive
4(c)	Raising of Funds from Equity & Procedural Aspects – Public Funding	5	Descriptive	

Year	Que. No.	Chapter Name	Marks	Category
	5(a)	Raising of Funds from Debt & Procedural Aspects	5	Practical
	5(b)	Raising of Funds from Debt & Procedural Aspects	5	Practical
	5(c)	Raising of Funds from Debt & Procedural Aspects	5	Practical
	6(a)	Raising of Funds – Private Funding	5	Descriptive
	6(b)	Infrastructure Investment Trusts	5	Descriptive
	6(c)	Raising of Funds from Equity & Procedural Aspects – Public Funding	5	Descriptive
	6A(a)	Raising of Funds – Non-Fund Based	5	Descriptive
	6A(b)	Raising of Funds – Private Funding	5	Descriptive
	6A(c)	An Overview on Listing & Issuance of Securities in International Financial Services Centre	5	Descriptive

Comparison with Study Material

Chapter No.	Chapter Head	ICSI Study Material
1	Introduction to Strategic Management	Chapter 1
2	Analyzing External & Internal Environment	Chapter 2
3	Business Policy & Formulation of Functional Strategy	Chapter 3
4	Strategic Analysis & Planning	Chapter 4
5	Competitive Positioning	Chapter 5
6	Managing Multi-Business Firm & Analyzing Strategic Edge	Chapter 6
7	Sources of Corporate Funding	Chapter 7
8	Raising of Funds from Equity & Procedural Aspects – Public Funding	Chapter 8
9	Real Estate Investment Trusts	Chapter 9
10	Infrastructure Investment Trusts	Chapter 10
11	Raising of Funds – Private Funding	Chapter 11
12	Raising of Funds – Non-Fund Based	Chapter 12
13	An Overview on Listing & Issuance of Securities in International Financial Services Centre	Chapter 13
14	Raising of Funds from Debt & Procedural Aspects	Chapter 14
15	Foreign Funding – Institutions	Chapter 15
16	Foreign Funding – Instruments, Laws & Procedures	Chapter 16
17	Role of Intermediaries in Fund Raising	Chapter 17
18	Project Evaluation	Chapter 18

morena8074@digdy.com 26-07-2024
09:34

TAXMANN

Contents



	PAGE
<i>Chapter-wise Marks Distribution</i>	<i>1-5</i>
<i>Previous Exam Trend Analysis</i>	<i>1-7</i>
<i>Comparison with Study Material</i>	<i>1-9</i>

PART I STRATEGIC MANAGEMENT

Chapter 1	
◆ INTRODUCTION TO STRATEGIC MANAGEMENT	1.3
Chapter 2	
◆ ANALYZING EXTERNAL & INTERNAL ENVIRONMENT	2.1
Chapter 3	
◆ BUSINESS POLICY & FORMULATION OF FUNCTIONAL STRATEGY	3.1
Chapter 4	
◆ STRATEGIC ANALYSIS & PLANNING	4.1
Chapter 5	
◆ COMPETITIVE POSITIONING	5.1
Chapter 6	
◆ MANAGING MULTI-BUSINESS FIRM & ANALYZING STRATEGIC EDGE	6.1

PART II
CORPORATE FINANCE

Chapter 7		
◆ SOURCES OF CORPORATE FUNDING		7.3
Chapter 8		
◆ RAISING OF FUNDS FROM EQUITY & PROCEDURAL ASPECTS – PUBLIC FUNDING		8.1
Chapter 9		
◆ REAL ESTATE INVESTMENT TRUSTS		9.1
Chapter 10		
◆ INFRASTRUCTURE INVESTMENT TRUSTS		10.1
Chapter 11		
◆ RAISING OF FUNDS – PRIVATE FUNDING		11.1
Chapter 12		
◆ RAISING OF FUNDS – NON-FUND BASED		12.1
Chapter 13		
◆ AN OVERVIEW ON LISTING & ISSUANCE OF SECURITIES IN INTERNATIONAL FINANCIAL SERVICES CENTRE		13.1
Chapter 14		
◆ RAISING OF FUNDS FROM DEBT & PROCEDURAL ASPECTS		14.1
Chapter 15		
◆ FOREIGN FUNDING – INSTITUTIONS		15.1
Chapter 16		
◆ FOREIGN FUNDING – INSTRUMENTS, LAWS & PROCEDURES		16.1
Chapter 17		
◆ ROLE OF INTERMEDIARIES IN FUND RAISING		17.1
Chapter 18		
◆ PROJECT EVALUATION		18.1

I

PART

STRATEGIC MANAGEMENT

1

CHAPTER

INTRODUCTION TO STRATEGIC MANAGEMENT

MEANING, PROCESS, PHASES, IMPORTANCE & LIMITATIONS OF STRATEGIC MANAGEMENT

Q1. Define Strategic Management.

Ans.: 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.

Definitions of Strategic Management:

Chandler – "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."

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

Palne and Naumes – "Strategic management involves the decision making and the activities in an organization 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."

Hambrick and Chen – "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."

Q2. What do you understand by Strategic Management Process? Also discuss four phases of Strategic Management Process.

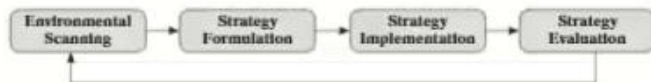
Or

Present a diagrammatic representation of components of Strategic Management Process.

Ans.: **Strategic Management Process:** It is the process by which the managers 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. **Four Phases of Strategic Management Process:** The strategic management consists of different phases, which are sequential in nature. 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.

Components of Strategic Management Process



- (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.

There are various techniques which may be used in environment scanning namely:

- ◆ SWOT Analysis
- ◆ PESTEL Analysis
- ◆ Industry Analysis

- (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.
- (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.
- (4) **Strategy Evaluation:** It 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 or corrective actions. Evaluation ascertains that 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.

Q3. "Each organization must build its competitive advantage keeping in mind the business warfare. This can be done by following the process of strategic management." Considering this statement, explain major benefits of strategic management. [Nov. 2021 (5 Marks)]

Ans.: Each organization has to build its competitive advantage over the competitors in the business warfare in order to win. This can be done only by following the process of strategic management. Strategic Management is very important for the survival and growth of business organizations in dynamic business environment. Other major benefits of strategic management are as follows:

- ◆ Strategic management helps organizations to be more proactive rather than reactive in dealing with its future. It facilitates to work within vagaries of environment and remains adaptable with the turbulence or uncertain future. Therefore, they are able to control their own destiny in a better way.
- ◆ It provides better guidance to entire organization on the crucial point – what it is trying to do. Also provides frameworks for all major business decisions of an enterprise such as on businesses, products, markets, organizational structures, etc.
- ◆ It facilitates to prepare the organization to face the future and act as pathfinder to various business opportunities. Organizations are able to identify the available opportunities and identify ways and means as how to reach them.
- ◆ It serves as a corporate defence mechanism against mistakes and pitfalls. It helps organizations to avoid costly mistakes in product market choices or investments.
- ◆ Over a period of time strategic management helps organization to evolve certain core competencies and competitive advantages that assist in the fight for survival and growth.

Q4. Good Health Is an Association of Persons (AOP), providing awareness to downtrodden on immunization, vaccination, sanitation and other health and hygiene issues. It is a not-for-profit organization, working in coordination with hospitals, medical support centers and local administration.

You are asked to take over the organization and manage it in a better way. Identify whether the concept of strategic management is relevant in this connection? And if so, what basic activities you would perform in order to manage it efficiently? [May 2022 (5 Marks)]

Ans.: The concept of strategic management process is effectively being used by a number of not-for-profit or charitable organizations. While 'Good Health'

may have several and alternative existence, still it has to generate resources and use them wisely to achieve organizational objectives. Organization needs to be managed strategically, irrespective whether they have profit motive. The strategic management at 'Good Health' should essentially cover:

- ◆ Analyzing and interpreting the strategic intent in terms of vision, mission and objectives.
- ◆ Generating required resources in terms of finance and manpower (volunteers, paid employees).
- ◆ Undertaking SWOT analysis from time to time.
- ◆ Setting goals in the area of downtrodden. It can be in terms of geographical coverage and number of downtrodden.
- ◆ Analyzing the desired future position with the past and present situation.

Q3. "The strategic management cannot counter all hindrances and always achieve success for an organization." Do you agree with this statement? Give arguments in support of your answer

Ans.: It is true that the presence of strategic management cannot counter all hindrances and always achieve success for an organization. This is on account of complex multiple forces acting on business organization and limiting its success.

These limitations are on account of following factors:

- (a) **Environment is highly complex and turbulent:** It is difficult to understand the complex environment and exactly pinpoint how it will shape-up in future. The organizational estimate about its future shape may awfully go wrong and jeopardize all strategic plans.
- (b) **Strategic management is a time-consuming process:** Organizations spend a lot of time in preparing, communicating the strategies that may impede daily operations and negatively impact the routine business.
- (c) **Strategic management is a costly process:** Strategic management adds a lot of expenses to an organization - particularly to small and medium organizations. Expert strategic planners need to be engaged, efforts are made for analysis of external and internal environments devise strategies and properly implement.
- (d) **Competition is unpredictable:** In a competitive scenario, where all organizations are trying to move strategically, it is difficult to clearly estimate the competitive responses to the strategies.

Q6. Swagatam was a chain of hotels. The business was good until the whole nation was impacted by COVID-19 pandemic in early 2022.

The management soon understood that pandemic had seriously disrupted the hotel sector and average revenue-per-available room fell by nearly 90% and they expected this decline to continue due to travel bans and fear seen in the society.

Pandemic required 14-day compulsory quarantine for the affected individuals and hospitals were short of rooms.

Management found a small opportunity as they had sufficient rooms, staff and could follow required health and safety standards. They decided to do service transformation by letting some of their units to hospitals to be transformed into covid-care units & rest of the units were rented to individuals as a quarantine facility.

- (a) Name the strategic level of management at which such decisions are made.
- (b) The above scenario depicts one of the limitations of strategic management. Discuss which limitation of strategic management is depicted here.
- (c) Here the decision taken by the management was reactive. Discuss the benefit of proactive approach over reactive approach.

[Nov. 2023 (1 + 2 + 2 = 5 Marks)]

Ans.:

- (i) The strategic level of management at which decisions like transforming hotel units into COVID-care units and quarantine facilities are made is at the "Corporate Level." This level of management is responsible for making decisions that affect the overall direction and scope of the entire organization.
- (ii) The given scenario highlights a limitation of strategic management known as highly complex and turbulent environment. Due to this, there exist environmental uncertainty and unpredictability of the external factors that affect an organization. In this case, the COVID-19 pandemic created a highly uncertain and unpredictable business environment for Swagatam Hotels. The pandemic significantly impacted the hotel sector, causing a rapid decline in revenue and necessitating a strategic shift to adapt to the changing circumstances.
- (iii) A proactive approach involves anticipating and addressing issues before they become critical, while a reactive approach responds to problems after they have occurred. In the scenario, the decision to transform hotel units into COVID-care units and quarantine facilities was reactive, driven by the unexpected impact of the pandemic.

IMPORTANCE OF STRATEGIC MANAGEMENT FOR COMPANY SECRETARIES

Q7. 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. Elucidate.

Ans.: A lot has changed since the passage of the Companies Act, 2013. A Company Secretary has stepped into various crucial roles such as Key Managerial Personnel (KMP), 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 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.

Q8. "A Company Secretary in today's era while discharging his professional obligations has to perform several key roles which are also integral components of strategic management" – Evaluate the statement by discussing the role of Company Secretary in strategic management.

Or

What are the functions and importance of strategic management for professionals like Company Secretaries?

Ans.: 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 & 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:** A 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) **Compliance:** 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 should be conversant with the laws as well as the amendments that take place.

A Company Secretary has to ensure compliance of various like Companies Act; SEBI Act, Securities Contracts (Regulation) Act and rules and regulations made thereunder; Foreign Exchange Management Act; Consumer Protection Act; Depositories Act; Environment & Pollution Control Laws; Labour & 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 like –

- National Company Law Tribunal (NCLT)
- National Company Law Appellate Tribunal (NCLAT)
- Competition Commission of India (CCI)
- Registrar of Companies (ROC)
- Tax Tribunals.

Q9. What competencies are required for Company Secretary to become effective player of strategic management?

Ans.: To be an effective player of strategic management, a Company Secretary needs to embrace the following core competencies:

- ◆ Thorough knowledge of the company's business.
- ◆ Sound knowledge of laws relating to company, capital markets, industry related etc.

- ◆ Communication and professional skills, legal skills, management skills and IT skills.
- ◆ Sensitive towards thoughts and feelings of board directors and the CEO.
- ◆ Updated knowledge of legal environment, financial environment & business environment.
- ◆ Sound knowledge of corporate governance.
- ◆ Ability to work and achieve a consensus within multidisciplinary settings.
- ◆ Flexibility, creativeness towards business of the company.
- ◆ Remaining calm under pressure and not losing sight of perspective.

MEANING, BENEFITS & LIMITATIONS OF STRATEGIC PLANNING

Q10. What do you understand by the term 'Strategic Planning'?

Or

Write a short note on: Strategic Planning Cycle

Ans.: As per Allison & Kaye, "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:

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

- ◆ Deliberating mission of the organization.
- ◆ Developing goals based on chosen mission.
- ◆ Examining internal environment (*Strengths & Weaknesses*).
- ◆ Examine external environment (*Opportunities & 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.

Q11. What are the benefits and limitations of Strategic Planning?

Ans.: **Benefits of Strategic Planning:** Strategic planning can help your organization in a number of critical ways:

- (a) **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.
- (b) **Focus:** Good strategic planning forces future thinking and can refocus and re-energize a disorientated organization.
- (c) **Problem solving:** Strategic planning focuses on an organization's most critical problems, choices and opportunities.
- (d) **Teamwork:** Strategic planning provides an excellent opportunity to build a sense of teamwork, to promote learning, and to build commitment across the organization.
- (e) **Communication:** All stakeholders have an interest in knowing the direction in which organization is heading and also how their contribution will fit in overall plan.
- (f) **Greater control:** Strategic planning can provide an organization greater control the environment in which it operates.

Limitations of Strategic Planning:

- (i) **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.
- (ii) **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.
- (iii) **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.

Q12. Strategic planning is an important constituent of strategic management. In the light of the same explain the meaning of strategic planning. Also outline the characteristics of strategic planning.

[May 2023 (5 Marks)]

Ans.: Strategic plans are made by the senior management for the entire organization after taking into account the organization strength and weaknesses in the light of opportunities and threats in the external environment. They involve acquisition and allocation of resources for the attainment of organizational objectives.

Strategic planning deals with one or more of three key questions:

- ◆ What are we doing?
- ◆ For whom do we do it?
- ◆ How to improve and excel?

Characteristics of strategic planning: Following are the characteristics of strategic planning:

- Strategic planning shapes the organization and its resources.
- Strategic planning assesses the impact of environmental variables.
- Strategic planning takes a holistic view of the organization.
- Strategic planning develops overall objectives and strategies.
- Strategic planning is concerned with the long-term success of the organization.
- Strategic planning is a senior management responsibility.

ROLE OF BOARD OF DIRECTORS IN STRATEGIC DECISION

Q13. Explain the role of Board of Directors in decisions related to organization's Corporate Social Responsibility.

Ans.: **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, displaying and promoting the behaviour through which a company wishes to conduct its business Consistent with the culture and values it has defined for the organization.
- ◆ 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 dues 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.

Q14. "Strategic decisions are different in nature than all other decisions." In the light of this statement explain major dimensions of strategic decisions. [May 2021 (5 Marks)]

Or

Care Ltd. has decided to acquire Trust Ltd. Discuss the major dimensions of strategic decisions. [Nov. 2023 (5 Marks)]

Ans.: Strategic decisions are different in nature than all other operational decisions. The dimensions of strategic decisions are not similar to that of other decisions which are taken at various levels of the organization during day-to-day working.

Following major dimensions of strategic decisions make them different than operational decisions:

1. Strategic decisions **require top-management decisions**. Strategic decisions involve thinking in totality of the organizations and there is also a lot of risk involved in that.
2. Strategic decisions involve the **allocation of large amounts of company resources** – financial, technical, human etc.
3. Strategic decisions are likely to have a **significant impact on the long-term prosperity** of the firm.

4. Strategic decisions are **future oriented**.
5. Strategic decisions usually have major multifunctional or multi-business consequences.
6. Strategic decisions necessitate consideration of factors in the firm's external environment.

CORPORATE SOCIAL RESPONSIBILITY

Q15. Write a short note on: Corporate Social Responsibility (CSR).

Or

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. Explain.

Ans.: **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.

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 fulfil 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.
5. Proper implementation of the projects taken up by the company so that the benefit goes to people in need.

Q16. How Corporate Social Responsibility Is Important Business Strategy?

Ans.: 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.

Q17. As a Company Secretary of listed entity, discuss the benefits of Corporate Social Responsibility.

Ans.: Corporate Social Responsibility (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.

Benefits of Corporate Social Responsibility: Some of points highlighting the benefits of CSR are given below:

- (a) **Favourable public image:** 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.
- (b) **Social involvement:** 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.
- (c) **Greater freedom and flexibility in decision-making:** 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.

- (d) **Improvement in internal activities:** A proper CSR Policy improves the internal activities of the organization which have an impact on the external environment, since the society is an inter-dependent system.
- (e) **Balance between the authority and responsibility:** A business organization 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.
- (f) **Encourages co-operative attitude:** 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.
- (g) **Better relationship with employees:** Companies can better address the grievances of its employees and create employment opportunities for the unemployed.
- (h) **Better indicator for investors:** 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.

Q18. Discuss briefly various factors that influence Corporate Social Responsibility (CSR).

Ans.: **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.

Q19. Define 'Corporate Social Responsibility' as per Rule 2(d) of the Companies (Corporate Social Responsibility Policy) Rules, 2014.

Or

Referring to the provisions of Companies Act, 2013 relating to 'Corporate Social Responsibility' (CSR), state which activities would not qualify as CSR? [Dec. 2016 (4 Marks)]

Ans.: Corporate Social Responsibility (CSR) [Rule 2(d)]: Corporate Social Responsibility (CSR) means activities undertaken by a Company in pursuance of its statutory obligation laid down in section 135 in accordance with the provisions contained in these rules.

Activities not included in CSR: Corporate Social Responsibility shall not include following:

- (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 organizations 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.
- (iv) Activities benefitting employees of the company as defined in section 2(k) 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.

Q20. From the following information in respect of two companies viz. ZYX Ltd. and CBA Private Ltd., compute the amount the companies are required to spend on account of Corporate Social Responsibility (CSR):

Financial Year	ZYX Ltd. Net Profit(Loss) (₹ in Crore)	CBA Private Ltd. Net Profit(Loss) (₹ in Crore)
2014-2015	Not Incorporated	(4)
2015-2016	6	(1)
2016-2017	18	6

[June 2017 (4 Marks)]

Ans.: Amount required to be spent on CSR [Section 135(5)]: The Board of every company to which CSR provisions are applicable shall ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the 3 immediately preceding financial years, or where the company has not completed the period of 3 financial years since its incorporation, during such immediately preceding financial years in pursuance of its CSR Policy.

Explanation: Net Profit shall not include such sums as may be prescribed, and shall be calculated in accordance with the provisions of section 198.

Calculation of Average Net Profit:

$$\text{XYZ Ltd.} = \frac{6,00,00,00 + 18,00,00,00}{2} = ₹ 12,00,00,000$$

$$\text{CBA Private Ltd.} = \frac{-4,00,00,000 - 1,00,00,000 + 6,00,00,000}{3} = ₹ 33,33,333$$

Amount required to be spent on CSR Activities:

$$\text{XYZ Ltd.} = ₹ 12,00,00,00 \text{ Crore} \times 2\% = ₹ 24,00,000$$

$$\text{CBA Private Ltd.} = ₹ 33,33,333 \times 2\% = ₹ 66,667$$

Q21. RS Limited has incurred ₹ 5,00,000 for the fulfilment of Labour Law, Land Acquisition Act and Food Safety & Standards Act in the month of May, 2018. The company has accounted for this ₹ 5,00,000 as Corporate Social Responsibility (CSR) expenditure. Explain the provision of Companies Act, 2013 discuss whether the company has rightly accounted for the amount in CSR. [June 2018 (4 Marks)]

Ans.: As per Section 135(3) of the Companies Act, 2013, CSR Committee is required to formulate and recommend to the Board, CSR Policy which shall indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII.

Schedule VII specifies various activities which may be included by companies in their Corporate Social Responsibility Policies.

The Board of directors every company to which CSR provisions are applicable shall ensure that the activities as are included in CSR Policy are undertaken by the company.

Amount spent for Labour Law, Land Acquisition Act and Food Safety & Standards Act are not included in Schedule VII and hence amounts spend for it cannot be accounted as CSR expenditure by the RS Limited.

Q22. Any expenditure incurred for the benefit of the society will be considered as expenditure in pursuance of corporate social responsibility policy. Comment. [Dec. 2018 (3 Marks)]

Ans.: As per Section 135(3) of the Companies Act, 2013, CSR Committee is required to formulate and recommend to the Board, CSR Policy which shall indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII.

Schedule VII specifies various activities which may be included by companies in their Corporate Social Responsibility Policies.

The Board of directors every company to which CSR provisions are applicable shall ensure that the activities as are included in CSR Policy are undertaken by the company.

The expenditure incurred for the benefit of society shall be considered as expenditure in pursuance to Section 135 of Companies Act, 2013, only if the company spends such amount on various activities specified in Schedule VII and included under CSR Policy of the Company.

Q23. Warner Ltd. is an Indian company with a net profit of ₹ 4 Crore, ₹ 7 Crore, ₹ 6 Crore and ₹ 7 Crore respectively in the last four years. Net profit for each of last four years including dividend of ₹ 1 Crore received from WB Ltd. which is an Indian company. Discuss whether Warner Ltd. is required to spend on CSR activities? If yes, how much it should spend? If no, state the reasons for it. [Dec. 2019 (4 Marks)]

Ans.: Companies to which CSR provisions are applicable [Section 135(1)]:

CSR provisions are applicable to companies which fulfils any one of the following criteria during the immediately preceding financial year:

- ◆ Net worth – ₹ 500 Crore or more
- ◆ Turnover – ₹ 1,000 Crore or more.
- ◆ Net profit – ₹ 5 Crore or more.

Amount required to be spent on CSR [Section 135(5)]: The Board of every company to which CSR provisions are applicable shall ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the 3 immediately preceding financial years, or where the company has not completed the period of 3 financial years since its incorporation, during such immediately preceding financial years in pursuance of its CSR Policy.

Explanation: Net Profit shall not include such sums as may be prescribed, and shall be calculated in accordance with the provisions of section 198.

As per Rule 2(h) of the Companies (CSR Policy) Rules, 2014, Net Profit means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act. Net Profit shall not include the following:

- (i) Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise.
- (ii) Any dividend received from other companies in India, which are covered under and complying with the provisions of Section 135 of the Act.

It is assumed that WB Ltd. is covered under section 135 of the Companies Act, 2013 and dividend received by Warner Ltd. from WB Ltd. will be excluded while calculating net profit for the purpose of CSR provisions.

Thus, net profit of last three years of Warner Ltd. for the purpose of CSR provisions after excluding dividend of ₹ 1 Crore will be ₹ 6 Crore, ₹ 5 Crore and ₹ 6 Crore.

$$\text{Average Net Profit} = \frac{6,00,00,000 + 5,00,00,000 + 6,00,00,000}{3} = ₹ 5,66,66,667$$

$$\text{Amount required to be spent on CSR Activities by Warner Ltd.} = ₹ 5,66,66,667 \times 2\% = ₹ 11,33,333.$$

Q24. DEF Traders Ltd. is incorporated as a small company. State with reference to the relevant legal provisions whether it is required to set up a Corporate Social Responsibility Committee? [Dec. 2020 (3 Marks)]

[Dec. 2020 (3 Marks)]

Ans.: Companies to which CSR provisions are applicable [Section 135(1)]: CSR provisions are applicable to companies which fulfils any one of the following criteria during the immediately preceding financial year:

- ◆ Net worth – ₹ 500 Crore or more
- ◆ Turnover – ₹ 1,000 Crore or more.
- ◆ Net profit – ₹ 5 Crore or more.

Small Company [Section 2(85)]: Small company means a private company –

- (i) **Paid-up share capital** of which does not exceed **₹ 4 Crore** or such higher amount as may be prescribed which shall not be more than **₹ 10 Crore and**
- (ii) **Turnover** of which as per its last profit and loss account does not exceed **₹ 40 Crore** or such higher amount as may be prescribed which shall not be more than **₹ 100 Crore**.

Nothing in this definition shall apply to: [*This means following companies cannot be small companies*]

- (a) Holding or a subsidiary company
- (b) Company registered u/s 8
- (c) Company or body corporate governed by any Special Act.

DEF Traders Ltd. is a small company. It does not meet the criteria specified in section 135 of the Companies Act, 2013 and hence DEF Traders Ltd. is not required to constitute CSR Committee.

Q25. Board of Directors of Charity Ltd. wants to understand from you applicability of the provisions relating to CSR to companies including requirements to constitute CSR Committee. Inform the Board.

[June 2021 (5 Marks)]

Ans.: Companies to which CSR provisions are applicable [Section 135(1)]: CSR provisions are applicable to companies which fulfils any one of the following criteria during the immediately preceding financial year:

- ◆ Net worth – ₹ 500 Crore or more
- ◆ Turnover – ₹ 1,000 Crore or more.
- ◆ Net profit – ₹ 5 Crore or more.

CSR Committee: Every company to whom CSR provisions are applicable shall constitute a CSR Committee of the Board.

Composition of CSR Committee: CSR Committee shall consist of 3 or more directors, out of which at least 1 director shall be an independent director.

However, unlisted public company and private company which is not required to appoint an independent director, CSR Committee shall consist of 2 or more directors.

Applicability of CSR provisions to foreign branch office/project office: As per Rule 3(1) of the Companies (CSR Policy) Rules, 2014, every company including its holding or subsidiary, and a foreign company defined under section 2(42) of the Act having its branch office or project office in India, which fulfils the

criteria specified in section 135(1) of the Act shall comply with the provisions of section 135 of the Act and CSR Rules.

Role and responsibilities of the CSR Committee [Section 135(3)]: Following shall be the responsibilities of the CSR Committee:

- (a) To formulate and recommend to the Board, CSR Policy which shall indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII.
- (b) To recommend the amount of expenditure to be incurred on CSR activities.
- (c) To monitor CSR Policy of the company from time to time.

Q26. XYZ Ltd. is carrying out a project under its CSR initiatives. Some of its employees are working in this project. The company wants to monetize and account it under the head of 'CSR expenditure'? Advise the company.

[Dec. 2021 (3 Marks)]

Ans.: As per MCA General Circular, the contribution and involvement of employees in CSR activities of the company will no doubt generate interest/pride in CSR work and promote transformation from Corporate Social Responsibility as an obligation, to Socially Responsible Corporate in all aspects of their functioning.

Companies therefore, should be encouraged to involve their employees in CSR activities. However, monetization of such services of employees would not be counted towards CSR expenditure.

Q27. Mind-Game Ltd., is a subsidiary company of Mind-Guru Ltd. Mind-Game attracts the provisions of section 135 of the Companies Act, 2013 and it has minimum average obligation to spend Corporate Social Responsibility (CSR) amount of ₹ 15 Crore during each of the preceding 5 years. In this connection, Board of directors needs your expert views on the following matters:

- (i) What is the meaning of "Impact assessment"?
- (ii) Whether impact assessment is required to be undertaken by all the companies?
- (iii) Who can conduct impact assessment?

[June 2022 (5 Marks)]

Ans.:

(i) Impact Assessment: The impact assessment is exercise to assess the social impact of a particular project. Impact assessment intends to evaluate "social return on investment".

Impact assessment is the exercise of taking a retroactive view on the CSR Activities completed by the entity.

Impact assessment is seemingly another step to encourage companies to take considered decisions before deploying CSR amounts and assess the impacts of their investments to capture the impact being generated

by them. This shall not only serve as feedback for companies to plan and better allocate resources, but shall also deepen the impact of CSR.

(ii) Who are required to undertake Impact Assessment: Since impact assessment is cost-intensive and time consuming, the idea is to obligate only certain classes of companies which have large amounts of spending and have completed their large CSR projects.

Accordingly, as per Rule 8(3) of the Companies (CSR Policy) Rules, 2014, every company having average CSR obligation of ₹ 10 Crore or more in pursuance of section 135(5) of the Act, in the 3 immediately preceding financial years, shall undertake impact assessment, through an independent agency, of their CSR projects having outlays of ₹ 1 Crore or more, and which have been completed not less than one year before undertaking the impact study.

The impact assessment reports shall be placed before the Board and shall be annexed to the annual report on CSR.

A Company undertaking impact assessment may book the expenditure towards CSR for that financial year, which shall not exceed 2% of the total CSR expenditure for that financial year or ₹ 50 lakh, whichever is higher.

(iii) The impact assessment shall be conducted by an independent agency.

Q28. A company's net profit calculated under section 198 of the Companies Act, 2013 as per the audited financial statements was as under:

Year 2021-2022 : Net Profit ₹ 8 Crore

Year 2020-2021 : Net Profit ₹ 5 Crore

Year 2019-2020 : Net Profit ₹ 4 Crore

The profit for the financial year 2021-2022 included the profit of ₹ 1 Crore from its foreign subsidiary company and ₹ 1 Crore from an Indian company covered under section 135 of the Companies Act, 2013, as dividend. Comment on the amount, if any, liable to be spent on Corporate Social Responsibility (CSR) activities by the company.

[Dec. 2022 (3 Marks)]

Ans.: Companies to which CSR provisions are applicable [Section 135(1)]: CSR provisions are applicable to companies which fulfils any one of the following criteria during the immediately preceding financial year:

- ◆ Net worth – ₹ 500 Crore or more
- ◆ Turnover – ₹ 1,000 Crore or more.
- ◆ Net profit – ₹ 5 Crore or more.

Amount required to be spent on CSR [Section 135(5)]: The Board of every company to which CSR provisions are applicable shall ensure that the company spends, in every financial year, at least 2% of the average net profits of the

company made during the 3 immediately preceding financial years, or where the company has not completed the period of 3 financial years since its incorporation, during such immediately preceding financial years in pursuance of its CSR Policy.

Explanation: Net Profit shall not include such sums as may be prescribed, and shall be calculated in accordance with the provisions of section 198.

As per Rule 2(h) of the Companies (CSR Policy) Rules, 2014, Net Profit means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act. Net Profit shall not include the following:

- (i) Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise.
- (ii) Any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act.

Calculation of net profit for the purpose of CSR provisions:

Particulars	2021-2022	2020-2021	2019-2020
Net profit as given	8,00,00,000	5,00,00,000	4,00,00,000
(-) Profit arising from any overseas branch	(1,00,00,000)	-	-
(-) Dividend received from other companies in India, which are covered under and complying with the provisions of section 135	(1,00,00,000)	-	-
	6,00,00,000	5,00,00,000	4,00,00,000

$$\text{Average Net Profit} = \frac{6,00,00,000 + 5,00,00,000 + 4,00,00,000}{3} = ₹ 5,00,00,000$$

Amount required to be spent on CSR by the company = 5,00,00,000 × 2% = ₹ 10,00,000.

Q29. Case Study:

Supreme Group of Industries (SGI) has invested in diverse projects which impact the 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 endeavours to play a pivotal role in serving communities and projects which address the basic societal requirements. SGI has been involved in various Social Responsibility initiatives over last many years. These efforts have substantially improved the standard of living of the people through health care, education, livelihood and community development initiatives, making their living experience dramatically better. These activities impacting the

lives of marginalized communities are spread across the globe reaching regions beyond SGI's business locations. The key philosophy of all CSR initiatives of SGI is guided by three core commitments of Social Responsibility Initiatives:

- (a) S – SCALE
- (b) I – IMPACT
- (c) S – SUSTAINABILITY

For the fiscal year 2025, SGI seeks to strategically consolidate the company's CSR initiatives to focus on discrete social problems, all aimed at enabling lives, living and livelihoods of marginalized communities. SGI has identified the following focus areas:

- ◆ Community Infrastructure & Environment
- ◆ Community Health care
- ◆ Education and Skills enhancement

With the endeavour to restructure its CSR initiatives, the Board of SGI in its recent board meeting, approved the following proposals:

- (1) Formation of Corporate Social Responsibility & Governance (CSRG) committee to finalize the CSR policy in light of the Group's CSR plans for the fiscal year 2025.
- (2) Appointment of a management consultant, to provide professional help to the CSRG committee on the factors influencing the proposed CSR initiatives of the group.
- (3) Appointment of a Practising Company Secretary, to advice on the role of board of directors with regards to the CSR related activities.

Mrs. Meena, an executive director, who was a qualified management graduate from a premier management Institute, shared the emerging significance of corporate governance with the Board members during the board meeting. All the directors were eager to assess its applicability to the SGI group in light of the new CSR initiatives proposed by the Board. Mr. Pratyush, the company secretary who was present at the board meeting, also enlightened the board on the emerging concept of corporate governance. Board asked Mr. Pratyush to table in the next Board meeting the objectives of corporate governance and the role of company secretary in light of corporate governance framework.

Next day morning, Mr. Pratyush came to his office and briefed his team on the expectations of the board from the corporate secretarial team and asked them to compile a note for the board on the objectives of corporate governance and the role of company secretary in the corporate governance. To aid them with the preparation of the note, he recapitulated his team on the recent developments of corporate governance framework.

Based on the facts mentioned in the above case study:

- (a) Assume yourself as a Chairperson of the CSRG committee and prepare a report addressed to the Board explaining the Meaning and Benefits of Corporate Social Responsibility. The report should also include a section on the factors influencing Board's CSR initiative based on the inputs received from the management consultant.
- (b) Assume yourself as the Practising Company Secretary appointed by the Board and provide a write-up to the Board on their role in CSR related activities of the company, in light of the recent case law pertaining to Board's compliance responsibility of implementing and reporting.
- (c) Assume yourself as a young qualified Company Secretary in the corporate secretarial team led by Mr. Pratyush and compile a note to the Board based on Mr. Pratyush's briefing on:
 - (i) Objectives of corporate governance.
 - (ii) Role of Company Secretary in the implementation of corporate governance framework in SGI group.

[June 2024 (5 + 5 + 5 = 15 Marks)]

Ans.:

(a) Report on Meaning & Benefits of Corporate Social Responsibility

To

Board of Directors

Supreme Group of Industries (SGI)

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.

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 fulfil 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.
5. Proper implementation of the projects taken up by the company so that the benefit goes to people in need.

Benefits of Corporate Social Responsibility: Some of points highlighting the benefits of CSR are given below:

- (a) Favourable public image:** 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.
- (b) Social Involvement:** 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.
- (c) Greater freedom and flexibility in decision-making:** 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.
- (d) Improvement in Internal activities:** A proper CSR Policy improves the internal activities of the organization which have an impact on the external environment, since the society is an inter-dependent system.
- (e) Balance between the authority and responsibility:** A business organization 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.
- (f) Encourages co-operative attitude:** 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.

- (g) Better relationship with employees:** Companies can better address the grievances of its employees and create employment opportunities for the unemployed.
- (h) Better indicator for investors:** 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.

Date:

(Chairman CSRG Committee)

(b) Report on Role of Board of Directors in CSR related activities of Company

To

Board of Directors

Supreme Group of Industries (SGI)

Role of Board of Directors in CSR related activities: 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:

- (1) Disclose contents of such policy in its report and also place it on the company's website, if any.
- (2) Ensure that the activities included in the CSR policy are undertaken by the company.
- (3) 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.
- (4) Satisfy itself regarding the utilization of the disbursed CSR funds.
- (5) 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 section 134(3)(o), specify the reasons for not spending the amount and transfer the unspent CSR amount as per provisions of section 135(5) & (6) of the Companies Act, 2013.
- (6) 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:

- (a) Matters relating to monitoring for all projects – ongoing or otherwise.
- (b) Administrative Overheads
- (c) Setting off excess amount

- (d) Transfer of Capital Asset
- (e) CSR Reporting
- (f) Impact Assessment Report
- (g) Disclosure on Website etc.

Recent case laws pertaining to 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 2014-2015, 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 31.3.2015. Further, it was not prejudicial to interest of shareholders or creditors. They also filed 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 Honourable 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 ₹ 50,000 but which extend to ₹ 25,00,000, and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5,00,000 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 ₹ 1,50,000 i.e. ₹ 50,000 on each the Company, and its two Officers.

Date:

.....

Mr. Pratyush

(Practicing Company Secretary)

(c) 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 objective 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.

Role of Company Secretary in Corporate Governance: 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.
- ◆ Company Secretary plays a key role in ensuring that the Board procedures are followed and regularly reviewed.

- ◆ Company Secretary provides the Board with guidance as to its duties, responsibilities and powers under various laws, rules and regulations.
- ◆ Company Secretary 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.
- ◆ Company Secretary 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.

CORPORATE GOVERNANCE

Q30. Write a short note on - Objectives of Corporate Governance.

Ans.: 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 objective 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.

Q31. Briefly discuss the role of Company Secretary In Corporate Governance. Also discuss to core competencies that Company Secretary should have so that he can be an effective player of strategic management.

Ans.: 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.
- ◆ Company Secretary plays a key role in ensuring that the Board procedures are followed and regularly reviewed.
- ◆ Company Secretary provides the Board with guidance as to its duties, responsibilities and powers under various laws, rules and regulations.
- ◆ Company Secretary 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.
- ◆ Company Secretary 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.

2

CHAPTER

ANALYZING EXTERNAL & INTERNAL ENVIRONMENT

BUSINESS ENVIRONMENT

Q1. What do you understand by Business Environment?

Or

"Business environment is aggregate of all conditions, events and influences that surround and affect the business". Explain.

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

Bayard O. Wheeler defines business environment as "the total of all the things, external to a business firm, which affect the organization 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*).

Q2. Enumerate the Importance of Environmental Study.

Ans.: Importance of Environmental Study: 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.

Q3. Discuss briefly characteristics of Business Environment.

Ans.: Characteristics of Business Environment: Various characteristics of Business Environment are as follows:

- (1) **Dynamic:** The environment keeps on changing as the changes occur. Frequently the environment changes, more frequently it will impact the business.
- (2) **Impact:** Environment gives direct and sometimes indirect effect on the working of the business.
- (3) **Two factors:** Environment mainly consists of two types of factors namely internal and external environmental factors.
- (4) **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.

Q4. Write a short note on: Business Environment.

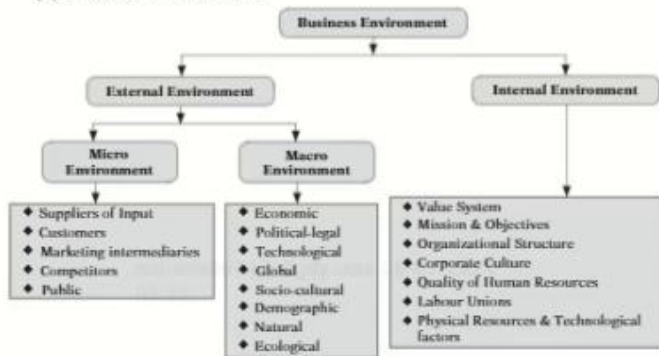
Or

Make diagrammatic presentation of various components of business environment.

Ans.: Business Environment: 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 various components of business environment are –

- (i) External Environment
- (ii) Internal Environment



EXTERNAL & INTERNAL ENVIRONMENT

Q5. Write a short note on: External Micro Environment

Or

"Micro environment includes those players whose decisions and actions have a direct bearing on the company." Explaining this statement you are required to state various constituents of micro environment.

Ans.: 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 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:** 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 organization'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.

Q6. Because of the uncontrollable nature of macro forces, a firm has to adjust itself to harness the opportunities thrown by such macro forces and mitigate the threats. In this connection, you are required to state the various external macro environmental factors.

Ans.: 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 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 maximization. In a mixed economy, public and private sectors have a co-existence and they may individually or jointly own the factors of production.

- (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, 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.
- (c) **Technological Environment:** 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.
- (d) **Global or International Environment:** The Global environment or 'border less world' plays an important role in shaping business activity. With the liberalization and globalization 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 Organization (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.

- (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.

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.

- (h) **Ecological Environment:** Though natural resources such as air, water and solar energy can be replenished, yet, business organizations 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.

Q7. Distinction between: Micro Environment & Macro Environment

Ans.:

Points	Micro Environment	Macro Environment
Meaning	The micro-environment consists of the factors in the company's immediate environment that affects the performance and working of the company.	The environment which is not specific to a particular firm but has the ability to influence the working of all the business groups is known as macro environment.
Elements	Elements of micro environment are consumers, competitors, market suppliers, market intermediaries.	Elements of micro environment are demographic environment, economic environment, political-legal environment, socio-cultural environment, technological environment, global environment.
Nature	The elements of micro environment are specific to particular business and affects it's working on short term basis.	The elements of macro environment are general environment and affect the working of all firms in the industry.
Controllability	Micro environmental factors are more controllable than micro environmental factors.	Macro environmental factors are generally more uncontrollable than micro environment factors.

Points	Micro Environment	Macro Environment
Influence	Micro environment has direct influence on the business.	Macro environment has indirect influence on the business.

Q8. Discuss various internal environmental factors which are controllable because the firm can change or modify these factors to improve its efficiency.

Ans.: Internal 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:

- (i) **Value System:** The value system of an organization means the ethical beliefs that guide the organization in achieving its mission and objectives. The value system of a business organization also determines its behaviour towards its employees, customers and society at large. The value system of a business organization makes an important contribution to its success and its prestige in the world of business.

- (ii) **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 maximization of profit. Mission is defined as the overall purpose or reason for its existence which guides and influences its business decision and economic activities.

- (iii) **Organization Structure:** The organizational 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 organization requires that the organization structure should be conducive for quick decision-making. The board of directors is the highest decision-making body in a business organization. For efficient and transparent working of the board of directors in India it has been suggested that the number of independent directors be increased.

- (iv) **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.

- (v) **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 organization. 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.
- (vi) **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 are required.
- (vii) **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 FORCE MODEL

Q9. Discuss briefly five competitive forces in an industry as identified by Michael Porter.

Or

Explain briefly the competitive forces in an industry as identified by Michael Porter. [May 2018 (5 Marks)]

Or

According to Michael Porter, what are the five competitive forces that exist within industry? [Nov. 2023 (5 Marks)]

Ans.: The Porter's Five Forces tool is a simple but powerful tool to evaluate the power of business. This is useful as it helps to understand both the strength of current competitive position and the strength of the position moving into.

Five forces model of Michael Porter is widely used tool for systematically diagnosing the significant competitive pressures in the market and assessing their strength and importance. The model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market. These five forces are:

- (1) **Threat of new entrants:** New entrants are always a powerful source of competition. The new capacity and product range they bring in throw up

new competitive pressure. A firm's profitability tends to be higher when other firms are blocked from entering the industry. New entrants can reduce industry profitability because they add new production capacity leading to increase supply of the product even at a lower price and can substantially erode existing firm's market share position. To discourage new entrants, existing firms can try to raise barriers to entry.

- (2) **Bargaining power of customers:** This is another force that influences the competitive condition of the industry. This force will become heavier depending on the possibilities of the buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products. Quite often, users of industrial products come together formally or informally and exert pressure on the producer. The bargaining power of the buyers influences not only the prices that the producer can charge but also influences in many cases, costs and investments of the producer because powerful buyers usually bargain for better services which involve costs and investment on the part of the producer.
- (3) **Bargaining power of suppliers:** Quite often suppliers, too, exercise considerable bargaining power over companies. The more specialized the offering from the supplier, greater is his clout. If the suppliers are also limited in number they stand a still better chance to exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and therefore, industry attractiveness and profitability.
- (4) **Rivalry among current players:** 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.
- (5) **Threats from substitutes:** This force is especially threatening when buyers can easily and substitute products with attractive prices or better quality and when buyers can switch from one product or service to another with little cost.
- Substitute products are a latent source of competition in an industry. In many cases they become a major constituent of competition. Substitute products offering a price advantage or performance improvement to the consumer can drastically alter the competitive character of an industry and they can bring it about all of a sudden.

The collective strength of these five competitive forces determines the scope to earn attractive profits. The strength of the forces may vary from industry to industry.

Attractive industry – high profits	Unattractive industry – low profits
↓	↓
High barrier to entry	Low barrier to entry
Weak suppliers bargaining power	Strong suppliers bargaining power
Weak buyers bargaining power	Strong buyers bargaining power
Few substitute products or services	Many substitute products or services
Low competition	Intense competition

Q10. Which steps are required to be followed to implement the Porter's Model?

Ans.: Following steps are to be followed to implement the Porter's Model:

Step 1 – Gather the information on each of the five forces: Gather information about industry and to check it against each of the factors (such as "number of competitors in the industry") influencing the force. Various factors that are required to be identified are given below:

Threat of new entry:

- ◆ 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

Supplier Power:

- ◆ Number of suppliers
- ◆ Suppliers' size
- ◆ Ability to find substitute materials
- ◆ Materials scarcity
- ◆ Cost of switching to alternative materials
- ◆ Threat of integrating forward

Buyer Power:

- ◆ Number of buyers
- ◆ Size of buyers
- ◆ Size of each order
- ◆ Buyers cost of switching suppliers
- ◆ Price sensitivity
- ◆ Threat of integrating backward

Threat of substitutes

- ◆ Number of substitutes
- ◆ Performance of substitutes
- ◆ Cost of changing

Rivalry among existing competitors

- ◆ 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

Step 2 – Analyze the results and display them on a diagram: After gathering all the information, one 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. One should also note that five forces affect different industries differently so one cannot use the same results of analysis for 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 as per step 2. 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.

Q11. Discuss Porter's Model for world famous multinational fast food chain – Pizza Hut.

Ans.: Pizza Hut is world famous multinational fast food chain. 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 force model for Pizza Hut may be drawn as under:

Threat of new entrants:

- ◆ Entry into the Pizza Chain business is not easy. Pizza chains suffer from blows due to increased ingredient prices, slim margins and stiff competition.
- ◆ An already existing chain like Pizza Hut has an advantage over the new competitor in terms of technology, resources and experience.
- ◆ Relationships with the supplier matters a lot in the pizza industry. This helps to keep the cost of production low in order to increase profitability.
- ◆ In such an industry, customer loyalty is a powerful factor and Pizza chains have hordes of loyal customers who swear by their pizzas.

Threat of substitutes:

- ◆ Apart from pizzerias, there are other substitutes available in the fast food segment like KFC, Burger, Taco Bell, Subway and even family restaurants etc.
- ◆ The quickly growing demands for the packed food and ready-to-eat instant food items including frozen pizzas are absorbing a lot of customers from pizza chains as a whole.
- ◆ There are other substitutes also available to pizza market such as the local super markets who not only provide frozen pizzas but also sell ready-to-bake pizzas and often large size pizza which is a major setback.

Bargaining power of customers:

- ◆ Fast food consumers are large in number and most of them rely on few options.
- ◆ Individual customers are unlikely to purchase a large amount of pizzas, hence individual customers do not affect overall sales.
- ◆ Quick Service Restaurants are in high demand especially in malls, colleges, office areas etc. Consequently, pizzas are quite inelastic to the price fluctuations with this section of people.

Bargaining power of suppliers:

- ◆ There is a huge diversified supply chain available for its ingredients and raw materials.
- ◆ Raw material is perishable and can't be stored for long.
- ◆ Suppliers don't find themselves in a strong bargaining position as the core ingredient for this food industry is widely available (flour, cheese, sauce etc.)
- ◆ Labour is also abundant and cheap for this labour intensive industry.
- ◆ Suppliers tend to keep long term relationships with the purchasers thereby making it easier for the purchasers to negotiate on lower prices.

Intensity of competitive rivalry:

- ◆ Stiff competition among fast food chains such as Domino's, McDonald's, KFC, Subway etc.
- ◆ Fierce price discounting, coupons, fast home deliveries and special customer offers have intensified the competition while also cutting down margins.
- ◆ Apart from this established competition, there is competition from local pizzerias that provide a lot of innovative options, fast deliver at lesser charge.

Q12. "Understanding the competitive landscape is important to build upon a competitive advantage". Explain. [May 2021 (5 Marks)]

Or

Mr. LMN has established a successful venture in the textiles sector in Maharashtra. His enterprise specializes in crafting unique and high-quality home furnishings, which have garnered significant market presence. However, there was a sales dip in the previous year. Seeking professional advice, Mr. LMN consulted a strategic management expert who suggested his first course of action should be to grasp the dynamics of the competitive landscape.

In order to comprehend the competitive landscape, what steps should Mr. LMN follow? [Nov. 2023 (5 Marks)]

Ans.: Competitive landscape is a business analysis which identifies competitors, either direct or indirect. Competitive landscape is about identifying and understanding the competitors and at the same time, it permits the comprehension of their vision, mission, core values, niche market, strengths and weaknesses.

An in-depth investigation and analysis of a firm's competition allows it to assess the competitors' strengths and weaknesses in the marketplace and helps it to choose and implement effective strategies that will improve its competitive advantage.

Steps to understand the competitive landscape for building competitive advantage are:

- Identify competitors:** The first step to understand the competitive landscape is to identify the competitors in the firm's industry and have actual data about their respective market share.
- Understand competitors:** Once the competitors have been identified, the strategist can use market research report, internet, newspapers, social media, industry reports, and various other sources to understand the products and services offered by them in different markets.
- Determine strengths of competitors:** What are the strengths of the competitors? What do they do well? Do they offer great products? Do they utilize marketing in a way that comparatively reaches out to more consumers? Why do customers give them their business?
- Determine weaknesses of competitors:** Weaknesses (and strengths) can be identified by going through consumer reports and reviews appearing in various media. After all, consumers are often willing to give their opinions, especially when the products or services are either great or very poor.
- Put all information together:** At this stage, the strategist should put together all information about competitors and draw inference about what they are not offering and what the firm can do to fill in the gaps.

The strategist can also know the areas which need to be strengthened by the firm.

Q13. What are the factors which determine the nature of rivalry in an industry? [Nov. 2021 (5 Marks)]

Ans.: The intensity of rivalry in an industry is a significant determinant of an industry's attractiveness and profitability. The intensity of rivalry can influence the costs of suppliers, distribution, and of attracting customers and thus, can directly affect the profitability. "The more intensive the rivalry, the less attractive is the industry". Rivalry among competitors tends to be cutthroat and an industry's profitability is low when:

- An industry has no clear leader. Therefore, continuous war for leadership.
- Competitors in the industry are numerous.
- Competitors operate with high fixed costs. Thus, aiming for better Return on Investment with more fierce tactics.
- Competitors face high exit barriers, and therefore, continue to fight for market share.
- Competitors have little opportunity to differentiate their offerings.
- The industry faces slow or diminished growth.

Q14. "The bargaining power of suppliers determines an industry's attractiveness and profitability." Discuss. [May 2022 (5 Marks)]

Ans.: Quite often, suppliers too, exercise considerable bargaining power over purchasing companies. The more specialized the offering from the supplier, greater may be its clout. Further, when the suppliers are limited in number, they may openly exhibit their bargaining power.

The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry, and therefore, an industry's attractiveness and profitability.

Suppliers can influence the profitability of an industry in a number of ways.

Suppliers can command bargaining power over a firm when:

- Their products are crucial to the buyer and substitutes are not available.
- They can ensure high switching costs.
- They are more concentrated than their buyers. Less suppliers, more buyers.

Q15. Buyers of an industry's products or services can sometimes exert considerable pressure on the company. In the light of the five forces as propagated by Michael Porter explain this force. Also state as to when this leverage is evident. [May 2023 (5 Marks)]

Ans.: Bargaining Power of Buyers: This is another force that influences the competitive condition of an industry. This force becomes heavier depending on the possibility of buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products. Quite often, users of industrial products come together formally or even informally and exert pressure on the producer. The bargaining power of the buyers influences not only the prices that the producer can charge but also influences costs and investments of the producer. This is because powerful buyers usually bargain for better services which involves more investment on the part of the producer.

Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services. This leverage is particularly evident when:

- Buyers have full knowledge of the source(s) of products and their substitutes. Thus, challenging the price being charged by producers.
- They spend a lot of money on the industry's products *i.e.* they are big buyers. Thus, in a position to demand favourable terms of contract.
- The industry's product is not perceived as critical to the buyer's needs and buyers are more concentrated than firms supplying the product. They can easily switch to the substitutes available.

3

CHAPTER

BUSINESS POLICY & FORMULATION OF FUNCTIONAL STRATEGY

FEATURES, EVOLUTION & IMPORTANCE OF BUSINESS POLICY

Q1. What is Business Policy? Give its definition and features.

Ans.: Business Policy: Business Policy defines the scope or spheres within which decisions can be taken by the subordinates in an organization. It permits the lower level management to deal with the problems and issues without consulting top level management every time for decisions. Business policies are the guidelines developed by an organization to govern its actions. They define the limits within which decisions must be made. Business policy also deals with acquisition of resources with which organizational goals can be achieved. Business policy is the study of the roles and responsibilities of top level management, the significant issues affecting organizational success and the decisions affecting organization in long-run.

Features of Business Policy: 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 & Uniform:** Policy must be uniform and reliable enough to be efficiently followed by the subordinates.
- (4) **Appropriate:** Policy should be appropriate to represent the organizational goals.
- (5) **Simple:** A policy should be simple and easily understood by each and every person in the organization. *For example, "No smoking within 100 feet of welding operations designated by the painted yellow floor lines."*
- (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. *For example, "Cell phones are not permitted in the conference room."*

Q2. Discuss the Importance of Business Policy.

Ans.: Good and proper business policy is the key for success of business. Policies offer great advantages to the management if they are stated with clarity. It raises the confidence of the line managers. They make the decisions within a given boundary. The managers act without the need for consulting the senior managers every time which minimizes the need for close supervision. It also builds the confidence of the managers.

The importance of business policies are discussed as follows:

- (1) **Control:** Policy facilitates effective control on the working of the organization. It indirectly controls the managers at different levels without directly interfering in their routine working.
- (2) **Effective Communication:** Generally policies are written and well drafted statements. Hence there is not a remote chance of confusion or miscommunication. By setting policies the management ensures that decisions made will be consistent and in the best interest of the organization. Clearly laid down policies try to eliminate personal hunch and biasness.
- (3) **Clarity:** Policies clarify the viewpoint of management for the purpose of running particular activity/activities.
- (4) **Motivation:** Policy enables the line managers to be self reliant. They take the decision on their own in the confined border of the policy. This raises their confidence and motivates them. A well drafted policy provides a pattern within which delegation of authority is possible.
- (5) **Policy Review:** Regular review of policy is must to see to it that the existing policies are relevant in the given situation. If required policy may be modified or altered depending on as per business environment. Review of policy at regular intervals provides a method of anticipating future conditions and situations and helps to resolve how to deal with them.
- (6) **Economical and Efficient:** Policy enables the management to carry out its operations effectively and efficiently. It enhances the working of the organization.
- (7) **Co-ordination of Efforts:** Policies ensure co-ordination of efforts and activities at different levels in the organization. Activities and duties are assigned in such a way that all activities in the organization are integrated effectively. Policy coordinates with individual efforts.
- (8) **High Morale:** A well crafted policy can raise the overall morale of an enterprise. Policy enables the managers to understand the intention of the management.

FRAMEWORK OF STRATEGIC MANAGEMENT

Q3. Elaborate framework of Strategic Management.

Ans.: Strategic Management is the process of formulating, implementing, and evaluating cross functional decisions that enable an organization to achieve its objectives. The strategic management model entails strategy assessment, formulation/planning, execution and evaluation. It asks the basic questions like –

- Where are we now?
- Where do we want to go?
- How do we get there?

The Strategic Management Framework has multiple phases which are discussed below:

- (1) **Business Assessment:** Every Strategic Management Framework starts with assessment of business. This is the phase of gathering data and information to understand the needs of the business, the company's strategic direction, and the initiatives that will assist in growth and expansion. It is the phase to evaluate the internal and external factors influencing the business. The internal analysis looks at organizational structure, internal processes and core competencies of the employees. It also reviews employee interaction with each other and the management layer. The external analysis helps to identify industry and socio-economic factors that impact the competitive position of the business. Analytical tools, such as SWOT Analysis, are helpful during this phase.
- (2) **Strategy Formulation:** Based on the results of the analysis, the business can then formulate a strategy. Strategy Formulation is the phase of deciding the best course of action for accomplishing the business's objectives and purpose. This is the stage to develop a vision and mission, long term objectives, generate alternative strategies and choose which strategies to pursue.
- (3) **Translate strategy to action:** To translate strategy into action strategic planning is required. It is the process of converting the strategies into an integrated plan of action that can be implemented. It also involves creating a strategic plan which summarizes the time-phased outputs and drivers.
- (4) **Strategy Execution:** Strategy execution (implementation) is the phase of putting the strategy into action. It includes designing organization's structure, distributing resources, setting policies, developing decision making process, and managing human resources.

The bottom line is that there is not one prescription that fits all. Businesses have to create and adapt a strategic management process that works best for them and those that they serve.

VISION & MISSION

Q4. 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. Explain.

Ans.: Your vision statement is where you want your business to reach at. It is your future dream for your business. It is your optimum version of your business or where you can visualize being positioned in 3, 5 or 7 years time.

Examples of Vision Statements:

- ◆ **Disney** – "To make people happy".
- ◆ **ICSI** – "To be a global leader in promoting good corporate governance".
- ◆ **Google** – "To organize the world's information and make it universally accessible and useful".
- ◆ **Instagram** – "Capture and Share the World's Moments".

Vision serves the purpose of stating what an organization wishes to achieve in the long run. It articulates the position that the organization 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.

Features:

- (1) **Inspiring:** It motivates employees and is something that employees view as desirable.
- (2) **Clear:** It defines a prime goal.
- (3) **Future-oriented:** It describes where the company is going from the current level.
- (4) **Stable:** It offers a long-term perspective and is unlikely to be impacted by market or technology changes.
- (5) **Concise:** It should be easy to remember and repeat.
- (6) **Time horizon:** It defines a time horizon within which the company's desires to achieve its long term goals.
- (7) **Challenging:** It should not be something that can be easily met and discarded.
- (8) **Abstract:** It is general enough to encompass all of the organization's interests and strategic direction

Purpose:

Vision statements may fill the following functions for a company:

- ◆ It serves as foundations for a broader strategic plan.
- ◆ It motivates existing employees and also attracts potential employees by clearly categorizing the company's goals and attracting like-minded individuals.
- ◆ It 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.
- ◆ It helps 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.

Q5. "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." Discuss.

Or

What is a Mission Statement? State the points that may be considered while writing a Mission Statement of a company?

Ans.: Where your vision is your ultimate goal, your mission is how you will get there. Your mission explains why your business exists.

A mission statement defines the basic reason for the existence of that organization.

The mission statement should define its customers, products or services, markets, technology, philosophy and self-concept.

Following questions to be considered while preparing for a mission statement:

1. What is the basic purpose of your organization?
2. What is unique about your organization?
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?

Elements of Mission Statement

- ◆ Clearly Articulated
- ◆ Relevant
- ◆ Written in a positive tone

- ◆ Unique
- ◆ Enduring
- ◆ Adapted to the Target Audience.

Mission statement reflects the corporate philosophy, identity, character, and image of an organization.

A mission statement is a short statement of an organization's purpose, identifying the goal of its operations: what kind of product or service it provides, its primary customers or market, and its geographical region of operation.

It communicates primarily to the people who make up the organization – its members or employees – giving them a shared understanding of the organization's intended direction.

Q6. Distinguish between: Vision & Mission

Ans.:

Points	Vision	Mission
Meaning	A Vision Statement describes the desired future position of the company.	A Mission Statement defines the company's business, its objectives and its approach to reach those objectives.
Answer	It answers the question, "Where do we aim to be?"	It answers the question, "What do we do? What makes us different?"
What it tells	A Vision Statement outlines what the organization wants to be.	A Mission Statement tells you the fundamental purpose of the organization.
Time horizon	It concentrates on the future.	It concentrates on the present.
What it does	It is a source of inspiration.	It informs you of the desired level of performance.
Why	It describes a future identity.	It provides a path to realize the vision in line with its values.
Examples	State Bank of India Be the bank of choice for a transforming India.	State Bank of India Committed to providing simple, responsive and innovative financial solutions
	LinkedIn To create economic opportunity for every member of the global workforce.	LinkedIn To connect the world's professionals to make them more productive and successful
	Google To provide access to the world's information in one click.	Google To organize the world's information and make it universally accessible and useful.

VARIOUS STRATEGIES

Q7. What are the three main levels of management in any organization?

Ans.: An organization is divided into several functions and departments that work together to bring a particular product or service to the market. There are three main levels of management: corporate, business, and functional.

- (1) **Corporate Level:** Corporate level of management consists of the Chief Executive Officer (CEO), other senior executives, the board of directors, and corporate staff. The role of corporate-level managers is to oversee the development of strategies for the whole organization. This role includes defining mission and goals of the organization, determining what businesses it should be in, allocating resources among the different businesses, formulating and implementing strategies that span individual businesses, and providing leadership for the organization.
- (2) **Business Level:** Business level general managers are concerned with strategies that are specific to a particular business. The strategic role of these managers is to translate the general statements of direction and intent that come from the corporate level into concrete strategies for individual businesses.
- (3) **Functional Level:** Functional level managers are responsible for the specific business functions or operations (human resources, purchasing, product development, customer service, and so on) that constitute a company or one of its divisions. Thus, a functional manager's sphere of responsibility is generally confined to one organizational activity.

Q8. Write a short note on: Corporate Strategy

Ans.: Corporate level of management consists of the Chief Executive Officer (CEO), other senior executives, the board of directors, and corporate staff. The role of corporate-level managers is to oversee the development of strategies for the whole organization. This role includes defining the mission and goals of the organization, determining what businesses it should be in, allocating resources among the different businesses, formulating and implementing strategies that span individual businesses, and providing leadership for the organization.

Corporate strategy helps an organization to achieve and sustain success. It is basically concerned with the choice of businesses, products and markets. It is often correlated with the growth of the firm.

Corporate strategy in the first place ensures the growth of the firm and its correct alignment with the environment. Corporate strategies are concerned with the broad and long-term questions of what businesses the organization is in or wants to be in, and what it wants to do with those businesses. They set the overall direction the organization will follow. It serves as the design for filling the strategic planning gap. It also helps to build the relevant competitive advantages. A right fit between the organization and its external environment

is the primary contribution of corporate strategy. Basically the purpose of corporate strategy is to harness the opportunities available in the environment and countering the threats embedded therein. With the help of corporate strategy, organizations match their unique capabilities with the external environment so as to achieve its vision and mission.

Q9. What is the role of Corporate Level Managers in Strategic management?

Or

ABC Limited is in a wide range of businesses which include apparels, lifestyle products, furniture, real estate and electrical products. The company is looking to hire a suitable Chief Executive Officer. Consider yourself as the HR consultant for ABC Limited. You have been assigned the task to enlist the activities involved with the role of the Chief Executive Officer. Name the strategic level that this role belongs to and enlist the activities associated with it.

Ans.: There are three main levels of management in a typical organization: Corporate, Business, and Functional.

In given case, the role of Chief Executive Officer pertains to Corporate Level.

The corporate level of management consists of the Chief Executive Officer (CEO), other senior executives, the board of directors, and corporate staff. These individuals occupy the apex of decision making within the organization and broadly have following roles:

1. Oversee the development of strategies for the whole organization.
2. Defining the mission and goals of the organization,
3. Determining what businesses it should be in.
4. Allocating resources among the different businesses.
5. Formulating and implementing strategies that span individual businesses.
6. Providing leadership for the organization.
7. Provide a link between the people who oversee the strategic development of a firm and those who own it.

Q10. Write a short note on: Business Level Strategy

Ans.: Business Strategy is the strategy framed by the business managers to strengthen the overall performance of the enterprise. The strategic role of these managers is to translate the general statements of direction and intent that come from the corporate level into concrete strategies for individual businesses.

Business-level strategy focuses on how to attain and satisfy customers, offer goods and services that meet their needs, and increase operating profits. To do this, business-level strategy focuses on positioning itself against competitors and staying up to date on market trends and technology changes.

Economist Michael Porter theorizes that there are two main types of business strategy: cost leadership and differentiation.

A business can also integrate these two strategies.

Cost Leadership: Cost leadership is the tactic of winning over customers through aggressive pricing and making profits through high efficiency. For example, a car manufacturing company like Kia that prices its vehicles on the lower end of the price spectrum is employing a cost leadership strategy.

Differentiation: A company that differentiates adds unique features or services that command a higher selling price. A car company like Tesla that offers premium electric vehicles is using differentiation to create a competitive advantage in the market. Although cost leadership and differentiation may seem like opposite ends of the spectrum, many businesses use aspects of both strategies. For example, Toyota offers a hybrid electric vehicle that offers unique features but maintains a modest price point.

Q11. Distinguish between: Business Strategy & Corporate Strategy.

Or

How Business Level Strategies differ with Corporate Level Strategies?

Ans.: Following are the main points of distinction between Business Strategy & Corporate Strategy:

Points	Business Strategy	Corporate Strategy
Meaning	Business Strategy is framed by the business managers to strengthen overall performance of the enterprise.	Corporate Strategy is stated in the mission statement, which explains the type of business and ultimate goal of the firm.
Created by	Corporate Strategy is created by top level management.	Business Strategy is created by middle level management.
Nature	Corporate Strategy is decisive and legislative.	Business Strategy is executive and governing.
Term	Corporate Strategy is Long term strategy.	Business Strategy is short term strategy.
Major strategies	Expansion, Stability and Retrenchment.	Cost Leadership, Focus and Differentiation.
Deals with	Corporate Strategy deals with entire business organization.	Business Strategy deals with particular business unit or division.
Focus	Maximization of business growth and profitability.	Competing successfully in the marketplace.
Approach	Corporate Strategy uses extroverted approach, which links the business with its environment.	Business Strategy has an introverted approach i.e. it is concerned with the internal working of the organization.

Q12. What are the financial goals and metrics that are established based on benchmarking the "best-in-industry"?

Ans.: A financing strategy is integral to an organization's strategic plan. It sets out how the organization plans to finance its overall operations to meet its objectives now and in future.

A financing strategy summarizes targets, and the actions to be taken over 3 to 5 year period to achieve the targets. It also clearly states key policies which will guide those actions.

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

- (1) **Free Cash Flow:** Free cash flow can be a tremendously useful measure for understanding the true profitability of a business. It's harder to manipulate and it can tell a much better story of a company than more commonly used metrics like net income.

Free cash flow is a measure of the firm's financial soundness. It shows how efficiently 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 operating cash flow. Companies should utilize this metric when they anticipate substantial capital expenditures in the near future.

- (2) **Economic Value-Added:** The New York based financial advisory **Stern Stewart & Co.** postulated a concept of economic value added. *Economic value added measures the excess returns over cost of capital.* EVA measures whether the operating profit is sufficient enough to cover cost of capital. If a company's EVA is negative it is destroying shareholders wealth even though it may be reporting positive and growing EPS or return on capital employed. 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 effective management of current assets and current liabilities 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.
- (4) **Financing Decisions & Capital Structure:** Capital structure refers to the mix of a firm's capitalization and includes long term sources of funds such as debentures, preference share capital, equity share capital and retained earnings. Capital structure is "the make-up of a firm's capitalization". The decisions regarding the forms of financing, their requirements and their relative proportions in total capitalization are known as capital structure decisions. In arriving at and accomplishing this goal, one must take extreme care and prudence keeping in mind factors under which the company has to operate as also certain guiding principles of financing.

Accordingly, he should choose a pattern of capital which minimizes cost of capital and maximizes the owners return.

- (5) **Profitability Ratios:** Profitability ratios are used to measure the profitability or the operational efficiency of the firm to see the final results of business operations. These ratios are 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.

Q13. What are the key decisions that falls within the scope of financial strategy?

Ans.: A financing strategy is integral to an organization's strategic plan. It sets out how the organization plans to finance its overall operations to meet its objectives now and in future.

As a part of financial strategy every organization has to take following three types of decisions.

- (a) **Investment Decisions:** Investment decisions relate to the careful selection of viable and profitable investment proposals, allocation of funds to the investment proposals with a view to obtain net present value of

the future earnings of the company and to maximize its value. Every business organization has to carefully analyze the different alternatives of investment, determination of investment levels in different assets i.e. fixed assets and current assets.

- (b) **Finance Decisions:** The third and last function of finance includes dividend decisions. In fund raising decisions, he should keep in view the cost of funds from various sources, determination of debt-equity mix, the advantages and disadvantages of debt component in the capital mix, impact of taxation and depreciation in maximization of earnings per share to the equity holders, consideration of control and financial strain on the firm in determining level of gearing, impact of interest and inflation rates on the firm etc.
- (c) **Dividend Decisions:** The dividend decisions of a finance manager are mainly concerned with the decisions relating to the distribution of earnings of the company among its equity holders and the amounts to be retained by the company.

The main aim of all three decisions is profit maximization and wealth maximization of shareholders. The investment, finance and dividend decisions are interrelated to each other and therefore, the company while taking any decision, should consider the impact from all the three angles simultaneously.

Q14. What do you understand by Marketing Strategy?

Ans.: A marketing strategy is a business's overall game plan for reaching people and turning them into customers of the product or service that the business provides. The marketing strategy of a company contains the company's value proposition, key marketing messages, information on the target customer and other high-level elements.

The marketing strategy informs the marketing plan, which is a document that lays out the types and timing of marketing activities.

The Strategic Marketing answers three 'W's:

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

Q15. In terms of market position, firms may be classified as market leaders, market challengers, market followers or market nichers. Explain.

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

- (1) **Market Leader:** A market leader is a company that has the largest market share in an industry and which can use its dominance to affect the competitive landscape and direction the market takes. The leader may or may not be respected by other firms, but other firm has to acknowledge its dominance. Other firms can challenge, follow or avoid the

market leader. In India, well-known market leaders are Maruti Suzuki in cars, Hero Honda in two-wheelers, Hindustan Unilever in consumer packaged goods, Coca-Cola in soft-drink, McDonald's in fast food, LIC in life-insurance, and so forth. 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 competitor's 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
- ◆ Corporate acquisitions.

- (2) **Market Challenger:** Market challengers are known as runner-up firms. They occupy second, third and lower ranks in an industry. Bajaj Auto in two-wheelers, Tata Motors and Hyundai in cars, Reliance Petro and Essar Oils in refineries, Procter and Gamble in consumer packaged goods, Vodafone in cellular service providers etc., are some of the market challengers in India. Market challengers are capable to attack the leader and other competitors. Sometimes, capable challengers can overtake the leader, too. 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.

- (3) **Market Follower:** Followers are generally follows 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. They strategy is to maintain steady profits by controlling costs.

- (4) **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.

Q16. How entrants into market are classified by the Lieberman and Montgomery?

Ans.: According to Lieberman and Montgomery, every entrant into a market whether it is new or not is classified under 'Market Pioneer', 'Close Follower' or 'Late follower':

Market Pioneers: Market Pioneers are known to often open a new market to consumers based on major innovation. They emphasize these product developments, and in a significant amount of cases, studies have shown that early entrants or pioneers into a market have serious market-share advantages above all those who enter later. Pioneers have the first-mover advantage and in order to have this advantage, business's must ensure they have primary sources: Technological Leadership, Preemption of Assets or Buyer Switching Costs.

- ◆ Technological Leadership means gaining an advantage through either Research & Development or the "learning curve". This lets a business use the research and development stage as a key point of selling due to primary research of a new or developed product.
- ◆ Preemption 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. Thus allowing pre-existing information to be used and a lower risk when first entering a new market.

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. However, while Market Pioneers may have the "highest probability of engaging in product development and lower switching costs, to have the first-mover advantage, it can be more expensive due to product innovation being more costly than product imitation. It has been found that while Pioneers in both consumer goods and industrial markets have gained "significant sales advantages" they incur larger disadvantages cost-wise.

Close Followers: If there is an upside potential and the ability to have a stable market share, many businesses would start to follow in the footsteps of pioneers. These 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. By doing this, it allows businesses to find weaknesses in the products produced before, thus leading to improvements and expansion on the aforementioned product. Therefore, it could also lead to customer preference, which is essential in market success. 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. Early following into a market can often be encouraged by an established business's product that is "threatened or has industry-specific supporting assets".

Late Followers: Those who follow after the Close Followers are known as the Late Entrants. While being a Late Entrant can seem very daunting, there are some perks to being a latecomer. For example, Late Entrants have the ability to learn from those who are already in the market or have previously entered. Late Followers have the advantage of learning 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 have the advantage of catching the shifts in customer needs and wants towards the products. When bearing in mind customer preference, customer value has a significant influence. Customer value means taking into account the investment of customers as well as the brand or product. It is created through the "perceptions of benefits" and the "total cost of ownership". On the other hand, if the needs and wants of consumers have only slightly altered, Late Followers could have a cost advantage over early entrants due to the use of product imitation. However, if a business is switching markets, this could take the cost advantage away due to the expense of changing markets for the business. 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. If the marketing mix is not used correctly despite the entrant time the business will gain little to no advantages, potentially missing out on a significant opportunity.

Q17. Kamakshi is the Marketing Manager at a software company. She is responsible for developing and implementing marketing strategies for the company's products. Kamakshi leads a team of marketing professionals and works closely with the product development and sales teams to ensure that the company's products are effectively promoted in the market. She also analyses market trends and customer feedback to refine the marketing strategies. Which level is she working at? Discuss the roles and responsibilities of this level in organization.

[June 2024 (5 Marks)]

Ans.:

Functional Level: Functional level managers are responsible for the specific business functions or operations (human resources, purchasing, product development, customer service, and so on) that constitute a company or one of its divisions. Thus, a functional manager's sphere of responsibility is generally confined to one organizational activity.

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 co-ordination 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 sub-divided into promotion, sales, distribution, pricing strategies with each sub-function strategy contributing to functional strategy.

Kamakshi is working as Marketing Manager and is responsible for developing and implementing marketing strategies which is functional strategy and hence she is working for Functional Level Strategy.

Role and responsibilities of Functional Level Strategy:

- ◆ Functional Strategy assists in the overall business strategy, by providing information concerning the management of business activities.
- ◆ Functional Strategy explains the way in which functional managers should work, so as to achieve better results.

Functional Strategy states what is to be done, how is to be done and when is to be done at the functional level, which ultimately acts as a guide to the functional staff and to do so, strategies are to be divided into achievable plans and policies which work in tandem with each other.

Functional level managers are responsible for the specific business functions or operations (human resources, purchasing, product development, customer service, and so on) that constitute a company or one of its divisions. Thus, a functional manager's sphere of responsibility is generally confined to one organizational activity.

Q18. How you will implement the Human Resource Strategy?

Ans.: While implementing the human resource strategy one has to consider the following aspects:

- (1) **Assessing the current HR capacity:** This includes taking stock of the skills of the existing human resources of the organization 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 ask 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 organization in terms of strategic. During this phase you should also review your current HR practices and if these require any amendments.
 - (4) **Developing HR strategies to support strategies of the organization:** Some of the HR strategies which may be adopted to attain the organizational goals are as follows:
 - (a) **Restructuring Strategies:** This includes reducing staff, regrouping tasks to create well-designed jobs, and reorganizing work groups to perform more efficiently.
 - (b) **Training & Development Strategies:** This includes providing the current staff with training and development opportunities to encompass new roles in the organization.
 - (c) **Recruitment Strategies:** This includes recruiting new hires that already have the skills the organization will need in the future.
 - (d) **Outsourcing Strategies:** This includes outreaching to external individuals or organizations to complete certain tasks.
 - (e) **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.
 - (f) **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.
 - (g) **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.
 - (h) **Employee Compensation:** The organization 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.
 - (f) **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.

- (j) **Communication & Feedback:** Lines of communication should be kept open for ensuring employee retention. Their ideas, questions and concerns must be welcomed.
- (k) **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.
- (l) **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.
- (m) **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.

Q19. Write a short note on: Production Strategy.

Ans.: The production/operations strategy is related to the production system, operational planning and control and logistics management. It affects the nature of product/service, the markets to be served, and the manner in which the markets are to be served. All these collectively influence the operations system structure and objectives which are used to determine the operations plans and policies. Thus, a strategy of expansion through related diversification, for instance, will affect what products are offered to which market and how these markets are served. The operations system structure, which is concerned with the manufacturing/service and supply/delivery system, and operations system objectives, which are related to customer service and resource utilization, both determine what operations, plans and policies are set.

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

Business Strategies	Competitive Priorities	Competitive Advantages
<ul style="list-style-type: none"> ◆ Differentiation Strategy ◆ Cost Leadership Strategy ◆ Market Segmentation Strategy 	<ul style="list-style-type: none"> ◆ Price or Cost Strategy ◆ Quality Strategy ◆ Delivery Strategy ◆ Product Mix Strategy ◆ Service Strategy ◆ Eco-Friendly Products 	<ul style="list-style-type: none"> ◆ Flexible Response Strategy ◆ Low Cost Strategy

Q20. Discuss various types of production strategies are grouped under business strategies.

Ans.: Different types of production strategies that are grouped, listed and explained under business strategies are as follows:

- (a) **Differentiation Strategy:** Under a differentiation strategy, the company tries to be different and unique from its competitors. It may offer better quality, quantity, pricing, appearance, and after sales-service, when compared to its competitors. It may offer more features and facilities in its product. It may be more flexible while dealing with its customers. It may also offer quick and better delivery of its products. So, there are many ways, in which a company can remain different from its competitors. If it maintains this uniqueness and difference in its product quality and customer service, then it can charge higher prices.
- (b) **Cost Leadership Strategy:** Under a cost leadership strategy, the company tries to reduce its cost of production. This is done by producing goods on a very huge scale. By doing so, the company will get the benefits of economies of large scale. Higher the scale of production, lower will be the cost of production. This is because per unit cost of raw materials, labour, advertising, sales promotion, R & D, etc. will decrease.
- (c) **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. Example, many detergent companies offer different variants of detergents with different price brackets.

Q21. Discuss various types of production strategies that are grouped under competitive priorities.

Ans.: Different production strategies that are grouped, listed and explained under competitive priorities are as follows:

- (1) **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 (same) in nature. 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. So, the customers will purchase the company's product and not the competitors' products.
- (2) **Quality Strategy:** Under quality strategy, the company produces and sells high-quality goods and services. The prices of such goods and services are naturally very high. However, this strategy attracts those customers who prefer top quality products and are ready to pay necessary appropriate prices. The company must pay special attention to the design of its products. It must upgrade product design and add new product features to

analytically the current needs and demands of its customers. Products which are designed badly will naturally fail in the market. To gain success in the market, the company must smartly invest to make quality innovative products that are free from any defects.

- (3) **Delivery Strategy:** Under delivery strategy, the company delivers its product and services to their customers as early as possible that too 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.
- (4) **Product Mix or Flexibility Strategy:** Under Product Mix Strategy, the company produces and sells a product mix. A product mix is a group of products, which are sold by the same company. Here, the company does not depend only on one product for its survival and growth. It uses a product mix because it offers many advantages to the company. However, only large companies with huge production capacity can use this strategy.
- (5) **Service Strategy:** Under Service 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.
- (6) **Eco-friendly Strategy:** 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.

Q22. Management of your company is the process of integrating the flow of materials into, through and out of an organization to achieve a level of service that the right materials are available at the right place at the right time, of right quality and at the right cost. Briefly discuss the type of strategy your company is dealing with.

Ans.: Logistics Strategy: Management of logistics is a process which integrates the flow of materials into, through and out of an organization to achieve a level of service that the right materials are available at the right place at the right time, of right quality and at the right cost. For a business organization effective

logistics strategy will involve raising and finding solutions to the questions relating to raw material, manufacturing locations, products, transportation and deployment of inventory. Improvement in logistics can result in saving in cost of doing business.

When a company creates a logistics strategy, it is defining the service levels at which its logistics systems are highly effective. A company may develop a number of logistics strategies for specific product lines, specific countries or specific customers to address different categorical requirements.

Supply chain management helps in logistics and enables a company to have constant contact with its distribution team, which could consist of trucks, trains, or any other mode of transportation. Given the changes that affect logistics operations such as emerging technologies and industry initiatives, developing and using a formal logistics strategy is very important. For a business enterprise, effective logistic strategy will involve raising and finding solutions to the following questions:

- ◆ Which sources of raw materials and components are available?
- ◆ How many manufacturing locations are there?
- ◆ What products are being made at each manufacturing location?
- ◆ What modes of transportation should be used for various products?
- ◆ What is the nature of distribution facilities?
- ◆ What is the nature of materials handling equipment possessed? Is it ideal?
- ◆ What is the method for deploying inventory in the logistics network?
- ◆ Should the business firm own the transport vehicles?

Improvement in logistics can result in savings in cost of doing business. These savings can also reveal in the profits of the company. Some examples of how logistics can help a business are as follows:

- ◆ Cost savings
- ◆ Reduced inventory
- ◆ Improved delivery time
- ◆ Customer satisfaction
- ◆ Competitive advantage

Q23. What are the elements of Logistics Strategy Plan?

Or

Logistics strategy plan is an important part of formulation of strategy'. What are the major elements of Strategic Plan?

Ans.: The Logistics Strategy plan is developed within following eight elements:

- (1) **Customer Service Policy:** The appropriate level of service for customers, by product group or market segment; considering: order fulfillment requirements, enquiry and investigation capability and the available

satisfy the current needs and demands of its customers. Products which are designed badly will naturally fail in the market. To gain success in the market, the company must smartly invest to make quality innovative products that are free from any defects.

- (3) **Delivery Strategy:** Under delivery strategy, the company delivers its product and services to their customers as early as possible that too 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.
- (4) **Product Mix or Flexibility Strategy:** Under Product Mix Strategy, the company produces and sells a product mix. A product mix is a group of products, which are sold by the same company. Here, the company does not depend only on one product for its survival and growth. It uses a product mix because it offers many advantages to the company. However, only large companies with huge production capacity can use this strategy.
- (5) **Service Strategy:** Under Service 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.
- (6) **Eco-friendly Strategy:** 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.

Q22. Management of your company is the process of integrating the flow of materials into, through and out of an organization to achieve a level of service that the right materials are available at the right place at the right time, of right quality and at the right cost. Briefly discuss the type of strategy your company is dealing with.

Ans.: Logistics Strategy: Management of logistics is a process which integrates the flow of materials into, through and out of an organization to achieve a level of service that the right materials are available at the right place at the right time, of right quality and at the right cost. For a business organization effective

logistics strategy will involve raising and finding solutions to the questions relating to raw material, manufacturing locations, products, transportation and deployment of inventory. Improvement in logistics can result in saving in cost of doing business.

When a company creates a logistics strategy, it is defining the service levels at which its logistics systems are highly effective. A company may develop a number of logistics strategies for specific product lines, specific countries or specific customers to address different categorical requirements.

Supply chain management helps in logistics and enables a company to have constant contact with its distribution team, which could consist of trucks, trains, or any other mode of transportation. Given the changes that affect logistics operations such as emerging technologies and industry initiatives, developing and using a formal logistics strategy is very important. For a business enterprise, effective logistic strategy will involve raising and finding solutions to the following questions:

- ◆ Which sources of raw materials and components are available?
- ◆ How many manufacturing locations are there?
- ◆ What products are being made at each manufacturing location?
- ◆ What modes of transportation should be used for various products?
- ◆ What is the nature of distribution facilities?
- ◆ What is the nature of materials handling equipment possessed? Is it ideal?
- ◆ What is the method for deploying inventory in the logistics network?
- ◆ Should the business firm own the transport vehicles?

Improvement in logistics can result in savings in cost of doing business. These savings can also reveal in the profits of the company. Some examples of how logistics can help a business are as follows:

- ◆ Cost savings
- ◆ Reduced inventory
- ◆ Improved delivery time
- ◆ Customer satisfaction
- ◆ Competitive advantage

Q23. What are the elements of Logistics Strategy Plan?

Or

Logistics strategy plan is an important part of formulation of strategy'. What are the major elements of Strategic Plan?

Ans.: The Logistics Strategy plan is developed within following eight elements:

- (1) **Customer Service Policy:** The appropriate level of service for customers, by product group or market segment; considering: order fulfillment 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:** Centralized or decentralized 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 & 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 Organization Structure:** Function or flow based; allocation of responsibilities; managed or self managed teams.
- (8) **Logistics Targets & Metrics:** Measures of performance and achievement targets; operations improvements process and management.

Q24. What are the issues to be resolved by a business enterprise to have an effective logistic strategy? [May 2021 (5 Marks)]

Ans.: Management of logistics is a process which integrates the flow of supplies into, through and out of an organization to achieve a level of service which ensures that the right materials are available at the right place, at the right time, of the right quality and at the right cost.

For a business enterprise, effective logistic strategy will involve raising and finding solutions to the following questions:

- Which sources of raw materials and components are available?
- How many manufacturing locations are there?
- What products are being made at each manufacturing location?
- What modes of transportation should be used for various products?
- What is the nature of distribution facilities?
- What is the nature of materials handling equipment possessed? Is it ideal?
- What is the method for deploying inventory in the logistics network?
- Should the business firm own the transport vehicles or hire?

Q25. 'ALBELA' Foods and 'JustBE' Foods are successfully competing chain of restaurants in India. ALBELA's are known for their innovative approach, which has resulted in good revenues. On the other hand, JustBE is slow in responding to environmental change. The initial stages of Covid-19 pandemic and the ensuing strict lockdown had an adverse impact on both the companies. Realizing its severity and future consequences. ALBELA, foods immediately chalked out its post lockdown strategies, which include initiatives like:

- (a) Contactless dining
- (b) New category of foods in the menu for boosting immunity
- (c) Improving safety measures and hygiene standards
- (d) Introducing online food delivery app

Seeing the positive buzz around these measures taken by ALBELA Food, JustBE Foods also thinks to introduce these measures.

- (i) Identify the strategic approach taken by 'ALBELA' Foods and 'JustBE' Foods.
- (ii) Discuss these strategic approach.
- (iii) Which strategic approach is better and why?

[May 2021 (1 + 3 + 1 = 5 Marks)]

Ans.:

- (i) 'ALBELA' foods is **proactive** in its approach. On the other hand, 'JustBE' foods is **reactive** in its approach.
- (ii) Proactive strategy is planned strategy. While continuing with the previously initiated business approaches that are working well, the newly launched managerial initiatives aim to strengthen the company's overall position and performance. These are outcomes of management's analysis and strategic thinking about the company's situation and its conclusions about the positioning of the company in the marketplace. If done well, it helps the company to effectively compete for buyer patronage.
Reactive strategy is an adaptive reaction to changing circumstances. It is not always possible for a company to fully anticipate or plan for changes in the market. There is also a need to adapt strategy as new learning emerge about which pieces of strategy are working well and which aren't. By itself also, the management may hit upon new ideas for improving the current strategy.
- (iii) In reference to the given case, proactive strategy seems to be better because ALBELA foods had been able to utilize available opportunities, reduce adverse impact, enhance the demand for product and is also able to avail the first mover advantage.

Q26. What is cost leadership strategy? Under what circumstances an organization can gain competitive advantages from cost leadership strategy? Is there any risk in pursuing cost leadership strategy?

[Nov. 2022 (5 Marks)]

Ans.: Cost leadership strategy emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive. It frequently results from productivity increases and aggressive pursuit of cost reduction throughout the development, production, marketing, and distribution processes. It allows a firm to earn higher profits than its competitors.

The circumstances in which an organization can gain competitive advantages from cost leadership strategy are:

- ◆ When the market is composed of many price-sensitive buyers.
- ◆ When there are few ways to achieve product differentiation.
- ◆ When buyers do not care much about differences from brand to brand.
- ◆ When there are a large number of buyers with significant bargaining power.

The basic idea is to under price competitors and thereby gain market share driving some of the competitors out of the market.

Some risks of pursuing cost leadership are as follows:

- ◆ Competitors may imitate the strategy, therefore driving overall industry profits down.
- ◆ Technological breakthroughs in the industry may make the strategy ineffective; or that buyer interests may swing to other differentiating features besides price.

Q27. "Management at all levels develops strategies". Explain the different strategies formulated at different levels of management.

[May 2023 (5 Marks)]

Ans.: At different levels of management, various strategies are formulated to align with organizational goals and objectives which are as follows:

- (1) **Corporate Level Strategies:** At the highest level of management, corporate level strategies are developed. These strategies focus on the overall direction and scope of the entire organization. Major corporate-level strategies include Stability strategies, Growth strategies, Retrenchment strategies and Combination strategies.
- (2) **Business Level Strategies:** Business level strategies are developed by middle-level management and focus on individual business units or divisions within the organization. These strategies aim to achieve competitive advantage within specific markets. Common business-level strategies include Cost Leadership, Differentiation and Focus strategies.

- (3) **Functional Level Strategies:** Functional-level strategies are formulated by lower-level management or department heads responsible for specific functional areas, such as marketing, finance, operations, or human resources. These strategies align with business-level strategies and focus on achieving functional objectives. These strategies include Marketing strategies, Financial strategies, Operations strategies, Research & Development strategy and Human Resource strategies.

In conclusion, management at all levels develops strategies that align with the organization's goals. *Corporate level strategies determine the overall direction, business level strategies focus on competitive advantage within specific markets, and functional level strategies aim to achieve functional objectives in support of the broader strategies.*

Q28. Disha is appointed as Human Resource Manager in a Telecom company. Currently, the company is facing various HR challenges. Disha's role involves implementing effective human resource management strategies to address HR challenges and ensure the success of the company. Enumerate any five prominent areas where Disha can play a strategic role.

[Nov. 2023 (5 Marks)]

Ans.: Disha, the Human Resource Manager in a Telecom company, plays a pivotal strategic role in addressing HR challenges and fostering the company's success. Key areas where Disha contributes strategically include:

- (1) **Providing purposeful direction:** The human resource manager leads people and the organization towards the desired direction involving people. He can ensure harmony between organizational objectives and individual objectives.
- (2) **Creating a competitive advantage:** In the present business environment, maintaining a competitive position or gains either by cost leadership or differentiation is an important objective of any business. Having a highly committed and competent workforce is very important for getting a competitively advantageous position.
- (3) **Facilitation of change:** The human resource manager will be more concerned about furthering the organization not just maintaining it. He can devote more time to promote acceptance of change rather than maintaining the status quo.
- (4) **Managing workforce diversity:** In a modern organization, management of a diverse workforce is a great challenge. Workforce diversity can be observed in terms of male and female, young and old, educated and uneducated, unskilled and professional employee and so on. Motivation, maintaining morale and commitment are some of the key tasks that a HR manager can perform.
- (5) **Empowerment of human resources:** Empowerment means authorizing ever member of an organization to take up his/her own destiny realizing his/her full potential. Empowerment involves giving more power

to those who, at present, have little control over what they do and little ability to influence the decisions being made around them.

- (6) **Building core competency:** The human resource manager has an important role to play in developing the core competency of the firm. A core competence is a unique strength of an organization which may not be shared by others. Organization of business around core competence implies leveraging the limited resources of a firm.
- (7) **Development of work ethics and culture:** As changing work ethics requires increasing emphasis on individuals, jobs will have to be redesigned to provide challenge. A vibrant work culture will have to be developed in the organizations to create an atmosphere of trust among people and to encourage creative ideas by the people.

In these strategic roles, Disha contributes to the organizational success by aligning human resource practices with the overall objectives of the telecom company, ensuring resilience and competitiveness in the industry.

03.25

TAXMANN

4

STRATEGIC ANALYSIS & PLANNING

CHAPTER

STRATEGIC ANALYSIS – SWOT

Q1. What do you understand by Situation Analysis? Also state the need and suitability of Situation Analysis.

Ans.: Situation Analysis – Meaning: Situational analysis is the starting point for developing strategy. Before we can develop strategies for the future, however, we need to understand the present. Situational analysis is the process we use to gain understanding and insight into our present situation.

A situation analysis or environmental analysis is an essential component of strategy formulation. 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.

Need of situation analysis: While formulating a business plan, 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
- ◆ Barriers

The quality of the Situation Analysis will affect the success of whole plan.

Suitability of Situation Analysis: A small, well knitted and focused team from different functional areas of the organization 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.

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

Q2. SWOT analysis is a tool used by organizations for evolving strategic options for the future. Explain.

Ans.: The comparison of Strengths, Weaknesses, Opportunities & Threats is normally referred to as SWOT Analysis.

Originated by **Albert S Humphrey** in the 1960s, SWOT Analysis is as useful now as it was then. SWOT analysis is a tool used by organizations for evolving strategic options for the future. The term SWOT refers to the analysis of strengths, weaknesses, opportunities and threats. Strengths and weaknesses are identified in the internal environment, whereas opportunities and threats are located in the external environment.

Strength: Strength is an inherent capability of the organization which it can use to gain strategic advantage over its competitors.

Weakness: A weakness is an inherent limitation or constraint of the organization which creates strategic disadvantage to it.

Opportunity: An opportunity is a favourable condition in the organization's environment which enables it to strengthen its position.

Threat: A threat is an unfavourable condition in the organization's environment which causes a risk for, or damage to, the organization's position.

There are four components to this analysis. Strengths and weaknesses are often internal to your organization, while opportunities and threats generally relate to external factors. For this reason the SWOT Analysis is sometimes called Internal-External Analysis and the SWOT Matrix is sometimes called an IE Matrix.

All four components cover certain basic questions that need to be answered. These are as follows:

Strengths (A) Potential resource strengths & competitive capabilities	Weaknesses (B) Potential resource weaknesses & competitive deficiencies
Opportunities (C) Potential company's opportunities	Threats (D) Potential external threats to company's well-being

Importance of SWOT Analysis: It helps managers to craft a business model that will allow a company to gain a competitive advantage in its industry. Competitive advantage leads to increased profitability and this maximizes a company's chances of surviving in the fast-changing, competitive environment.

Key reasons for SWOT analysis are –

- ◆ It provides a logical framework.
- ◆ It presents a comparative account.
- ◆ It guides the strategist in strategy identification.

Q3. STU's association with India goes back to 1967, when it played a key role in constructing a very long highway in India spreading over multiple states. Since then, it is contributing in many ways to the country's growth story. Now it is looking at playing an active role in the key projects taken up by the central government. Suggest few Opportunities and Threats that the company should consider. [Nov. 2021 (5 Marks)]

Ans.: Faced with a constantly changing environment, each business unit needs to develop a marketing information system to track trends and developments, which can be categorized as an opportunity or a threat. The company has to review its strength and weakness in the background of environment's opportunities and threat, *i.e.*, an organization's SWOT analysis.

STU is looking at playing an active role in the key projects taken up by the central government. Following are the potential opportunities and threats to STU:

Potential Opportunities for STU:

- ◆ Alliances or joint ventures with central government that expand the STU's market coverage or boost its competitive capability.
- ◆ Possibilities of working on the future projects of central government.
- ◆ Serving additional customer groups or expanding into new geographic markets.
- ◆ Utilizing existing company skills or technological know-how to enter new projects.
- ◆ Openings to take market share away from rivals.
- ◆ Openings to exploit emerging new technologies.
- ◆ Integrating forward or backward.

Potential Threats for STU:

- ◆ Due to COVID-19 pandemic, companies may face the lockdown situation.
- ◆ Economic factors such as recession etc.
- ◆ Likely entry of potent new competitors.
- ◆ Technological changes/innovations in construction equipment.
- ◆ Costly new regulatory requirements.

- ◆ Growing bargaining power of suppliers.
- ◆ Vulnerability to industry driving forces.

Q4. What is the purpose of SWOT Analysis? Why is it necessary to do a SWOT analysis before selecting a particular strategy for a business organization? [June 2024 (5 Marks)]

Ans.:

The comparison of Strengths, Weaknesses, Opportunities & Threats is normally referred to as SWOT Analysis.

Originated by **Albert S Humphrey** in the 1960s, SWOT Analysis is as useful now as it was then. SWOT analysis is a tool used by organizations for evolving strategic options for the future. The term SWOT refers to the analysis of strengths, weaknesses, opportunities and threats. Strengths and weaknesses are identified in the internal environment, whereas opportunities and threats are located in the external environment.

Strength: Strength is an inherent capability of the organization which it can use to gain strategic advantage over its competitors.

Weakness: A weakness is an inherent limitation or constraint of the organization which creates strategic disadvantage to it.

Opportunity: An opportunity is a favourable condition in the organization's environment which enables it to strengthen its position.

Threat: A threat is an unfavourable condition in the organization's environment which causes a risk for, or damage to, the organization's position.

Every manager is entrusted with the responsibility of setting-up organization 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).

STRATEGIC ANALYSIS – TOWS

Q5. Briefly discuss 'TOWS Matrix Model' developed by the American international business professor Heinz Wethrich.

Or

"The TOWS Matrix is a tool for generating strategic options/choices." Do you agree with this statement? How it can help a strategist in decision making?

Ans.: The TOWS Matrix is derived from the SWOT Analysis model, which stands for the internal Strengths and Weaknesses of an organization and the external Opportunities and Threats that the business is confronted with.

The acronym TOWS is a variant of this and was developed by the American international business professor **Heinz Wethrich**.

The TOWS Matrix is aimed at developing strategic options from an external-internal analysis and is a practical tool, particularly in the fields of business administration and marketing.

Whereas SWOT Analysis starts with an internal analysis, the TOWS Matrix starts with an external environment analysis; the threats and opportunities are examined first.

The TOWS Matrix is tool for generating strategic options. Through TOWS matrix four distinct alternative kinds of strategic choices can be identified.

(1) SO – Maxi-Maxi [Aggressive Strategy] (*Strategies that use strengths to maximize opportunities*):

SO is a position that any firm would like to achieve. The strengths can be used to capitalize or build upon existing or emerging opportunities. Such firms can take lead from their strengths and utilize the resources to build up the competitive advantage.

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.

(2) ST – Maxi-Mini [Conservative Strategy] (*Strategies that use strengths to minimize threats*): ST is a position in which a firm strives to minimize existing or emerging threats through its strengths.

(3) WO – Mini-Maxi [Competitive Strategy]: (*Strategies that minimize weakness by taking advantage of opportunities*): The firm needs to overcome internal weaknesses and make attempts to exploit opportunities to maximum.

(4) WT – Mini-Mini [Defensive Strategy]: (*Strategies that minimize weakness and avoid threats*): WT is a position that any firm will try to avoid. A firm facing external threats and internal weaknesses may have to struggle for its survival. WT strategy is a strategy which is pursued to minimize or overcome weaknesses and as far as possible, cope with existing or emerging threats.

		Internal Elements	
		Organizational Strengths	Organizational Weaknesses
External Elements	Environmental opportunities (and risks)	SO Maxi-Maxi (Strategies that use strengths to maximize opportunities)	WO Mini-Maxi (Strategies that minimizes weakness by taking advantage of opportunities)
	Environmental threats	ST Maxi-Mini (Strategies that use strengths to minimize threats)	WT Mini-Mini (Strategies that minimizes weakness and avoid threats)

By using TOWS Matrix, a strategist can look intelligently at how he can best take advantage of the opportunities open to him, at the same time that he can minimize the impact of weaknesses and protect himself against threats. Used after detailed analysis of threats, opportunities, strength and weaknesses, it helps the strategist to consider how to use the external environment to his strategic advantage, and so he can identify some of the strategic options available to him.

From that standpoint, an organization gets a clear picture of its environment and the opportunity to think about strategy and what direction the company will go in. Next the company's strengths and weaknesses are considered; what it's good at internally and what it's not so good.

The external analysis is linked to the analysis and the resulting TOWS Matrix can help an organization to make decisions better, seize opportunities and protect itself better against threats.

Benefit & Importance: The TOWS Matrix helps businesses to identify their strategic options. An organization gets the opportunity to make the most of its strengths and get around its internal weaknesses and learn to deal with them properly. Externally, an organization learns to carefully look for market opportunities and recognize possibilities. And they learn how to control and overcome potential threats.

The TOWS Matrix can also help with brainstorming and developing great ideas to generate effective marketing strategies and tactics. Furthermore, the model goes beyond merely finding out the strengths and weaknesses within an organization and what opportunities and threats there are in its environment. It forces organizations to really think about how they can improve themselves, how they can guard against threats and become more aware of their expertise and potential shortcomings.

The incremental benefit of the TOWS matrix lies in systematically identifying relationships between these factors and selecting strategies on their basis. Thus TOWS matrix has a wider scope when compared to SWOT analysis. TOWS analysis is an action tool whereas SWOT analysis is a planning tool.

Q6. Apply TOWS Matrix Model for world famous Apple Inc.

Ans.: TOWS Matrix is an analytical tool that helps build over your strengths and make the best use of available opportunities while also minimizing the threats.

TOWS Matrix of Apple: Apple is the maker of I-phone, I-Pad and Mac book and is known for innovation and premium quality products. It has a strong brand image and is a market leader across several product categories. It means high profit margins on its products which are highly popular. The premium quality of its products is the reason that Apple enjoys high customer loyalty. However, the falling demand of PC's and Laptops has led to a decline in the markets share of Apple.

Strengths: www.biz742dipdy.com/26-07-2024

- Market leader in a range 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
- Narrow product range compared to the rivals
- Products and services incompatible with the other brands

Opportunities:

- Increasing demand for the mobile gadgets and technology
- Product diversification
- Make compatible products

Threats:

- Increased competition
- Rising costs of input and manufacturing
- Jobs' demise a major loss

APPLE TOWS MATRIX

Opportunities	Strengths SO - Use strengths to capitalize on available opportunities. - Use brand image to diversify and develop partnership with other brands.	Weaknesses 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	ST - Use strengths to avoid threats. - Control cost to beat competition. - Focus on cultural change.

PROJECT MANAGEMENT – PERT & CPM

Q7. Discuss in detail "Project Evaluation & Review Technique (PERT)" a statistical tool used in project management along with its advantages and disadvantages.

Ans.: The Project Evaluation & Review Technique (PERT) is a statistical tool used in project management, which was designed to analyze and represent the tasks involved in completing a given project. It was first developed by the United States Navy in the 1950s.

Project management can be understood as a systematic way of planning, scheduling, executing, monitoring, controlling the different aspects of the project, so as to attain the goal made at the time of project formulation. PERT and CPM are the two network based project management techniques, which exhibit the flow and sequence of the activities and events. Project Evaluation and Review Techniques (PERT) are appropriate for the projects where time needed to complete different activities are not known.

PERT was developed primarily to simplify the planning and scheduling of large and complex projects. In a PERT diagram, the main building block is the **event**, with connections to its known predecessor events and successor events.

Advantages of PERT:

- ◆ PERT chart explicitly defines and makes visible dependencies between the work breakdown structure elements.
- ◆ PERT facilitates identification of the critical path and makes this visible.

- ◆ PERT facilitates identification of early start, late start, and slack for each activity.
- ◆ PERT provides for potentially reduced project duration due to better understanding of dependencies leading to improved overlapping of activities and tasks where feasible.
- ◆ The large amount of project data can be organized and presented in diagram for use in decision making.
- ◆ PERT can provide a probability of completing before a given time.
- ◆ Provides management a tool for forecasting the impact of schedule changes.
- ◆ A considerable amount of data may be presented in a precise manner.
- ◆ The task relationships are presented graphically for easier evaluation.
- ◆ The network will highlight areas that require attention of higher priority to the key jobs without ignoring the lower priority tasks.

Disadvantages of PERT:

- ◆ There can be potentially hundreds or thousands of activities and individual dependency relationships.
- ◆ PERT is not easily scalable for smaller projects.
- ◆ The network charts tend to be large and unwieldy, requiring several pages to print and requiring specially-sized paper.
- ◆ Uncertainty about the estimate of time and resources due to being based on assumptions.

Q8. Distinguish between: PERT & CPM

Ans.:

Points	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?	PERT is technique of planning and control of time.	CPM is a method to control cost and time.
Orientation	PERT is event oriented.	CPM is activity oriented.
Use	PERT is used in research and development project, basically for non-repetitive type projects.	CPM is widely used in construction projects.
Uncertainty	In PERT network uncertainty is considered.	In CPM network no allowance is made for uncertainties in the duration of time.
Duration of activities	In PERT duration of activities are not so accurate and definite.	In CPM duration of activity is estimated with a fair degree of accuracy.

Points	PERT	CPM
Activities	In PERT activities are not differentiated as Critical and Non-critical activities	In CPM activities are differentiated as Critical and Non-critical activities
Model	Probabilistic Model	Deterministic Model
Focus	Pert is basically a tool for planning.	In CPM both time and cost can be controlled during planning.
Estimates	Three time estimates—(i) Optimistic time (\hat{ii}) Most likely time (\hat{iii}) Pessimistic time	Single time estimate
Crashing concept	Crashing concept is not applicable for PERT.	Crashing concept is applicable for CPM.

PORTFOLIO ANALYSIS

Q9. Write a short note on: Portfolio Analysis

Ans.: Strategic portfolio analysis involves identification and evaluation of all products or service groups offered by company on the market (so called product mix) and preparing specific strategies for every group according to its relative market share and actual or projected sales growth rate. It can be also used to make strategic decision about strategic business units.

Portfolio analysis in strategic management allows answering key questions how to shape the present and future business portfolio (of product or services) in order to reduce the risk of functioning in a changing environment and increase the effects of the implemented strategy.

Thus, Portfolio analysis can be defined as a set of techniques that help strategists in taking strategic decisions with regard to individual products or businesses in a firm's portfolio. It is primarily used for competitive analysis and corporate strategic planning in multi-product and multi-business firms.

BCG MATRIX

Q10. Discuss briefly the BCG Matrix developed by the Boston Consulting Group (BCG) which is used for the evaluation of organization's product portfolio in marketing and sales planning.

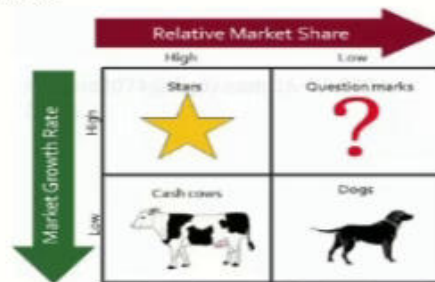
Ans.: The BCG Matrix was developed by the **Boston Consulting Group (BCG)** and is used for the evaluation of the organization's product portfolio in marketing and sales planning. BCG analysis is mainly used for Multi-Category/ Multi-Product companies. All categories and products together are said to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

- ◆ Market growth
- ◆ Market share

The BCG growth-share matrix is the simplest way to portray a corporation's portfolio of investments. Growth share matrix also known for its cow and dog metaphors is popularly used for resource allocation in a diversified company. Using the BCG approach, a company classifies its different businesses on a two-dimensional growth share matrix. In the matrix:

- ◆ The vertical axis represents market growth rate and provides a measure of market attractiveness.
- ◆ The horizontal axis represents relative market share and serves as a measure of company strength in the market.

Using the matrix, organizations can identify four different types of products or SBU as follows:



Stars: Stars are products or SBUs (Strategic Business Units) that are **growing rapidly**. They also need heavy investment to maintain their position and finance their rapid growth potential. They represent best opportunities for expansion.

Cash Cows: Cash Cows are **low-growth, high market share** businesses or products. They generate cash and have low costs. They are established, successful, and need less investment to maintain their market share. In long run when the growth rate slows down, stars become cash cows.

Question Marks: Question Marks, sometimes called problem children or wild-cats, are **low market share business in high-growth markets**. They require a lot of cash to hold their share. They need heavy investments with low potential to generate cash. Question marks if left unattended are capable of becoming cash traps. Since growth rate is high, increasing it should be relatively easier. It is for business organizations to turn them stars and then to cash cows when the growth rate reduces.

Dogs: Dogs are **low-growth, low-share** businesses and products. They may generate enough cash to maintain themselves, but do not have much future. Sometimes they may need cash to survive. Dogs should be minimized by means of divestment or liquidation.

Strategies based on the BCG Matrix: After a firm has classified its products or SBUs, it must determine what role each will play in the future. The four strategies that can be pursued are:

1. **Bull:** Here the objective is to increase market share, even by forgoing short term earnings in favour of building a strong future with large market share.
2. **Hold:** Here the objective is to preserve market share.
3. **Harvest:** Here the objective is to increase short-term cash flow regardless of long-term effect.
4. **Divest:** Here the objective is to sell or liquidate the business because resources can be better used elsewhere.

The growth-share matrix has done much to help strategic planning; however, there are some problems and limitations with the technique.

BCG matrix can be difficult, time-consuming, and costly to implement. Management may find it difficult to define SBUs and measure market share and growth. It also focuses on classifying current businesses but provide little advice for future planning. They can lead the company to placing too much emphasis on market-share growth or growth through entry into attractive new markets. This can cause unwise expansion into hot, new, risky ventures or divesting established units too quickly.

The BCG matrix is useful for classification of products, SBUs, or businesses, and for selecting appropriate strategies for each type as follows:

- (a) Build with the aim for long-term growth and strong future.
- (b) Hold or preserve the existing market share.
- (c) Harvest or maximize short-term cash flows.
- (d) Divest, sell or liquidate and ensure better utilization of resources elsewhere.

Thus, BCG matrix is a powerful tool for strategic planning analysis and choice.

Q11. What are the steps involved in BCG Matrix?

Ans.: The BCG matrix can be useful to companies if applied using the following general steps.

Step 1 – Choose the Unit: Strategic Business Units, individual brands, product lines or the firm as a whole are all areas that can be analyzed using the BCG matrix. The chosen unit drives the entire analysis and key definitions. The market, industry, competitors and position will all be based on the chosen unit.

Step 2 – Define the Market: Following the choice of the unit or area to be analyzed, the most important stage for the rest of the matrix is the definition of the market. An incorrectly defined market will lead to an incorrect classification of the unit. A Mercedes-Benz analyzed in a passenger vehicle market will be a dog with a small market share. However, analyzed within a luxury car market, it will be a cash cow.

Step 3 – Calculate Relative Market Share: At this stage, the relative market share for the chosen unit needs to be calculated. This can be done in terms of revenues or market share. The formula used here is a division of the selected brand's market share or revenues by the market share or revenues of the biggest competitor in the industry. The result is plotted on the x-axis.

Step 4 – Calculate Market Growth Rate: Online industry reports can be used to find the rate of growth for the industry. If this is not possible, then it can be estimated by looking at the average revenue growth of the leading firms in the industry. This measurement is a percentage and is plotted on the y-axis.

Step 5 – Draw Circles on the Matrix: Once all the measures are calculated, they can be put in the matrix. This can be done by drawing a circle for each brand within a unit, or all the brands in a company. The size of each circle should correspond to business revenue generated by the brand.

Q12. What are the limitations of the BCG Matrix?

Ans.: Notwithstanding the fact that the BCG matrix is applied by many businesses, it has also been criticized on the following grounds:

- ◆ BCG matrix classifies businesses as low and high, but generally businesses can be medium also. Thus, the true nature of business may not be reflected.
- ◆ Market is not clearly defined in this model.
- ◆ High market share does not always leads to high profits. There are high costs also involved with high market share.
- ◆ 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.
- ◆ Market growth is treated as a given, whereas a business could give the market an incentive.
- ◆ 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.

ANSOFF GROWTH MATRIX

Q13. What is the Ansoff Growth Matrix proposed by Igor Ansoff?

Ans.: The Ansoff's product market growth matrix (proposed by Igor Ansoff) is a useful tool that helps businesses decide their product and market growth

strategy. With the use of this matrix a business can get a fair idea about how its growth depends upon its markets in new or existing products in both new and existing markets. Companies should always be looking to the future. One useful device for identifying growth opportunities for the future is the product/market expansion grid. The product/market growth matrix is a portfolio-planning tool for identifying growth opportunities for the company.

	Existing Products	New Products
Existing Markets	Market Penetration	Product Development
New Markets	Market Development	Diversification

Option 1 [Market Penetration]: Market penetration refers to a growth strategy where the business focuses on selling existing products into existing markets. It is achieved by making more sales to present customers without changing products in any major way. Penetration might require greater spending on advertising or personal selling.

Overcoming competition in a mature market requires an aggressive promotional campaign, supported by a pricing strategy designed to make the market unattractive for competitors. Penetration is also done by effort on increasing usage by existing customers.

Option 2 [Market Development]: Market development refers to a growth strategy where the business seeks to sell its existing products into new markets. It is a strategy for company growth by identifying and developing new markets for current company products. This strategy may be achieved through new geographical markets, new product dimensions or packaging, new distribution channels or different pricing policies to attract different customers or create new market segments.

Option 3 [Product Development]: Product development refers to a growth strategy where business aims to introduce new products into existing markets. It is a strategy for company growth by offering modified or new products to current markets. This strategy may require the development of new competencies and requires the business to develop modified products which can appeal to existing markets.

Option 4 [Diversification]: Diversification refers to a growth strategy where a business markets new products in new markets. It is a strategy by starting up or acquiring businesses outside the company's current products and markets. This strategy is risky because it does not rely on either the company's successful product or its position in established markets. Typically the business is moving into markets in which it has little or no experience.

As market conditions change overtime, a company may shift product-market growth strategies. For example, when its present market is fully saturated a company may have no choice other than to pursue new market.

ADL MATRIX

Q14. Explain the "ADL Matrix". Matrix, a Portfolio Management technique that is based on the Product Life Cycle (PLC) which is developed in 1980's by Arthur D. Little, Inc. (ADL).

Ans.: The ADL Matrix or Arthur D Little Strategic Condition Matrix is a Portfolio Management technique that is based on the Product Life Cycle (PLC). It is developed in the 1980's by Arthur D. Little, Inc. (ADL), one of the best-known consulting firms, intended to help a company manage its collection of product businesses as a portfolio.

Like other portfolio planning matrices, the ADL matrix represents a company's various businesses in a 2-dimensional matrix. It is a structured methodology for consideration of strategies which are dependent on the life cycle of the industry. The ADL approach uses the dimensions of environment assessment and business – strength assessment i.e. Competitive Position and Industry Maturity. The environment assessment is an identification of the industry's life cycle and the business strength assessment is a categorization of the company's SBU's into one of five competitive positions, these five competitive positions by four life cycle stages. The combination between the dimensions yields 5 (competitive positions) by 4 (life cycle stages) matrix. The positioning in the matrix identifies a general strategy.

The ADL Matrix is often associated with strategic planning at business unit level. However it works equally well when applied to product lines, or at the level of an individual product.

		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 attempt to improve share.	Attempt to improve position. Push for share.	Custodial or maintenance. Find niche and attempt to improve 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

Competitive Position: Company's competitive position is determined by strategic actions and competitor's strategies. Quality and strength of competitive position are indicators of company's strength. The ADL matrix categorizes every segment of company according to its position which can be dominant, strong, favorable, tenable or weak.

- Dominant:** This is a comparatively rare and typically short-lived. In many cases is either monopoly or a strong and protected technology leadership.
- Strong:** Market share is strong and stable, regardless of competitors. The firm has a considerable degree of freedom over its choice of strategies and is often able to act without its market position being unduly threatened by its competitors.
- Favorable:** Company has 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:** Position in overall market is small or niche, either geographical or defined by product. Competitors are getting stronger.
- Weak:** Continuous loss of market share. Business line is too small to maintain profitability.

Industry Maturity: Industry maturity could almost be renamed into "Industry life cycle". Of course not only industries should be considered here but also segments. There are four categories of industry maturity: embryonic, growth, mature and aging.

- Embryonic:** The introduction stage, characterized by rapid market growth, very little competition, new technology, high investment and high prices.
- Growth:** The market continues to strengthen, sales increase, few (if any) competitors exist, and company reaps rewards for bringing a new product to market.
- Mature:** The market is stable, there is a well-established customer base, market share is stable, there are lots of competitors, and energy is put toward differentiating from competitors.
- Aging:** Demand decreases, companies start abandoning the market, the fight for market share among remaining competitors gets too expensive, and companies begin leaving or consolidating until the market is demise.

Positioning into one of the four categories is a very sophisticated procedure and depends on many factors.

Four steps in creating ADL Matrix:

- Determining the SBU's of the company (strategic segmentation done by clearly defined procedures)
- Identifying phases of industrial maturity for each SBU (this should be done for each business in all SBU's)
- Determine SBU's competitive position (company's competitiveness in specific, narrow defined industry)
- Plotting sizes and positions of SBU's on ADL Matrix.

GE MCKINSEY MATRIX

Q15. Explain a nine cell portfolio matrix tool which is used for screening large portfolio of Strategic Business Units (SBU) of the General Electric Company.

Ans.: In consulting engagement with General Electric Company in the 1970's McKinsey & Company developed a nine cell portfolio matrix as a tool for screening GE's large portfolio of Strategic Business Units (SBU). This business screen became known as GE/McKinsey Matrix which is shown below:

		Business Unit Strength		
		High	Medium	Low
Industry Attractiveness	High	Invest/grow	Invest/grow	Hold/selective
	Medium	Invest/grow	Hold/selective	Divest/harvest
	Low	Hold/selective	Divest/harvest	Divest/harvest

This model is also known as **Business Planning Matrix**, **GE Nine-Cell Matrix** and **GE Model**. The strategic planning approach in this model has been inspired from traffic control lights. The lights that are used at crossings to manage traffic are: green for go, amber or yellow for caution, and red for stop.

This model uses two factors while taking strategic decisions:

- Business Strength and
- Market Attractiveness.

The vertical axis indicates market attractiveness and the horizontal axis shows the business strength in the industry.

Industry Attractiveness: The industry attractiveness is measured by a number of factors like –

- ◆ Size of the market
- ◆ Market growth rate
- ◆ Industry profitability
- ◆ Competitive intensity
- ◆ Availability of Technology
- ◆ Pricing trends
- ◆ Overall risk of returns in the industry
- ◆ Opportunity for differentiation of products and services
- ◆ Demand variability
- ◆ Segmentation
- ◆ Distribution structure (e.g. direct marketing, retail, wholesale) etc.

Business Strength: Business strength is measured by considering the typical drivers like –

- ◆ Market share
- ◆ Market share growth rate
- ◆ Profit margin
- ◆ Distribution efficiency
- ◆ Brand image
- ◆ Ability to compete on price and quality
- ◆ Customer loyalty
- ◆ Production capacity
- ◆ Technological capability
- ◆ Relative cost position
- ◆ Management calibre etc.

	If a product falls in this colour section, the business is at advantageous position. To reap the benefits, the strategic decision can be to expand, to invest and grow.
	If a product falls in this colour section, it needs caution and managerial discretion is called for making the strategic choices.
	If a product falls in this colour section, it will eventually lead to losses that would make things difficult for organizations. In such cases, the appropriate strategy should be retrenchment, divestment or liquidation.

This model is similar to the BCG growth-share matrix. However, there are differences. Firstly, market attractiveness replaces market growth as the dimension of industry attractiveness, and includes a broader range of factors other than just the market growth rate. Secondly, competitive strength replaces market share as the dimension by which the competitive position of each SBU is assessed.

STRATEGIC BUSINESS UNIT

Q16. A Chennai based Fast Moving Consumer Goods (FMCG) major CDE Ltd. recently announced restructuring its business. The company indicated that the business would be split into mainly four different streams-FMCG, E-commerce, Retail, and Research & Development. The company management has decided that these four units will operate as separate businesses. The top corporate officer shall delegate responsibility for day-to-day operations and business unit strategy to the concerned managers. Identify the organization structure that CDE Ltd. has planned to implement. Discuss any four attributes and the benefits the firm may derive by using this organization structure. [Nov. 2021 (5 Marks)]

Ans.: CDE Ltd. has planned to implement Strategic Business Unit (SBU) structure.

Very large organizations, particularly those running into several products, or operating at distant geographical locations that are extremely diverse in terms of environmental factors, can be better managed by creating strategic business units. SBU structure becomes imperative in an organization with increase in number, size and diversity.

Attributes and benefits of Strategic Business Unit (SBU) structure: Attributes of Strategic Business Unit (SBU) and the benefits a firm may derive by using the SBU Structure are as follows:

- ◆ A scientific method of grouping the businesses of a Multi – Business Corporation which helps the firm in strategic planning.
- ◆ An improvement over the territorial grouping of businesses and strategic planning based on territorial units.
- ◆ Strategic planning for SBU is distinct from rest of businesses. Products/businesses within SBU receive same strategic planning treatment and priorities.

- ◆ Each SBU will have its own distinct set of competitors and its own distinct strategy.
- ◆ The CEO of SBU will be responsible for strategic planning and its profit performance.
- ◆ Products/businesses that are related from the stand point of function are assembled together as a distinct SBU.
- ◆ Unrelated products/businesses in any group are separated into separate SBU.
- ◆ Grouping the businesses on SBU lines helps in strategic planning by removing the vagueness and confusion.
- ◆ Each SBU is a separate business and will be distinct from one another on the basis of mission, objectives etc.

Q17. Write short note on: Strategic Business Unit (SBU)

[Nov. 2022 (5 Marks)]

Ans.: Strategic Business Unit (SBU) is a part of a large business organization that is treated separately for strategic management purposes. It is separate part of large business serving product markets with readily identifiable competitors. It is created by adding another level of management in a divisional structure after the divisions have been grouped under a divisional top management authority based on the common strategic interests.

Very large organizations, particularly those running into several products, or operating at distant geographical locations that are extremely diverse in terms of environmental factors, can be better managed by creating strategic business units. SBU structure becomes imperative in an organization with increase in number, size and diversity.

Characteristics of SBU: Most important characteristics of Strategic Business Units are:

1. It is a single business or a collection of related businesses which offer scope for independent planning and which might feasibly stand alone from the rest of the organization.
2. It has its own set of competitors.
3. It has a manager who has responsibility for strategic planning and profit performance, and who has control of profit-influencing factors.

Benefits of SBU:

- (a) Establishing co-ordination between divisions having common strategic interest.
- (b) Facilitate strategic management and control.
- (c) Determine accountability at the level of distinct business units.
- (d) Allow strategic planning to be done at the most relevant level within the total enterprise.

- (e) Make the task of strategic review by top executives more objective and more effective.
- (f) Help to allocate resources to areas with better opportunities.

Thus, an SBU structure with its set of advantages would be most suitable for the company with the given diverse businesses having separate identifiable competitors, but a common organizational goal.

GLUECK & JAUCH – GENERIC STRATEGIC ALTERNATIVE

Q18. Point out strategic alternatives that can be adopted by an organization to attain its objectives as indicated by "Glueck & Jauch – Generic Strategic Alternative".

Ans.: According to Glueck and Jauch there are four generic ways in which strategic alternatives can be considered. These are stability, expansion, retrenchment and combinations.

- (1) **Stability Strategies:** One of the important goals of a business enterprise is stability to safeguard its existing interests and strengths, to pursue well established and tested objectives, to continue in the chosen business path, to maintain operational efficiency on a sustained basis, to consolidate the commanding position already reached, and to optimize returns on the resources committed in the business.
- (2) **Expansion Strategy:** Expansion strategy is implemented by redefining the business by adding the scope of business substantially increasing the efforts of the current business. Expansion is a promising and popular strategy that tends to be equated with dynamism, vigor, promise and success. It is often characterized by significant reformulation of goals and directions, major initiatives and moves involving investments, exploration and onslaught into new products, new technology and new markets, innovative decisions and action programmes and so on. Expansion includes diversifying, acquiring and merging businesses.
- (3) **Retrenchment Strategy:** A business organization can redefine its business by divesting a major product line or market. Retrenchment or retreat becomes necessary or expedient for coping with particularly hostile and adverse situations in the environment and when any other strategy is likely to be suicidal. In business parlance also, retreat is not always a bad proposition to save the enterprise's vital interests, to minimize the adverse environmental effects, or even to regroup and recoup the resources before a fresh assault and ascent on the growth ladder is launched.
- (4) **Combination Strategies:** Stability, expansion or retrenchment strategies are not mutually exclusive. It is possible to adopt a mix to suit particular situations. An enterprise may seek stability in some areas of activity, expansion in some and retrenchment in the others. Retrenchment of ailing products followed by stability and capped by expansion in some situations

may be thought of. For some organizations, a strategy by diversification and/or acquisition may call for a retrenchment in some obsolete product lines, production facilities and plant locations.

PORTER'S GENERIC STRATEGIES

Q19. Discuss Michael Porter's three generic strategies – "Cost Leadership" (no frills), "Differentiation" (creating uniquely desirable products and services) and "Focus" (offering a specialized service in a niche market).

Ans.: The basic purpose of following a generic strategy is to gain competitive advantage so as to ensure long-time survival and growth. According to Porter, strategies allow organizations to gain competitive advantage from three different bases i.e. cost leadership, differentiation and focus. These bases are discussed below:

- (1) **Cost Leadership:** Cost leadership emphasizes producing standardized products at a very low per unit cost for consumers who are price-sensitive. It frequently results from productivity increases and aggressive pursuit of cost reduction throughout the development, production, marketing, and distribution processes. It allows a firm to earn higher profits than its competitors.

Example: Car manufacturers 'Maruti' and 'Tata Motors' work on reducing their costs to sell their cars in popular segment at attractive prices.

- (2) **Differentiation:** Differentiation is a strategy aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price-insensitive. It concerns with distinguishing a product/service from that of its competitors through unique design features, technological leadership, unique uses of products and attributes like quality, environmental impact and customer service.

Example: Samsung brings out mobile phone called Note 9 with distinct features.

- (3) **Focus:** Focus means producing products and services that fulfil the specific needs of small groups of consumers. It involves selecting or focusing a market or customer segment in which to operate.

Example: Nestle KitKat targeting on teenagers and young adults. Johnson & Johnson having host of products such as cream, shampoo, brushes for babies.

Q20. Michael E. Porter has suggested three generic strategies.

Briefly explain:

- (i) Basic objective to follow a generic strategy.
 (ii) Identify the type of strategy used in the following examples:

- (1) Bell Computer has decided to rely exclusively on direct marketing.

(ii) "Our basic strategy was to charge a price so low that micro-computer makers couldn't do the software internally for that cheaply."

(iii) 'DNTV', a TV Channel has identified a profitable audience niche in the electronic media. It has further exploited that niche through the addition of new channels like 'DNTV Profit and 'Image'. [June 2024 (2 + 3 = 5 Marks)]

Ans.:

Basic objective to follow a generic Strategy: The basic purpose of following a generic strategy is to gain competitive advantage so as to ensure long-time survival and growth. According to Porter, strategies allow organizations to gain competitive advantage from three different bases i.e. cost leadership strategy, differentiation strategy and focus strategy. These bases are discussed below:

- (1) **Cost Leadership:** Cost leadership emphasizes producing standardized products at a very low per unit cost for consumers who are price-sensitive. It frequently results from productivity increases and aggressive pursuit of cost reduction throughout the development, production, marketing, and distribution processes. It allows a firm to earn higher profits than its competitors.
- (2) **Differentiation:** Differentiation is a strategy aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price-insensitive. It concerns with distinguishing a product/service from that of its competitors through unique design features, technological leadership, unique uses of products and attributes like quality, environmental impact and customer service.
- (3) **Focus:** Focus means producing products and services that fulfil the specific needs of small groups of consumers. It involves selecting or focusing a market or customer segment in which to operate.

Identification of types of strategy involved:

- (i) Bell Computer has decided to rely exclusively on direct marketing – **Differentiation**.
- (ii) "Our basic strategy was to charge a price so low that microcomputer makers couldn't do the software internally for that cheaply" – **Cost Leadership**
- (iii) 'DNTV', a TV Channel has identified a profitable audience niche in the electronic media. It has further exploited that niche through the addition of new channels like 'DNTV Profit and 'Image' – **Focus Strategy**.

5

CHAPTER

COMPETITIVE POSITIONING

PORTE'S – COST LEADERSHIP, DIFFERENTIATION, COST FOCUS & DIFFERENTIATION FOCUS STRATEGIES

Q1. Elaborate Cost Leadership Strategy which is one of the three generic strategies as per Michael Porter.

Ans.: Under a cost leadership strategy, the company tries to reduce its cost of production. This is done by producing goods on a very huge scale. By doing so, the company will get the benefits of economies of large scale. Higher the scale of production, lower will be the cost of production. This is because per unit cost of raw materials, labour, advertising, sales promotion, R & D, etc. will decrease.

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:

1. 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.
2. 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.
3. 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. Walmart is known for squeezing its suppliers to price its products reasonably low.

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.

Q2. Discuss pros and cons of the Cost Leadership Strategy.

Ans.: 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 of 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.

Q3. 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. Explain.

Ans.: 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.

Pros of using Differentiation Strategy

- 1. Lower Price Competition:** Companies frequently engage in pricing wars with rivals. But organization can compete with its rivals by differentiating the product or service. Even if competitor's costs are cheaper, they will struggle to compete if the quality of our product is unsurpassed.
- 2. Unmatched Products and Services:** We 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 utilizing 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.

Q4. What is Focus Strategy? Also discuss types of Focus Strategy.

Ans.: 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:

- (1) **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.

- (2) **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 personalized 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.

Q5. In spite of high commodity inflation, shortage of components and the threat of third wave of COVID-19 pandemic in India, manufacturers of packaged goods, home appliances and consumer electronics are expecting the business to grow by 12 to 25 percent in the coming months. After one-and-a-half years of disruption, manufacturers are now confident about managing their inventories better, keeping their supply channels well-stocked and preparing themselves to minimize the impact of any COVID related restrictions even as they gear up for the festive season, which usually accounts for 25 to 35 per cent of their yearly sales.

The home appliances sector could be an example. After a dismal April-June quarter in the year 2021; producers of air conditioners, refrigerators and washing machines are expecting their business to grow by 15-20 percent in the months to come. All the companies operating in the sector have geared up to grab the opportunities available in the market.

A leading company in the home appliances domain, XXP India, is planning to launch various innovative product designs and offer loyalty programmes to lure consumers.

With reference to Michael Porter's generic strategies, identify which strategy XXP India has planned for? Explain how this strategy will be advantageous to the company to remain profitable?

[Nov. 2021 (5 Marks)]

Ans.: According to Michael Porter, strategies allow organizations to gain competitive advantage from three different bases: Cost Leadership, Differentiation & Focus. Porter called these base generic strategies.

XXP India Ltd. has planned for Differentiation Strategy. The company is planning to launch various innovative product designs and offer loyalty programmes to lure customers.

Differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product that features the desired attributes. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty, because consumers may become strongly attached to the differentiated features.

Advantages of Differentiation Strategy: A differentiation strategy may help an organization to remain profitable even with rivalry, new entrants, suppliers' power, substitute products, and buyers' power.

- Rivalry:** Brand loyalty acts as a safeguard against competitors. It means that customers will be less sensitive to price increases, as long as the firm can satisfy the needs of its customers.
- Buyers:** They do not negotiate for price as they get special features, and they have fewer options in the market.
- Suppliers:** Because differentiators charge a premium price, they can afford to absorb higher costs of supplies as the customers are willing to pay extra too.
- Entrants:** Innovative features are an expensive offer. So, new entrants generally avoid these features because it is tough for them to provide the same product with special features at a comparable price.
- Substitutes:** Substitute products can't replace differentiated products which have high brand value and enjoy customer loyalty.

Q6. Quick N Sturdy Inc., a multinational company, is undergoing feasibility study to introduce new luxury and sports car for specific group of customers. The product is meant for customers with distinctive preferences and special requirements. The product is not a standard one and as such the target market is also narrow. Company knows that demand for the product is large enough to be profitable for the company, but small enough to be ignored by other major industry players. The company wants to position itself in the niche market with the prime consideration to offer unique features in the product for the target market.

In the given situation, identify the generic strategy as suggested by Michael Porter. Also state the advantages and disadvantages of such strategy. [Nov. 2022 (1 + 2 + 2 = 5 Marks)]

Ans.: Quick N Sturdy Inc. has adopted Focused Differentiation Strategy which is one of the Michael Porter's Generic strategies. A focused differentiation strategy requires offering unique features that fulfil the demands of a narrow market. Some firms using a focused differentiation strategy concentrate their efforts on a particular sales channel, such as selling over the internet only. Others target particular demographic groups. *Firms that compete based on uniqueness and target a narrow market are following a focused differentiation strategy.*

Advantages of Focused Strategy:

- Premium prices can be charged by the organizations for their focused product/services.
- Due to the tremendous expertise in the goods and services that the organizations following focus strategy offer, rivals and new entrants may find it difficult to compete.

Disadvantages of Focused Strategy:

- The firms lacking in distinctive competencies may not be able to pursue focus strategy.
- Due to the limited demand of product/services, costs are high, which can cause problems.
- In the long run, the niche could disappear or be taken over by larger competitors by acquiring the same distinctive competencies.

STRATEGY IMPLEMENTATION

Q7. Distinction between: Strategy Formulation & Strategy Implementation

Ans.:

Points	Strategy Formulation	Strategy Implementation
Meaning	Strategy formulation means crafting a combination of strategies and picking out the best one to achieve the organizational goals and objectives and thereby reaching the vision of the organization.	Strategy implementation refers to the execution of the opted strategy i.e. it converts the chosen strategy into action, for the realization of organizational goals and objectives.
Focus	It focuses on effectiveness.	It focuses on efficiency.
Process	It is primarily an intellectual process.	It is primarily an operational process.
Skills required	It requires conceptual intuitive and analytical skills.	It requires motivation and leadership skills.
What it requires	It requires co-ordination among the executives at the top level.	It requires co-ordination among the executives at the middle and lower levels.

Q8. An effective implementation of strategy in an organization needs multiple supporting factors. Comment.

Ans.: 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:

- Action Planning:** For successful strategy implementation organizations must develop a detailed action plan i.e. chronological lists of action steps (tactics) which add the necessary detail to strategies and assign responsibility 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.

- (2) **Organizational Structure:** To implement strategy successfully strategists should also give due attention towards organizational structure and see whether the current structure is appropriate for their intended strategy as different structures suit the implementation of different strategies.
- (3) **Human Resource Factors:** Human Resource factors plays important role in successful implementation of strategies in an organization. The consideration of human resources requires the management to think about the organization's communication needs.
- (4) **Annual Business Plan:** For successful strategy implementation organizations must pay due attention on their annual business plan. Implementation of strategy without annual business plan may result in failure of strategy.
- (5) **Monitoring and Control:** Monitoring and controlling the plan covers a list of options. 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:

- ◆ It helps to assure the organization efforts conform to the plan.
- ◆ It enables the organization to ensure that the results achieved correspond to objectives.
- ◆ Further monitoring allows for corrective action.
- ◆ Since monitoring is part of control process, it encourages improved performance.
- ◆ Monitoring provides the essential link between the written plan and the day-to-day operation of the business.

Q9. State the important issues that an organization is confronted in process of strategy implementation.

Ans.: An organization is confronted with a number of issues in the process of strategy implementation. Some of the important issues are discussed as follows:

- (1) **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.
- (2) **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.

- (3) **Organizational Structure & 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.
- (4) **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 physical and human resources required to accomplish strategic tasks for the achievement of organizational objectives.
- (5) **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.
- (6) **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.
- (7) **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.
- (8) **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.
- (9) **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.

Q10. "Strategy formulation and strategy implementation are intertwined and linked with each other." Elucidate this statement with suitable arguments. [May 2022 (5 Marks)]

Ans.: Strategy formulation and strategy implementation are intertwined and linked with each other. Two types of linkages exist between these two phases of strategic management.

The forward linkages deal with the impact of strategy formulation on strategy implementation while the backward linkages are concerned with the impact in the opposite direction.

Forward Linkages: The different elements in strategy formulation starting with objective setting through environmental and organizational appraisal, strategic alternatives and choice to the strategic plan determine the course that an organization adopts for itself. With the formulation of new strategies, or reformulation of existing strategies, many changes have to be affected within the organization. For instance, the organizational structure has to undergo a change in the light of the requirements of the modified or new strategy. The style of leadership has to be adapted to the needs of the modified or new strategies. In this way, the formulation of strategies has forward linkages with their implementation.

Backward Linkages: Just as implementation is determined by the formulation of strategies, the formulation process is also affected by factors related with implementation. While dealing with strategic choice, remember that past strategic actions also determine the choice of strategy. Organizations tend to adopt those strategies which can be implemented with the help of the present structure of resources combined with some additional efforts. Such incremental changes, over a period of time, take the organization from where it is to where it wishes to be.

It is to be noted that while strategy formulation is primarily an entrepreneurial activity, based on strategic decision-making, the implementation of strategy is mainly an administrative task based on strategic as well as operational decision-making.

Q11. You are a consultant advising a small manufacturing company embarking on a digital transformation journey. The company's leadership is concerned about managing the change effectively. Using the best practices for managing change in small and medium-sized businesses, outline a strategy to help the company navigate this transformation successfully.

[June 2024 (5 Marks)]

Ans.:

A small company which is embarking on a digital transformation journey may adopt best practices for managing changes which are discussed below:

Best practices for Managing 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:

- 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.
- 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 realize 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.

- 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.
- 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.
- Training and Psychological Counselling:** Management can change the basic values of the people by training and psychological counselling. 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.
- 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

Q12. What is the concept of Strategic Leadership? Also briefly discuss the functions and importance of a Strategic Leader.

Or

“Strategic Leadership is the ability to influence others to voluntarily make decisions that enhance the prospects for the organization's long-term success while maintaining long-term financial stability” – In support of this statement discuss the functions and importance of a strategic leader.

Ans.: Strategic Leadership: 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.

Purposes of Strategic Leadership: 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 organization'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 & Importance of 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.

Q13. What do you understand by Strategic Leadership? Also discuss various forms of Strategic Leadership.

Ans.: 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 prioritizes 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 organizational growth is highly dependent on leadership.

Types of Strategic Leadership: There are following three well defined types of strategic leadership:

- 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.
- Transformational Leadership:** Transformational leaders integrate leadership and strategy, and they use their vision to direct the employees' activities and behaviours. They affect both the organization 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 recognize roles and set goals. Strategic leadership of this kind encourages action and is adaptable. Transformational leaders can motivate people to change to improve their circumstances.
- 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.

Q14. You have been appointed as a Chief Executive Officer (CEO) in a company which is facing many difficulties in proper execution of its strategy. Explain the leadership roles which you should play in pushing for good strategy execution.

Ans.: A Chief Executive Officer (CEO) has many different leadership roles to play: visionary, chief entrepreneur and strategist, chief administrator, culture builder, resource acquirer and allocator, capabilities builder, process integrator, crisis solver, spokesperson, negotiator, motivator, arbitrator, policy maker, policy enforcer, and head cheerleader. Managers have five leadership roles to play in pushing for good strategy execution:

- Staying on top of what is happening, closely monitoring progress, working through issues and obstacles.
- Promoting a culture that mobilizes and energizes organizational members to execute strategy and perform at a high level.

- Keeping the organization responsive to changing conditions, alert for new opportunities and remain ahead of rivals in developing competitively valuable competencies and capabilities.
- Ethical leadership and insisting that the organization conduct its affairs like a model corporate citizen.
- Pushing corrective actions to improve strategy execution and overall strategic performance.

Q15. Ramesh and Suresh own software development firms ACS Ltd. and BDS Ltd. Ramesh and Suresh pitch their business in international markets and win international contracts. Ramesh has fifty software engineers in his team. Suresh, on the other hand, leads a team of forty software engineers. Every project has a specific and fixed timeline. Individual projects are assigned to project heads by Ramesh and Suresh. Ramesh adheres to strict rules and procedures. He met with the project heads to get an update but exchanged ideas occasionally. He set a weekly target of forty hours to complete the assigned goal or task. The group that met the deadline and completed the task received 10% bonus. The group that was unable to meet the deadline was penalized. The group that did not meet the deadline was penalized with unpaid extra working hours to complete the task. Suresh, unlike Ramesh, did not prioritise a structured approach to work. Suresh inspired the project managers by making them feel like leaders rather than just participants. Suresh's empowering attitude helped to align individual goals with group goals. Ramesh established routines to maximize his team efficiency. Suresh, on the other hand, used positive reinforcement to maximize his team efficiency.

- Identify the leadership style employed by Ramesh and Suresh.
- What are the conditions/situations that make such leadership styles more appropriate?
- Discuss the characteristics of the leadership styles.

[Nov. 2023 (5 Marks)]

Ans.:

- Ramesh adopted transactional leadership style, while Suresh adopted transformational leadership style.
- Transactional leadership style can be appropriate in settled and static environment, in growing or mature industries and in organizations that are performing well.
Transformational leadership style may be appropriate in turbulent environment, in industries at the very start or end of their life cycles, in poorly performing organizations when there is a need to inspire a company to embrace major changes.

- Transactional leadership style uses the authority of its office to exchange rewards such as pay, status symbols etc. Transactional leaders prefer a more formalized approach to motivation, setting clear goals with explicit rewards or penalties for achievement and non-achievement. Transactional leaders focus mainly to build on existing culture and enhance current practices.

Q16. Which six essential skills are required for strategic leadership as per Harvard Business Review?

Ans.: 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.

Q17. You have been appointed as head of the Strategic Business Unit (SBU) of a large multproduct company. Explain the leadership roles, you have to play as a Manager in pushing for good strategy execution.

[May 2023 (5 Marks)]

Ans.: A head of the Strategic Business Unit (SBU) has many different leadership roles to play: visionary, chief entrepreneur and strategist, chief administrator, culture builder, resource acquirer and allocator, capabilities builder, process integrator, crisis solver, spokesperson, negotiator, motivator, arbitrator, policy maker, policy enforcer, and head cheerleader. Managers have five leadership roles to play in pushing for good strategy execution:

- Staying on top of what is happening, closely monitoring progress, working through issues and obstacles.
- Promoting a culture that mobilizes and energizes organizational members to execute strategy and perform at a high level.
- Keeping the organization responsive to changing conditions, alert for new opportunities and remain ahead of rivals in developing competitively valuable competencies and capabilities.

- Ethical leadership and insisting that the organization conduct its affairs like a model corporate citizen.
- Pushing corrective actions to improve strategy execution and overall strategic performance.

Q18. Aashna Kedla has been recently appointed as the head of a strategic business unit of a large multiproduct company. Advise Mrs. Kedla about the leadership role to be played by her in the execution of strategy.

[June 2024 (5 Marks)]

Ans.:

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 prioritizes 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.

Managers have five leadership roles to play in pushing for good strategy execution:

- Staying on top of what is happening, closely monitoring progress, working through issues and obstacles.
- Promoting a culture that mobilizes and energizes organizational members to execute strategy and perform at a high level.
- Keeping the organization responsive to changing conditions, alert for new opportunities and remain ahead of rivals in developing competitively valuable competencies and capabilities.
- Exercising ethical leadership and insisting that the organization conduct its affairs like a model corporate citizen.
- Pushing corrective actions to improve strategy execution and overall strategic performance.

E-BUSINESS STRATEGIC FRAMEWORK

Q19. Write a short note on: E-business Strategy

Ans.: 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 computerized 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 organizations and people.

E-business Strategic Framework: The e-business strategic framework addresses three broad sets of questions. These are:

- Where do we (as a company) want to compete?
- What type of value do we want to create?
- How should we set up and organize our company to deliver the desired value?

Q20. Financial Technology (Fintech) is used to describe new tech that seeks to improve and automate the delivery and use of financial services. Discuss.

Ans.: Fintech, the word, is a combination of "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, smart phones.

Some of the most active areas of fintech innovation include or revolve around the following areas:

- ◆ Crypto currency and digital cash.
- ◆ Block-chain 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 block-chain) to automatically execute contracts between buyers and sellers.
- ◆ Open banking, a concept that leans on the block chain 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.
- ◆ Cyber security, given the proliferation of cybercrime and the decentralized storage of data, cyber security and fintech are intertwined.

moreno074@digdy.com 28-07-2024
09:38

TAXMANN®

6

CHAPTER

MANAGING MULTI-BUSINESS FIRM & ANALYZING STRATEGIC EDGE

BUSINESS PROCESS RE-ENGINEERING (BPR)

Q1. What do you understand by Business Process Re-engineering (BPR)? What are the steps involved in BPR?

Or

Discuss various steps involved in Business Process Re-engineering (BPR) while implementing in an organization. [May 2021 (5 Marks)]

Or

"The approach to BPR begins with defining the scope and objectives of the re-engineering project." With reference to this statement explain briefly the steps for implementing BPR. [Nov. 2023 (5 Marks)]

Or

What is the rationale behind Business Process Re-engineering (BPR)? What steps would you recommend to implement BPR in an organization? [June 2024 (5 Marks)]

Ans.: Business Process Re-engineering: Business process re-engineering is the act of recreating a core business process with the goal of improving product output, quality or reducing costs.

Typically, it involves the analysis of company workflows, finding processes that are sub-par or inefficient and figuring out ways to get rid of them or change them.

Business Process Re-engineering (BPR) is an approach to unusual improvement in operating effectiveness through the redesigning of critical business processes and supporting business systems. It looks at the minute details of the process, such as why the work is done, who does it, where is it done and when it is done. BPR refers to the analysis and redesign of workflows and processes both within the organization and between the organization and the external entities like suppliers, distributors, and service providers.

The orientation of redesigning efforts is basically radical. In other words, it is a total deconstruction and rethinking of business process in its entirety, unconstrained by its existing structure and pattern. Its objective is to obtain

quantum jump in process performance in terms of time, cost, output, quality, and responsiveness to customers.

Steps in Business Process Re-engineering: Following steps are involved in Business Process Re-engineering –

- (1) **Determining objectives and framework:** Objectives are the desired end results of the redesign process which the management and organization attempts to achieve. This will provide the required focus, direction, and motivation for the redesign process.
- (2) **Identify customers and determine their needs:** The designers have to understand customers - their profile, their steps in acquiring, using and Act disposing a product. The purpose is to redesign business process that clearly provides added value to the customer.
- (3) **Study the existing process:** The existing processes will provide an important base for the redesigners. The purpose is to gain an understanding of the 'what', and 'why' of the targeted process. However, some companies go through the re-engineering process with clean perspective without laying emphasis on the past processes.
- (4) **Formulate a redesign process plan:** The information gained through the earlier steps is translated into an ideal redesign process. Customer focused redesign concepts are identified and formulated. In this crucial step alternative processes are considered and the optimum is selected.
- (5) **Implement the redesign:** It is easier to formulate new process than to implement them. Implementation of the redesigned process and application of other knowledge gained from the previous steps is a key to achieve dramatic improvements. It is the joint responsibility of the designers and management to operationalise the new process.

Q2. What are the objectives of Business Process Re-engineering (BPR)?

Ans.: 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.

Q3. Write a short note on: Typology of Business Process Re-engineering (BPR)

Ans.: Earl 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:

- (a) **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 fulfilment processes.
- (b) **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 example being information technology, financial systems and human resources systems.
- (c) **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.
- (d) **Management Processes:** those processes through which firms plan, organize and control resources. Examples include strategy development, direction setting, and managing the organization.

BENCHMARKING

Q4. What do you understand by term 'Benchmarking'? Also state three major types of benchmarking were identified by Tuominen and Bogan and English?

Ans.: Benchmarking is an approach of setting goals and measuring productivity of firms based on best industry practices or against the products, services and practices of its competitors or other acknowledged leaders in the industry. It developed out of need to have information against which performance can be measured. Benchmarking helps businesses in improving performance by learning from the best practices and the processes by which they are achieved. Thus, benchmarking is a process of continuous improvement in search for competitive advantage. Firms can use benchmarking practices to achieve improvements in diverse range of management functions like product development, customer services, human resources management, etc.

Three major types of benchmarking were identified by Tuominen and Bogan and English:

- (1) **Strategic Benchmarking:** Managers use this type of benchmarking to identify the best way to compete in the market. During the process, the companies identify the winning strategies (usually outside their own industry) that successful companies use and apply them to their own strategic process. It is also common to compare the strategic goals in order to spot new strategic choices.
- (2) **Performance Benchmarking:** It is concerned with comparing your company's products and services. According to Bogan & 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. Performance benchmarking

determines how strong our products and services are compared to our competition.

- (3) **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. Process benchmarking is a separate type of benchmarking, but 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.

For example, an organization using performance comparison identifies that their product 'X' is superior in features, manufacturing quality and design, but have more price than competitor's product 'Y'. Then the company determines, which processes add the most to the cost of the product and seek how to improve them by looking at similar, but less cost heavy processes in other companies.

Q5. What are the various steps involved in Benchmarking Process?

Ans.: Various steps in Benchmarking Process are as under:

- (1) **Identifying need for benchmarking:** This step will define the objectives of the benchmarking exercise. It will also involve selecting the type of benchmarking. Organizations identify realistic opportunities for improvements.
- (2) **Clearly understanding existing decisions processes:** The step will involve compiling information and data on performance.
- (3) **Identify best processes:** Within the selected framework best processes are identified. These may be within the same organization or external to them.
- (4) **Comparison of own process and performance with others:** Benchmarking process also involves comparison of performance of the organization with performance of other organization. Any deviation between the two is analyzed to make further improvements.
- (5) **Prepare a report and implement the steps necessary to close the performance gap:** A report on benchmarking initiatives containing recommendations is prepared. Such a report also contains the action plans for implementation.
- (6) **Evaluation:** Business organizations evaluate the results of the benchmarking process in terms of improvements vis-à-vis objectives and other criteria set for the purpose. It also periodically evaluates and reset the benchmarks in the light of changes in the conditions that impact the performance.

Q6. Write a short note on: Benchmarking Wheel

Ans.: 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.

Q7. Make a list of advantages and disadvantages of benchmarking.

Ans.: **Advantages of benchmarking:**

- ◆ 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 of benchmarking:

- ◆ 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.

Q8. Paramount group of companies is having a strong foot print in the areas of Aviation, Healthcare, Fast Moving Consumer Goods, Home appliances and Electronic goods. Processes, Technology and Marketing capabilities are different for each business. However, each business operates among a group of rivals that produce competing products.

In order to get ahead of competition and to contribute for sustained competitive advantages, company intends to improve customer services and in turn increase its market share. To achieve this, company is desirous to analyze its products, processes and service levels for each of its segments.

Company is studying various trade publications, understanding the taste and preferences of customers, meeting with suppliers and also using other relevant information available in public domain for each of its business operations. After studying as above, company wants to compare diverse range of practices and processes being followed by acknowledged leaders in the industry, measures its own productivity and identify the gaps. Instead of following bricks-and-mortar practices, company will be setting goals to be achieved for improvement in its product, processes and services, based on best practices being followed by the companies on a regular basis.

Identify the strategic tool to be used by Paramount group of companies. Also explain in brief the common elements involved in using this tool.

[May 2022 (1 + 4 = 5 Marks)]

Ans.: Paramount group of companies have used **BENCHMARKING** as a strategic tool.

Benchmarking is an approach of setting goals and measuring productivity of firms based on best industry practices or against the products, services and practices of its competitors or other acknowledged leaders in the industry. Thus, benchmarking is a process of continuous improvement in search for competitive advantage. Firms can use benchmarking practices to achieve improvements in diverse range of management functions like product development, customer services, human resources management, etc.

Some of the common elements of benchmarking process are as under:

- (1) Identifying need for benchmarking:** This step will define the objectives of the benchmarking exercise. It will also involve selecting the type of benchmarking. Organizations identify realistic opportunities for improvements.
- (2) Clearly understanding existing decisions processes:** The step will involve compiling information and data on performance.
- (3) Identify best processes:** Within the selected framework best processes are identified. These may be within the same organization or external to them.
- (4) Comparison of own process and performance with others:** Benchmarking process also involves comparison of performance of the

organization with performance of other organization. Any deviation between the two is analyzed to make further improvements.

- (5) Prepare a report and implement the steps necessary to close the performance gap:** A report on benchmarking initiatives containing recommendations is prepared. Such a report also contains the action plans for implementation.
- (6) Evaluation:** Business organizations evaluate the results of the benchmarking process in terms of improvements vis-à-vis objectives and other criteria set for the purpose. It also periodically evaluates and reset the benchmarks in the light of changes in the conditions that impact the performance.

TOTAL QUALITY MANAGEMENT (TQM)

Q9. Explain the concept of "Total Quality Management (TQM)" and its important principles.

Ans.: Success of any organization depends on offering quality products at competitive prices. All over the world, it is being realized that quality control be ensured through inspection and test alone. Every department and individual has a contribution to make in achievement of quality.

Quality can be the most significant factor in determining the long-run success or failure of any organization. High quality of products can give a competitive edge to an organization. On the other hand good quality generates satisfied customers who reward the organization with continued patronage and favourable word of mouth advertising.

TQM owes its genesis to post war research of American management consultants like **Dr. Joseph Juran** and **W. Edwards Deming** who introduced statistical control techniques to the Japanese during Japan's rebuilding period.

In view of globalization of markets, Governments have begun to realize that quality is essential to international trade and the national economy, public purchasing authorities have been instructed to buy goods that confirm the quality standards. Some time back, the European Economic Community collectively established a common set of quality standards known as ISO 9000. While ISO 9000-ISO 9003 series is a reference for external quality assurance, ISO 9004 is for internal quality management. Taken together these standards aim at achieving TQM.

Important principles of TQM: Total Quality Management is an approach that organizations use to improve their internal processes and increase customer satisfaction. When properly implemented, it can lead to decreased costs related to corrective or preventative maintenance, better overall performance, and an increased number of satisfied and loyal customers.

However, TQM is not something that happens overnight. While there are a number of measures that help organizations quickly start to implement a

quality management system, there are some underlying philosophies that the company must integrate throughout every department of the company and at every level of management.

Therefore, whatever resources an organization use, it should remember these seven important principles of Total Quality Management as a foundation for all their activities.

- (1) **Quality can and must be managed:** The first step in the TQM process is to realize there is a problem and that it can be controlled. Many companies believe that their operations are too large to effectively manage the level of quality, which is rendered untrue by TQM.
- (2) **Processes, not people, are the problem:** If a process causes problems then the solution is not in hiring new employees or giving them a lot of training sessions. The solution is that the processes are to be corrected first and then train the people on these new procedures.
- (3) **Don't treat symptoms, look for the cure:** To fully reach your potential, a solution for the problem has to be found. For example, if an organization's shipping department is lagging behind, then it could be because of the holdups in manufacturing. Therefore go for the source to correct the problem.
- (4) **Every employee is responsible for quality:** Everyone in the company, from the workers on the line to the upper management, must realize that they have an important part to play in ensuring high levels of quality in their products and services. Everyone has a customer to delight, and they must all step up and take responsibility for them.
- (5) **Quality must be measurable:** A quality management system is only effective when you can quantify the results. You need to see how the process is implemented and if it is having the desired effect. This will help you set your goals for the future and ensure that every department is working towards the same result.
- (6) **Quality improvements must be continuous:** Total Quality Management is not something that can be done once and then forgotten. It's not a management "phase" that will end after a problem has been corrected. Real improvements must occur frequently and continually in order to increase customer satisfaction and loyalty.
- (7) **Quality is a long-term investment:** Quality management is not a quick fix. TQM is a long-term investment, and it is designed to help one find long-term success.

Q10. What are the Characteristics for most practical Implementations of Total Quality Management (TQM)?

Ans.: The most practical implementations of Total Quality Management involve the following most widely principles:

- (1) **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.
- (2) **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 benefiting customers.
- (3) **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.
- (4) **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.
- (5) **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.
- (6) **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.
- (7) **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.
- (8) **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.

SIX SIGMA

Q11. Six Sigma is a defined and disciplined business methodology to increase customer satisfaction and profitability by streamlining operations, improving quality and eliminating defects in every organization-wide process. Discuss.

Or

What is meant by Six Sigma? Briefly explain. [June 2024 (5 Marks)]

Ans.: Six Sigma is a defined and disciplined business methodology to increase customer satisfaction and profitability by streamlining operations, improving quality and eliminating defects in every organization-wide process.



Six Sigma is:

- (1) **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.
- (2) **A Vision:** Six Sigma Methodology helps the Senior Management create a vision to provide defect free, positive environment to the organization.
- (3) **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.
- (4) **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.
- (5) **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.
- (6) **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.

more@s074@digdy.com 26-07-2024
09:36

II

PART

CORPORATE FINANCE

7

CHAPTER

SOURCES OF CORPORATE FUNDING

EQUITY SHARE CAPITAL

Q1. Board of directors of Progressive Limited decides to issue equity shares of a company with differential voting rights. Examining the provision of Companies Act, 2013, State the conditions to be complied with the company in this regard. [Dec. 2016 (8 Marks)]

Or

Swadha Ltd. is a well-established company which wants to issue equity shares with differential voting rights in the near future. In this regard, explain the related provisions/conditions of Companies (Share Capital and Debentures) Rules, 2014. [June 2024 (5 Marks)]

Ans.:

Shares with differential rights [Section 43(a)(ii)]: Shares with differential rights means shares issued with differential rights as to *dividend, voting* or *otherwise* in accordance with section 43(a)(ii) of the Companies Act, 2013.

Provisions of the Companies (Share Capital & Debentures) Rules, 2014 relating to shares with differential rights are discussed below.

Conditions for issuing shares with differential rights [Rule 4(1)]: No company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with the following conditions:

- (1) Authorization from AOA:** The article of association authorizes the issue of shares with differential rights.
- (2) Resolution:** The issue of shares is authorized by an **ordinary resolution** passed at a general meeting of the shareholders. However, in case of listed company issue of such shares shall be approved by shareholders through **postal ballot**.
- (3) Limit on voting power:** 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.

- (4) **Track record of distributable profits:** The Company having consistent track record of distributable profits for the last 3 years.
- (5) **No default in financial statements & annual returns:** The Company has not defaulted in filing financial statements and annual returns for 3 financial years immediately preceding the financial year in which it is decided to issue such shares.
- (6) **No subsisting default in certain matters:** The company has no subsisting default in following:
- Payment of a declared dividend to its equity shareholders.
 - Repayment of its matured deposits.
 - Redemption of its preference shares or debentures that are due for redemption.
 - Payment of interest on deposits or debentures.
 - Payment of preference dividend.
- (7) **No defaults in respect of dividend, term loans etc.:** The company has not defaulted in following:
- Dividend on preference shares.
 - 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.
 - Dues with respect to statutory payments relating to its employees to any authority.
 - In crediting the amount in Investor Education & Protection Fund to the Central Government.
- However, a company may issue equity shares with differential rights upon expiry of **5 years** from the end of the financial Year in which such default was made good.
- (8) **No penalty under certain laws:** The company has not been penalized by Court or Tribunal during the last 3 years of any offence under the following laws:
- RBI Act, 1934
 - SEBI Act, 1992
 - Securities Contracts Regulation Act, 1956
 - Foreign Exchange Management Act, 1999
 - Any other special Act, under which such companies being regulated by sectoral regulators.

Q2. Which of the following companies is eligible to issue shares with Differential Voting Rights (DVRs) during the financial year 2022-23?

Type of company	Nature of default	Whether Articles of Association of the company authorized to issue shares with DVR?
A Ltd. - Unlisted company	Company has made default in filing annual return for the financial years 2018-19 & 2019-20. Default was made good during the financial year 2020-21.	Yes
B Pvt. Ltd.	No

[June 2022 (3 Marks)]

Ans.: Section 43(a)(ii) of the Companies Act, 2013 read with Rule 4 of Companies (Share Capital & Debentures) Rules, 2014 provides that company limited by shares shall issue equity shares with differential rights if article of association authorizes the issue of shares with differential rights.

Company cannot issue shares with differential rights if company has defaulted in filing financial statements and annual returns for 3 financial years immediately preceding the financial year in which it is decided to issue such shares.

In light of the above provisions:

- A Ltd. can issue shares with differential rights as the company has made default during financial years 2018-19 & 2019-20 only in respect of filing annual return, which was made good during the financial year 2020-21. Articles of Association of A Ltd. also authorize to issue shares with differential rights.
- B Pvt. Ltd. cannot issue shares with differential rights unless it alter its Articles of Association in such a manner so as to authorize it to issue shares with differential rights.

PREFERENCE SHARE CAPITAL

Q3. Preference share are cumulative unless expressly stated to be non-cumulative. Comment.

[June 2011 (5 Marks)]

Ans.: Dividends on preference shares, like equity shares, can be paid only out of profits.

With regard to the payment of dividends, preference shares may be cumulative or non-cumulative.

A cumulative preference share confers a right on its holder to claim fixed dividend of the past and the current year and out of future profits. The dividend keeps on accumulating until it is fully paid.

The non-cumulative preference share gives right to its holder to a fixed amount or a fixed percentage of dividends out of the profits of each year. If no profits are available in any year, the shareholders get nothing, nor can they claim, unpaid dividend in any subsequent year.

Preference shares are cumulative unless expressly stated to be non-cumulative.

Q4. What are the conditions which must be fulfilled for issue and redemption of preference shares?

[June 2011 (6 Marks)], [June 2015 (5 Marks)]

Ans.: Issue & Redemption of Preference Shares [Section 55]:

- (1) **Irredeemable preference shares cannot be issued:** No company limited by shares shall issue any preference shares which are irredeemable.
- (2) **Period for which preference shares can be issued:** If authorized by its articles, a company limited by shares may issue preference shares which are liable to be redeemed within a period not exceeding **20 years** from the date of their issue subject to prescribed conditions.

However, a company may issue preference shares for a period exceeding 20 years for infrastructure projects, subject to the redemption of prescribed percentage of shares on an annual basis at the option of such preferential shareholders.

As per Rule 10 of the Companies (Share Capital & Debentures) Rules, 2014, 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 10% of such preference shares per year from the 21st year onwards or earlier, on proportionate basis, at the option of the preference shareholders. The term "infrastructure projects" means the infrastructure projects specified in **Schedule VI**.

- (3) **Source of funds for redemption:** Preference shares shall be redeemed:
 - (a) Out of the profits of the company which would otherwise be available for dividend.
 - (b) Out of the proceeds of a fresh issue of shares.
 - (c) Partly out of the profits of the company and partly out of the proceeds of a fresh issue of shares.
- (4) **Paid-up value of redemption:** Preference shares shall be redeemed only if they are *fully paid-up*.
- (5) **Capital Redemption Reserve Account:** Where preference shares are proposed to be redeemed out of the profits a sum equal to the nominal

amount of the shares should be transferred to the Capital Redemption Reserve Account.

Capital Redemption Reserve Account may be applied for issue of fully paid-up bonus shares.

(6) Premium on redemption of preference shares:

- (i) In case of prescribed class of companies whose financial statement required to comply with the prescribed accounting standards under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.
- (ii) In a other cases, the premium payable on redemption shall be provided for:
 - (a) Out of the profits of the company.
 - (b) Out of the company's securities premium account, before such shares are redeemed.
 - (c) Partly out of the profits of the company and partly out of securities premium account.

- (7) **Redemption of preference shares by issue of further redeemable preference shares:** Where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (*such shares referred as unredeemed preference shares*), it may, with the consent of the holders of 3/4th in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

While giving approval, the Tribunal shall order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

Explanation: The issue of further redeemable preference shares or redemption of preference shares shall not be deemed to be an increase or a reduction, in the share capital of the company.

Q5. Whether equity shares already issued can be converted into redeemable preference shares?

[Dec. 2012 (4 Marks)]

Ans.: There is not specific provision in the Companies Act, 2013 regarding conversion of equity shares into redeemable preference shares. However, it was held that where the equity shares are to be converted into redeemable preference shares it was necessary to adopt the process of reduction of capital u/s 66 of the Companies Act, 2013. [*Re. Chowgule & Co. (P) Ltd., St. James Court Estates Ltd.*]

Q6. In no circumstances a company can issue redeemable preference shares with a redemption period of 20 years. [June 2015 (5 Marks)]

Ans.: As per Section 55 of the Companies Act, 2013, a company limited by shares shall not issue preference shares which are irredeemable.

A company limited by shares may issue preference shares which are liable to be redeemed within a period **20 years** from the date of issue.

As per Rule 10 of the Companies (Share Capital & Debentures) Rules, 2014, 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 21st year onwards or earlier, on proportionate basis, at the option of the preference shareholders. The term "infrastructural projects" means the infrastructure projects specified in **Schedule VI**.

Thus, it is incorrect to say that in no circumstances a company can issue redeemable preference shares with a redemption period of 20 years.

Q7. Distinguish between: Preference Share Capital & Equity Share Capital [Dec. 2015 (4 Marks)]

Ans.: Following are the main points of distinction between preference share capital & equity share capital:

Points	Preference Share Capital	Equity Share Capital
Dividend	Preference shares are entitled to a fixed rate of dividend.	Rate of dividend on equity shares is recommended by the board of directors in its report to the shareholders, which is approved by the shareholders at the AGM.
Preference in dividend	Dividend on the preference shares is paid in preference to the equity shares.	Dividend on equity shares is paid only after preference dividend has been paid.
Preference in winding-up	In case of winding-up, preference shareholders get preference over equity shareholders with regard to the payment of capital.	In case of winding-up, equity share holders get payment of capital after the payment of capital to preference shareholders.
Cumulativeness	Dividend on preference share may be cumulative.	Dividend on equity shares is not cumulative.
Voting rights	Voting rights of preference shareholders are restricted. As per section 47(2), a preference shareholder can vote only in following cases: (a) When his special rights as a preference shareholder are being varied.	An equity shareholder can vote on all matters affecting the company.

Points	Preference Share Capital	Equity Share Capital
	(b) Any resolution for the winding-up of the company or for the repayment or reduction of its equity or preference share capital. (c) If preference dividend has not been paid for a period of 2 years or more.	
Bonus & right shares	No bonus shares/right shares are issued to preference share holders	A company may issue rights shares or bonus shares to the company's existing equity shareholders.
Redemption	Preference shares are liable to be redeemed within a period 20 years from the date of issue.	Equity shares cannot be redeemed except under a scheme involving reduction of capital or buy-back of its own shares.

DEBENTURES**Q8. Distinguish between: Debentures & Shares [June 2009 (5 Marks)], [Dec. 2014 (4 Marks)]**

Ans.: Following are the main points of distinction between debentures & shares:

Points	Debentures	Shares
Status	Debenture holders are the creditors of the company.	Shareholders are the owners of the company.
Voting rights	Debenture holders have no voting rights .	Shareholders have voting rights .
Rate of income	Debenture interest is paid at a pre-determined fixed rate .	Dividend on equity shares is paid at a variable rate .
Treatment against profit	Interest on debentures is the charge against profits.	Dividends are appropriation of profits.
Types	There are different kinds of debentures, such as Secured/Unsecured, Redeemable/Irredeemable, Registered/Bearer, Convertible/ Non-convertible, etc.	There are only two kinds of shares – equity shares and preference shares.
Balance sheet presentation	In the company's balance sheet, debentures are shown under head " Non-Current Liabilities ".	In the company's balance sheet, shares are shown under head " Shareholders Funds ".
Conversion	Debentures can be converted into shares as per the terms of issue of debenture.	Shares cannot be converted into debentures in any circumstances.

Points	Debentures	Shares
Forfeiture	Debentures cannot be forfeited for non-payment of call moneys.	Shares can be forfeited for non-payment of allotment and call moneys.
Liquidation	At the time of liquidation, debenture holders are paid-off before the shareholders.	At the time of liquidation shareholders are paid at last, after paying debenture holders, creditors, etc.

Q9. Write a short note on: Types of Debentures*Or***Distinguish between: Naked Debentures & Secured Debentures**
[Dec. 2009 (3 Marks)]*Or***Distinguish between: Perpetual Debentures & Bearer Debentures**
[Dec. 2009 (3 Marks)]*Or***Explain the term 'Naked Debentures'.** [June 2012 (2 Marks)]**Ans.:** Various types of debentures are as follows:

- (1) Naked or Unsecured Debentures:** Debentures of this kind do not carry any charge on the assets of the company. The holders of such debentures do not therefore have the right to attach particular property by way of security as to repayment of principal or interest and thus called as naked or unsecured debentures.
- (2) Secured Debentures:** Debentures that are secured by a charge of the whole or part of the assets of the company are called mortgage debentures or secured debentures. After creating charge on debentures, a charge is required to be registered with ROC within 30 days of creation.
- (3) Redeemable Debentures:** Debentures that are redeemable on expiry of certain period are called redeemable debentures.
- (4) Perpetual/irredeemable Debentures:** If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period, e.g. winding-up, they are called perpetual/irredeemable debentures.
- (5) Bearer Debentures:** Such debentures are payable to bearer and are transferable by mere delivery. The name of the debenture holder is not registered in the books of the company, but the holder is entitled to claim interest and principal as and when due. A *bona fide* transferee for value is not affected by the defect in the title of the transferor.
- (6) Registered Debentures:** Such debentures are payable to the registered holders whose name appears on the debenture certificate and is registered on the companies register of debenture holders maintained as per Section 88 of the Companies Act, 2013.

Q10. KAJ Ltd., a company incorporated under the Companies Act, 2013 wants to go for issue of secured debentures. Referring to relevant provisions and Rules, state the conditions to be satisfied before the company goes for such issue of debentures. Will your answer be different in case such issue of debentures is by a Government company where the Central Government has given a guarantee? [Dec. 2017 (4 Marks)]

Ans.: As per Section 71 of the Companies Act, 2013, a company may issue secured debentures subject to prescribed terms and conditions.

Rule 18 of the Companies (Share Capital & Debentures) Rules, 2014 makes the following provisions in this regard.

The company shall not issue secured debentures, unless it complies with the following conditions, namely:

- (1) Period for which debentures can be issued:** An issue of secured debentures may be made, provided the date of its redemption shall not exceed 10 years from the date of issue.
However, following classes of companies may issue secured debentures for a period exceeding 10 years but not exceeding 30 years:
 - (i) Companies engaged in setting up of infrastructure projects.
 - (ii) Infrastructure Finance Companies.
 - (iii) Infrastructure Debt Fund Non-Banking Financial companies.
 - (iv) Companies permitted by a Ministry or Department of the Central Government or by RBI or by the NHB or by any other statutory authority to issue debentures for a period exceeding 10 years.
- (2) Creation of charge:** Such an issue of debentures shall be secured by the creation of a charge on the properties or assets of the company or its subsidiaries or its holding company or its associate companies, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon.
- (3) Appointment of debenture trustee:** the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than 60 days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders.
- (4) Property on which charge shall be created:** The security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on -
 - (i) Any specific movable property of the company or its holding company or subsidiaries or associate companies or otherwise.
 - (ii) Any specific immovable property wherever situate, or any interest therein.

In case of a non-banking financial company, the charge or mortgage may be created on any movable property.

In case of any issue of debentures by a Government company which is fully secured by the guarantee given by the Central Government or one or more State Government or by both, the requirement for creation of charge shall not apply.

In case of any loan taken by a subsidiary company from any bank or financial institution the charge or mortgage may also be created on the properties or assets of the holding company.

Considering above provisions, answer to given case is as follows:

- (i) KAJ Ltd. may issue of secured debentures subject to compliance of above stated provisions.
- (ii) If KAJ Ltd. is Government Company and it issues debentures where the Central Government has given a guarantee it need not comply with the requirement for creation of charge.

Q11. Distinguish between: Redemption of preference shares & Redemption of debentures
[June 2018 (4 Marks)]

Ans.: Following are the main points of distinction between Redemption of shares & Redemption of debentures:

Points	Redemption of Preference Shares	Redemption of debentures
Nature	Redemption of preference shares is payment to owner of the company.	Redemption of debentures amount to repayment of loan as debenture holders who are creditors of the company.
Redeemable/irredeemable	No company limited by shares shall issue any preference shares which are irredeemable.	Companies can issue redeemable as well as irredeemable debentures.
When redeemed	Preference shares are liable to be redeemed within a period not exceeding 20 years from the date of their issue. However, 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 10% of such preference shares per year from the 21st year onwards or earlier, on proportionate basis, at the option of the preference shareholders.	Redeemable debentures are required to be redeemed within period specified in offer document while irredeemable debentures are redeemed only at the time of liquidation of the company.

Points	Redemption of Preference Shares	Redemption of debentures
Funds for redemption	Preference shares shall be redeemed: (a) Out of the profits of the company which would otherwise be available for dividend. (b) Out of the proceeds of a fresh issue of shares. (c) Partly out the profits of the company and partly out of the proceeds of a fresh issue of shares.	Debentures can be redeemed out of Debenture Redemption Reserve which is created out of profits of the company which would otherwise be available for dividend.
Reserves	Where preference shares are proposed to be redeemed out of the profits a sum equal to the nominal amount of the shares should be transferred to the Capital Redemption Reserve Account.	For the purpose of redemption of debentures the company is required to comply with creation of Debenture Redemption Reserve.

Q12. A public company may issue secured irredeemable debentures.
Comment. [Dec. 2018 (5 Marks)]

Ans.: Perpetual/Irredeemable Debentures: If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period, e.g. winding-up, they are called perpetual/irredeemable debentures.

As per Rule 18(1)(a) of the Companies (Share Capital & Debentures) Rules, 2014, an issue of secured debentures may be made, provided the date of its redemption shall not exceed 10 years from the date of issue.

However, following classes of companies may issue secured debentures for a period exceeding 10 years but not exceeding 30 years:

- Companies engaged in setting up of infrastructure projects.
- Infrastructure Finance Companies.
- Infrastructure Debt Fund Non-Banking Financial companies.
- Companies permitted by a Ministry or Department of the Central Government or by RBI or by the NHB or by any other statutory authority to issue debentures for a period exceeding 10 years.

Thus, after the commencement of the Companies Act, 2013, no company either public or private can issue perpetual or irredeemable debentures.

BONDS**Q13. What do you understand by the term 'Bond'? Also state various types of bonds issued in India.**

Ans.: 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.

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 & 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 NSE and BSE, hence can be easily liquidated and sold in the open market.

Q14. In the recent past, a listed housing finance company issued MASALA BONDS for a sum of ₹ 3,000 Crore. Explain the term MASALA BONDS. Is there any advantage of MASALA BONDS over NORMAL BONDS?**[June 2019 (5 Marks)]**

Ans.: 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 the in the other borrowings, the currency is normally dollar, euro, yen etc.

The Masala Bonds were reckoned under both corporate debt and external commercial borrowings for Foreign Portfolio investment.

The RBI 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 main 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 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. This is a big advantage, as many companies which had raised 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. Many public and private companies are in the fray to issue Masala Bonds as the companies can have access to more funds at a marginally higher cost of financing.

LOAN AGAINST SECURITIES & PROPERTIES**Q15. Advantages and disadvantages of taking loans against shares by promoters in a listed company. [Dec. 2020 (5 Marks)]**

Ans.: Generally, wherever the promoter decides to set up another venture, funds are required as promoter's contribution.

Advantages of taking loans against shares by promoters in a listed company:

- (i) Funds can be raised easily because the shares have liquidity and are easily saleable valuation is determined based on market price. After hair cut/ margin loan against equity is granted by Banks, NBFCs or other entities.
- (ii) Large funds can be raised.
- (iii) Shares are pledged in favour of lender but voting rights remain with the promoter.
- (iv) Promoter can make repayment based on the availability of funds.

Disadvantages of taking loans against shares by promoters in a listed company:

- (i) If the market price of the share goes down, the margin has to be maintained. The shortfall is to be met by either additional pledge of shares, or by making repayment of loan to the extent of shortfall.
- (ii) In case the promoter is not able to fulfil his commitment, the lender has a right to sell the shares to the extent of short fall as per terms and

conditions of agreement. Such large scale sale may result into further downtrend in the stock market, thus creating further shortfall.

- (iii) This situation does not leave any room sometimes with the promoter and the confidence of its shareholders goes down.
- (iv) Multiplier impacts worsen the situation.
- (v) The promoter has to disclose details of pledge of its equity and all charges. A higher percentage of pledge may result into confidence shake of the investors.

SECURITIZATION

Q16. Write a short note on: Securitized Debt Instruments

Ans.: 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.

Securitized debt instruments are regulated by the SRFAESI Act, 2002, SEBI (Issue and Listing of Securitized Debt Instruments & Security Receipts) Regulations, 2008.

Q17. Write a short note on: Eligibility for making public offer of securitized debt instruments

Ans.: 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.
- (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 SRFAESI 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.
- (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:

- (a) have a net worth of not less than ₹ 2 Crore;
- (b) have in its employment, a minimum of two persons who, between them, have at least 5 years.

Q18. What are the conditions for listing of Security Receipts?

Ans.: An issuer may list its security receipts on a recognized stock exchange subject to the following conditions:

- (a) Security receipts have been issued on a private placement basis.
- (b) Issuer has issued such security receipts in compliance with the applicable laws.
- (c) Offer or invitation to subscribe to security receipts shall be made to such number of persons not exceeding 200 or such other number, in a financial year, as may be prescribed from time to time.
- (d) Security receipts proposed to be listed are in dematerialized form.
- (e) 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) Minimum allotment made to the qualified buyers is ₹ 10 lakh.
- (g) 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) 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.

Q19. Securitization is a technique used to convert illiquid assets/claims into tradable securities. Explain the process along with examples of assets that can be securitized. [Dec. 2023 (5 Marks)]

Ans.: Securitization is a technique used to convert illiquid assets/claims into tradable securities. 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. 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).

Steps in a securitization: There are four steps in a securitization:

- (i) Special Purpose Distinct Entity (SPDE) is created to hold title to assets underlying securities.
- (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.
- (iv) The SPDE pays the originator for the assets with the proceeds from the sale of securities.

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.

8

CHAPTER

RAISING OF FUNDS FROM EQUITY & PROCEDURAL ASPECTS – PUBLIC FUNDING

ISSUE OF SECURITIES – BASIC CONCEPTS

Q1. Write a note on: Various methods of raising funds by a company from primary market [Dec. 2013 (4 Marks)]

Or

Discuss briefly following methods of raising funds from the primary capital market:

- (1) Public Issue
- (2) Right Issue
- (3) Preferential Allotment
- (4) Private Placement
- (5) Qualified Institutional Placement (QIP)

[June 2012 (5 × 3 = 15 Marks)]

Or

What do you understand by Qualified Institutions Placement (QIP)?

[June 2013 (5 Marks)]

Ans.: Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus. For raising capital from the public by the issue of shares, a public company has to comply with the provisions of the Companies Act, 2013, the SCR Act, 1956 including the Rules & Regulations made there under and the guidelines and instructions issued by the concerned Government Authorities, Stock Exchanges and SEBI etc.

A company can raise funds from the primary market through different methods as given below:

- (1) **Public Issue:** When company issues securities to new investors for becoming part of shareholders family of the issuer it is called a public issue. Public issue can be further classified into following two categories:

(a) **Initial Public Offer (IPO):** When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO.

- (b) **Further Public Offer (FPO) or Follow on offer:** When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a FPO.
- (2) **Right Issue:** When an issue of securities is made by an issuer to its existing shareholders it is called a rights issue.
- (3) **Bonus Issue:** When the company issue securities to its existing shareholders without any consideration it is called a bonus issue. Such shares are issued generally by capitalizing the company's profit & loss account, free reserve or securities premium account.
- (4) **Private Placement:** When an issuer makes an issue of securities to a select group of persons it is called private placement. However, issue of securities by way of private placement cannot be made to more than **49 persons**. Private placement of securities can be of following three types:
- (a) **Preferential Allotment:** When a listed issuer issues shares or convertible securities, to a select group of persons it is called a preferential allotment.
- (b) **Qualified Institutions Placement (QIP):** When a listed issuer issues equity shares or securities convertible in to equity shares to selected Qualified Institutions Buyers (QIBs) it is called Qualified Institutions Placement.
- (c) **Institutional Placement Programme (IPP):** When a listed issuer makes a further public offer of equity shares, or offer for sale of shares by promoter to QIBs, IPP can only be used to raise minimum public shareholding requirements to 25%.

Q2. "A Company can raise funds from the primary market through different methods, different types of issues and by means of offer document and red herring prospectus." Enumerate. [June 2018 (6 Marks)]

Or

Explain the term 'red-herring prospectus' associated with public offering of equity shares. [June 2013 (4 Marks)]

Ans.: Various methods of raising funds from primary market: Please refer to answer of Question No. 1.

Offer Document: Offer document means a prospectus, red-herring prospectus or shelf prospectus and information memorandum in terms of Section 31 of the Companies Act, 2013 in case of a public issue. In case of a rights issue, 'letter of offer' is offer document.

An offer document covers all the relevant information to help an investor to make his investment decision.

Red-herring prospectus: Red herring prospectus means a prospectus which does not include complete particulars of the *quantum* or *price* of the securities offered.

Provisions of red-herring prospectus are applicable to all companies except those are covered under shelf prospectus. The provision is mainly applicable for book building.

A company proposing to issue a red-herring prospectus shall file it with the ROC at least 3 days prior to the opening of the subscription list and the offer.

A red-herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red-herring prospectus and a prospectus shall be highlighted as variations in the prospectus.

BOOK BUILDING

Q3. What is Book Building? What is difference between 'Fixed Price Process' & 'Book Building Process'? [June 2010 (5 Marks)]

Or

Briefly explain the term 'Book Building' related to public issue. [June 2011 (2 Marks)], [Dec. 2011 (5 Marks)]

Or

Book-building process of determining price of a public issue is preferred in case of Initial Public Offer (IPO) while fixed price process is used for Further Public Offer (FPO). Comment. [Dec. 2013 (4 Marks)], [Dec. 2015 (4 Marks)]

Ans.: In fixed price process the issue price known in advance to the investors while in book building process the issue price is not known in advance to the investors as only price band is offered.

'Fixed price process' and 'book-building process' are pricing mechanisms in the issue of shares in public issue.

Book building means a process undertaken to elicit demand and to assess price for determination of the *quantum* or *value* of specified securities or Indian Depository Receipts (IDR). Book Building is basically a process used in IPO for efficient price discovery. It is a mechanism where, during the period for which the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price. The offer price is determined after the bid closing date.

Following are the main points of difference between fixed price process & book building process:

Points	Fixed Price Process	Book Building Process
Meaning	In fixed price process the issue price known in advance to the investors.	In book building process the issue price is not known in advance to the investors. Only price band is offered.
Demand	Demand for these securities offered is known only after the closure of the issue.	Demand for the securities offered can be known everyday as the book is built.

Points	Fixed Price Process	Book Building Process
Payment	Payment is made at the time of subscription wherein refund is given after allocation.	Payment is made only after allocation.
Document	In fixed price process the company issues prospectus.	In book building the company has to issue red herring prospectus.
Concept	This is old and traditional concept.	This concept is comparatively new to Indian Security Market.

Q4. ABC Ltd., a public company, has come with public issue of 15,00,000 equity shares through book building process. The price band is ₹ 500 – ₹ 600.

Following table shows demand of securities at various price levels. What should be the cut-off price as per book building mechanism?

Bid Price	No. of Investors	Demand (No. of shares)
520	25	8,50,000
530	10	4,00,000
535	15	2,00,000
545	4	4,00,000
560	6	1,00,000
575	5	2,00,000
585	3	1,10,000
590	3	1,40,000
595	3	3,50,000
600	1	7,00,000

[June 2021 (5 Marks)]

Ans.: Arrange the data given in problem from 'high price bid' to 'low price bid' as shown below.

Bid	Bid Price	No. of Investors	Demand (No. of shares)	Cumulative Demand
1	600	1	7,00,000	7,00,000
2	595	3	3,50,000	10,50,000
3	590	3	1,40,000	11,90,000
4	585	3	1,10,000	13,00,000
5	575	5	2,00,000	15,00,000
6	560	6	1,00,000	16,00,000
7	545	4	4,00,000	20,00,000
8	535	15	2,00,000	22,00,000

Bid	Bid Price	No. of Investors	Demand (No. of shares)	Cumulative Demand
9	530	10	4,00,000	26,00,000
10	520	25	8,50,000	34,50,000

The total bids from Bidders 1 to 5 ensure all 15,00,000 shares will be sold (7,00,000 + 3,50,000 + 1,40,000 + 1,10,000 + 2,00,000). The cut-off price is therefore Bid 5 price = ₹ 575.

Bidders 1 to 5 get allotments at that price. Bidders 6 to 10 don't get an allotment because their bids are below the cut-off price.

On allotment, the extra amount paid will be refunded to the investor. Since the cut-off price is ₹ 575, the bidder number one who applied 7,00,000 shares will be allotted shares at cut-off price at ₹ 40,25,00,000 (7,00,000 × ₹ 575). The balance ₹ 1,75,00,000 (7,00,000 × ₹ 25) will be refunded to the investor. Bidders 2 to 4 will get the refund accordingly.

DEFINITIONS & APPLICABILITY

Q5. Write short note on: Qualified Institutional Buyers (QIBs)

[Dec. 2012 (4 Marks)]

Ans.: QIBs are investment institutions who buy the shares of a company on a large scale. Qualified Institutional Buyers are those Institutional investors who are generally perceived to possess expertise and the financial proficiency to evaluate and to invest in the Capital Markets.

Qualified Institutional Investors [Regulation 2(1)(zd)]: Qualified Institutional Investors comprises of –

- (1) Mutual Fund, Venture Capital Fund, Alternative Investment Fund & Foreign Venture Capital Investor registered with the SEBI.
- (2) Category-I & Category-II Foreign Portfolio Investor registered with the SEBI.
- (3) Public Financial Institution.
- (4) Scheduled Commercial Bank.
- (5) Multilateral and bilateral development financial institution.
- (6) State industrial development corporation.
- (7) Insurance Company registered with the IRDA.
- (8) Provident Fund with minimum corpus of ₹ 25 Crore.
- (9) Pension Fund with minimum corpus of ₹ 25 Crore.
- (10) National Investment Fund.
- (11) Insurance Funds set-up and managed by army, navy or air force of the Union of India.

(12) Insurance Funds set-up and managed by the Department of Posts, India.

(13) Systemically Important NBFC.

Thus, only above stated institutional buyer are QIB and not other institutional buyers.

Q6. Write a note on: Draft Offer Document [Dec. 2013 (4 Marks)]

Ans.: Draft Offer Document [Regulation 2(1)(n)]: Draft offer document means the draft offer document filed with the SEBI in relation to a public issue under the SEBI (ICDR) Regulations, 2018.

Draft Offer document means the offer document in draft stage.

- ◆ The draft offer documents are filed with SEBI, at least 30 days prior to the filing of the Offer Document with ROC or designated stock exchange.
- ◆ SEBI may specify changes in the Draft Offer Document and the Issuer or the Lead Merchant Banker shall carry out such changes in the draft offer document before filing the Offer Document with ROC or designated stock exchange.
- ◆ The Draft Offer document is available on the SEBI website for public comments for a period of 21 days from the filing of it with SEBI.

Draft Offer Document to be made public: The draft offer document filed with SEBI shall be made public for comments for a period of 21 days from the date of filing with SEBI by hosting it on the websites of the SEBI, recognized stock exchanges and merchant bankers associated with the issue.

After a period of 21 days, the Lead Merchant Bankers shall file with SEBI a statement giving information of the comments received during that period and the consequential changes to be made in the draft offer document.

Q7. Who are Anchor Investors? How is allocation made to Anchor Investors? [Dec. 2022 (5 Marks)]

Ans.: Anchor Investor: Anchor investor means a qualified institutional buyer who makes an application for a value of at least ₹ 10 Crore 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 ₹ 2 Crore for an issue made by Small & Medium Enterprises (SME).

Allocation to anchor investors on Main Board: Allocation to Anchor Investors on Main Board shall subject to the following:

- (1) **For first ₹ 10 Crore:** Maximum 2 anchor investors shall be permitted for allocation.
- (2) **For above ₹ 10 Crore and up to ₹ 250 Crore:** Minimum 2 and maximum 15 anchor investors shall be permitted for allocation subject to minimum allotment of ₹ 5 Crore per anchor investor.
- (3) **For above ₹ 250 Crore:** Minimum of 5 such investors and a maximum of 15 such investors for allocation up to ₹ 250 Crore and an additional 10

such investors for every additional ₹ 250 Crore or part thereof, shall be permitted, subject to a minimum allotment of ₹ 5 Crore per such investor.

Allocation to anchor investors on SME Exchange: Allocation to Anchor Investors on SME Exchange shall subject to the following:

- (a) **For first ₹ 2 Crore:** Maximum 2 anchor investors shall be permitted for allocation.
- (b) **For above ₹ 2 Crore and up to ₹ 25 Crore:** Minimum 2 and maximum 15 anchor investors shall be permitted for allocation subject to minimum allotment of ₹ 1 Crore per anchor investor.
- (c) **For above ₹ 25 Crore:** Minimum of 5 such investors and a maximum of 15 such investors for allocation up to ₹ 25 Crore and an additional 10 such investors for every additional ₹ 25 Crore or part thereof, shall be permitted, subject to a minimum allotment of ₹ 1 Crore per such investor.

ELIGIBILITY REQUIREMENTS OF IPO ON MAIN BOARD [4 TO 8]

Q8. What are the eligibility norms for public issue by an unlisted company? [June 2010 (4 Marks)]

Or

SEBI has provided alternative eligibility norms for the public issues of securities. Comment. [Dec. 2012 (4 Marks)]

Ans.: Eligibility requirements for an initial public offer: [Regulation 6(1)]: An issuer shall be eligible to make an Initial Public Offer (IPO) only if it meets all the following conditions:

- (1) **Assets Criteria:** The issuer has net tangible assets of at least ₹ 3 Crore, calculated on a restated and consolidated basis, in each of the preceding three full years (of 12 months each), of which not more than 50% are 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. The limit of 50% on monetary assets shall not be applicable in case the IPO is made entirely through an Offer for Sale (OFS).
- (2) **Profit Criteria:** The issuer has an average operating profit of at least ₹ 15 Crore, calculated on a restated and consolidated basis, during the preceding 3 years (of 12 months each), with operating profit in each of these preceding 3 years.
- (3) **Net-worth Criteria:** The issuer has a net worth of at least ₹ 1 Crore in each of the preceding 3 full years (of twelve months each), calculated on a restated and consolidated basis.
- (4) **Name Criteria:** The issuer has changed its name within the last 1 year, at least 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 its new name.

Alternative Norms [Regulation 6(2)]: An issuer not satisfying above conditions shall be eligible to make IPO 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 (QIB)** and to refund the full subscription money if it fails to do so.

Q9. What do you understand by Initial Public Offer (IPO)? State the eligibility requirements for an Initial Public Offer under Regulation 6(1) of SEBI (ICDR) Regulations, 2018. [June 2024 (5 Marks)]

Ans.:

Initial Public Offer (IPO): Initial Public Offer 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.

Eligibility requirements for an initial public offer: [Regulation 6(1)]: An issuer shall be eligible to make an Initial Public Offer (IPO) only if it meets all the following conditions:

(1) **Assets Criteria:** The issuer has net tangible assets of at least ₹ 3 Crore, calculated on a restated and consolidated basis, in each of the preceding three full years (of 12 months each), of which not more than 50% are 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. The limit of 50% on monetary assets shall not be applicable in case the IPO is made entirely through an Offer for Sale (OFS).

(2) **Profit Criteria:** The issuer has an average operating profit of at least ₹ 15 Crore, calculated on a restated and consolidated basis, during the preceding 3 years (of 12 months each), with operating profit in each of these preceding 3 years.

(3) **Net-worth Criteria:** The issuer has a net worth of at least ₹ 1 Crore in each of the preceding 3 full years (of twelve months each), calculated on a restated and consolidated basis.

(4) **Name Criteria:** If the issuer has changed its name within the last 1 year, at least 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 its new name.

Alternative Norms [Regulation 6(2)]: An issuer not satisfying above conditions shall be eligible to make IPO 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 (QIB)** and to refund the full subscription money if it fails to do so.

Q10. RP Ltd. is planning to issue an IPO in 2019 for which a draft offer document is proposed to be filed in September, 2019. The following data is available regarding the company:

	(₹ in Crore)		
	2015-2016	2016-2017	2017-2018
Net Tangible Assets	5.00	8.00	7.00
Monetary Assets	1.00	3.00	3.00
Net Worth	3.00	4.00	5.00

(i) Advise the company whether they can proceed with the IPO.

(ii) Will your answer be different if value of monetary assets is ₹ 4 Crore in 2016-2017?

(iii) How will you deal with the situation, if company has monetary assets of ₹ 5 Crore in the year 2017-2018? [Dec. 2020 (5 Marks)]

Ans.:

(i) Regulation 6 of the SEBI (ICDR) Regulations, 2018 deals with the eligibility requirement of an IPO.

The provisions pertaining to Net Tangible Assets, Monetary Assets and Net worth are as under:

(a) The issuer has net tangible assets of at least ₹ 3 Crore 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.

(b) The issuer has a net worth of at least ₹ 1 Crore in each of the preceding three full years, calculated on a restated and consolidated basis.

In the given case, RP Ltd. has net tangible assets of at least ₹ 3 Crore in 3 years and Net worth of at least ₹ 1 Crore. Monetary assets are also within the threshold limit of 50% in each year, thereby satisfying all the conditions. Therefore, RP Ltd. can proceed with the IPO.

(ii) A company can proceed for IPO, if value of monetary assets is up to 50% of the Net Tangible Assets. In case monetary assets is ₹ 4 Crore in 2016-2017 i.e. 50% of Net Tangible Asset. Hence, RP Ltd. can still proceed for IPO.

As per SEBI regulation, if more than 50% of the net tangible assets are held in monetary assets, the issuer has utilized or made firm commitment to utilize such

basis, for the preceding one full year has been earned by it from the activity indicated by its new name.

Alternative Norms [Regulation 6(2)]: An issuer not satisfying above conditions shall be eligible to make IPO 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 (QIB)** and to refund the full subscription money if it fails to do so.

Q9. What do you understand by Initial Public Offer (IPO)? State the eligibility requirements for an Initial Public Offer under Regulation 6(1) of SEBI (ICDR) Regulations, 2018. [June 2024 (5 Marks)]

Ans.:

Initial Public Offer (IPO): Initial Public Offer 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.

Eligibility requirements for an initial public offer: [Regulation 6(1)]: An issuer shall be eligible to make an Initial Public Offer (IPO) only if it meets all the following conditions:

- (1) Assets Criteria:** The issuer has net tangible assets of at least ₹ 3 Crore, calculated on a restated and consolidated basis, in each of the preceding three full years (of 12 months each), of which not more than 50% are 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. The limit of 50% on monetary assets shall not be applicable in case the IPO is made entirely through an Offer for Sale (OFS).

- (2) Profit Criteria:** The issuer has an average operating profit of at least ₹ 15 Crore, calculated on a restated and consolidated basis, during the preceding 3 years (of 12 months each), with operating profit in each of these preceding 3 years.
- (3) Net-worth Criteria:** The issuer has a net worth of at least ₹ 1 Crore in each of the preceding 3 full years (of twelve months each), calculated on a restated and consolidated basis.
- (4) Name Criteria:** If the issuer has changed its name within the last 1 year, at least 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 its new name.

Alternative Norms [Regulation 6(2)]: An issuer not satisfying above conditions shall be eligible to make IPO 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 (QIB)** and to refund the full subscription money if it fails to do so.

Q10. RP Ltd. is planning to issue an IPO in 2019 for which a draft offer document is proposed to be filed in September, 2019. The following data is available regarding the company:

	(₹ in Crore)		
	2015-2016	2016-2017	2017-2018
Net Tangible Assets	5.00	8.00	7.00
Monetary Assets	1.00	3.00	3.00
Net Worth	3.00	4.00	5.00

(i) Advice the company whether they can proceed with the IPO.

(ii) Will your answer be different if value of monetary assets is ₹ 4 Crore in 2016-2017?

(iii) How will you deal with the situation, if company has monetary assets of ₹ 5 Crore in the year 2017-2018? [Dec. 2020 (5 Marks)]

Ans.:

- Regulation 6 of the SEBI (ICDR) Regulations, 2018 deals with the eligibility requirement of an IPO.

The provisions pertaining to Net Tangible Assets, Monetary Assets and Net worth are as under:

(a) The issuer has net tangible assets of at least ₹ 3 Crore 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.

(b) The issuer has a net worth of at least ₹ 1 Crore in each of the preceding three full years, calculated on a restated and consolidated basis.

In the given case, RP Ltd. has net tangible assets of at least ₹ 3 Crore in 3 years and Net worth of at least ₹ 1 Crore. Monetary assets are also within the threshold limit of 50% in each year, thereby satisfying all the conditions. Therefore, RP Ltd. can proceed with the IPO.

- A company can proceed for IPO, if value of monetary assets is up to 50% of the Net Tangible Assets. In case monetary assets is ₹ 4 Crore in 2016-2017 i.e. 50% of Net Tangible Asset. Hence, RP Ltd. can still proceed for IPO.

As per SEBI regulation, if more than 50% of the net tangible assets are held in monetary assets, the issuer has utilized or made firm commitment to utilize such

excess monetary assets in its business or project. Therefore, if monetary assets are ₹ 5 Crore in 2017-2018, the company should have made firm commitment to utilize such excess monetary assets in its business or project, otherwise the company will have to adopt route given in Regulation 6(2).

Q11. Ultra-Information Services Limited, provides IT and ITES services. The Board of Directors of the Company want to go for Initial Public Offer (IPO) to raise funds for expansion of the Company. During the previous year, the Company started a new line of business of providing aeronautical designs to an Australian entity and accordingly changed its name to Ultra Aero Technology Services Limited. As a Company Secretary, advise the Board of Directors about eligibility for an IPO.

[Dec. 2021 (5 Marks)]

Ans.: As per Regulation 6(1) of the SEBI (ICDR) Regulations, 2018, an issuer shall be eligible to make an IPO only if, in case the issuer has changed its name within the last one year, at least 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.

Hence, based on the above it can be concluded that as the Company has changed its name in the previous year, it would be eligible for an IPO, if at least 50% of the revenue calculated on a restated and consolidated basis, for the preceding one full year has been earned from its aeronautical designing business.

Regulation 6(2) provides that an issuer not satisfying above conditions shall be eligible to make IPO 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 (QIB)** and to refund the full subscription money if it fails to do so.

Therefore, Ultra Aero Technology Services Limited may also opt for this route if the conditions specified in Regulation 6(1) are not satisfied

ISSUE OF WARRANTS

Q12. Warrant cannot be issued along with public issue or right issue of specified securities. Comment.

[Dec. 2017 (5 Marks)]

Or

The Board of Directors of Minto Limited wanted to set up a new production plant at Manesar. In the Board Meeting where the budgets were being discussed, one Director suggested that funds can be raised by issuing warrants to fund the new project. As a Company Secretary, advise the Board of Directors, whether the Company can issue warrants.

[Dec. 2021 (5 Marks)]

Ans.: Warrants are securities that give the holder the right, but not the obligation, to buy a certain number of securities (usually the issuer's common stock i.e. equity shares) at a certain price before a certain time.

Occasionally, companies offer warrants for direct sale or give them to employees as incentive, but the vast majority of warrants are "attached" to newly issued bonds or stock.

Issue of warrants [Regulation 13]: An issuer shall be eligible to issue warrants in an initial public offer subject to the following:

- Tenure of such warrants:** The tenure of such warrants shall not exceed 18 months from the date of their allotment in the initial public offer.
- No. of warrants:** A specified security may have one or more warrants attached to it.
- Price & Consideration:** 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.
- Forfeiture of warrant:** 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.

Similar provisions are also applicable for issue of warrants in right issue. [Regulation 67]

Accordingly, Minto Ltd. can issue warrants after complying with the aforementioned conditions.

Q13. Prime Ltd. issued some warrants which allowed the holders to purchase, with one warrant, one equity share at ₹ 18.275 per share. The equity share was quoted at ₹ 25 per share and the warrant was selling at ₹ 9.50. In this case, you are required to compute –

(i) The minimum price of warrant and

(ii) The warrant premium

[June 2016 (4 Marks)]

Ans.: Value of warrant is calculated as follows:

Condition	Minimum value of warrant
Current market price > Exercise price	(Current market price – Exercise price) × N
Current market price < Exercise price	Warrant has no value

Thus,

$$\text{Value of warrant} = 25 - 18.275 = 6.725$$

$$\text{Warrant premium} = 9.50 - 6.725 = 2.775$$

Q14. ABC Company Ltd. had issued 2000 equity shares of ₹ 80 each with attachable warrant on 20th June, 2018. The warrant can be exchanged in equity in the proportion of 1:1. S, a shareholder who was allotted 200 equity shares with attachable warrant on 20th June, 2018 wants to know the warrant premium if the market value of warrant is ₹ 18 and exercise price is ₹ 70.

(i) Calculate the warrant premium for S.

(ii) What are the conditions of eligibility of ABC Company Ltd to issue Warrant?

(iii) When ABC Company can forfeit the warrant?

[Dec. 2021 (2 + 2 + 1 = 5 Marks)]

Ans.:

(i) **Value of warrant & warrant premium:** Value of warrant is calculated as follows:

Condition	Minimum value of warrant
Current market price > Exercise price	(Current market price – Exercise price) × N
Current market price < Exercise price	Warrant has no value

Thus,

$$\text{Value of warrant} = 80 - 70 = 10$$

$$\text{Warrant premium} = 18 - 10 = 8$$

(ii) **Eligibility condition for issuance of warrant:** Please refer to answer of Question No. 13.

(iii) **Forfeiture of warrant:** Please refer to answer of Question No. 11.

PROMOTERS CONTRIBUTION

Q15. What is the lock-in period for promoter's contribution?

[Dec. 2011 (4 Marks)]

Or

Write short note on: Lock-in period

[Dec. 2011 (4 Marks)]

Or

Explain the term 'lock-in period' associated with public offering of equity shares.

[June 2013 (4 Marks)]

Ans.: Lock-in means promoters or other specified persons cannot sale the shares to others during prescribed period. The idea is that promoter should have stake in

the company. Moreover, they are not expected to make profit by selling the shares which earlier they had.

Lock-in of specified securities held by the promoter's (in case of IPO)

[Regulation 16]: The specified securities held by the promoters shall not be transferable ("locked-in") for the periods as stipulated hereunder:

(1) **Lock-in for minimum promoter's contribution:** Minimum promoter's contribution including contribution made by alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with IRDA, shall be locked-in for a period of **18 months** from the date of allotment in IPO.

However, in case the majority of the issue proceeds excluding the portion of offer for sale is proposed to be utilized for capital expenditure, then the lock-in period shall be **3 years** from the date of allotment in IPO.

(2) **Lock-in for excess promoter's contribution:** Promoter's holding in excess of minimum promoter's contribution shall be locked-in for a period of **6 months** from the date of allotment in the initial public offer.

However, in case the majority of the issue proceeds excluding the portion of offer for sale is proposed to be **utilized for capital expenditure**, then the lock-in period shall be **1 year** from the date of allotment in the initial public offer.

(3) **Lock-in for SR equity shares:** The 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*.

Lock-in of specified securities held by the promoters (in case of FPO)

[Regulation 115]: The specified securities held by the promoters shall not be transferable ("locked-in") for the periods as stipulated hereunder:

(1) **Lock-in for minimum promoter's contribution:** Minimum promoters contribution including contribution made by alternative investment funds, or foreign venture capital investors, as applicable, shall be locked-in for a period of **18 months** from the date of allotment of the FPO.

However, in case the majority of the issue proceeds excluding the portion of offer for sale is proposed to be utilized for capital expenditure, then the lock-in period shall be **3 years** from the date of allotment in IPO.

(2) **Lock-in for excess promoter's contribution:** Promoters holding in excess of minimum promoters' contribution shall be locked-in for a period of **6 months**.

However, in case the majority of the issue proceeds excluding the portion of offer for sale is proposed to be utilized for capital expenditure, then the lock-in period shall be **1 year** from the date of allotment in IPO.

- (3) **Lock-in for SR equity shares:** The SR equity shares shall be under lock-in until their conversion to equity shares having voting rights same as that of ordinary shares.

Q16. Write short note: Minimum Promoters Contribution
[June 2012 (4 Marks)], [Dec. 2012 (4 Marks)]

Ans.: Promoters must have some reasonable contribution in the company. If they have no stake in the company, they are less likely to be less careful.

Minimum Promoters Contribution [Regulation 14]:

- (1) The promoters of the issuer shall hold at least 20% of the post-issue capital.

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 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.

The requirement of minimum promoters' contribution shall not apply in case an issuer does not have any identifiable promoter.

- (2) The minimum promoter's contribution shall be as follows:

- (a) The promoters shall contribute 20%, either by way of equity shares, including SR equity shares held or by way of subscription to convertible securities. 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. 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.

- (3) The promoters shall satisfy the requirements of minimum contribution at least one day prior to the date of opening of the issue.
- (4) In case the promoters have to subscribe to equity shares or convertible securities towards minimum promoters contribution, the amount of promoters contribution 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.

Where the promoters contribution has already been brought in and utilized, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document. Where the minimum promoters contribution is more than ₹ 100 Crore and IPO is for partly paid shares, the promoters shall bring in at least ₹ 100 Crore 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.

Q17. Critically examine: Promoters contribution to be brought in before public issue opens. [Dec. 2018 (4 Marks)]

Or

Explain minimum promoters contribution to be brought in before public issue open under regulation 14(3) & (4). [Dec. 2021 (5 Marks)]

Ans.: As per Regulation 14(3) of the SEBI (ICDR) Regulations, 2018, the promoters shall satisfy the requirements of minimum contribution at least one day prior to the date of opening of the issue.

As per Regulation 14(4), in case the promoters have to subscribe to equity shares or convertible securities towards minimum promoters contribution, the amount of promoters contribution 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.

Where the promoters contribution has already been brought in and utilized, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document. Where the minimum promoters contribution is more than ₹ 100 Crore and IPO is for partly paid shares, the promoters shall bring in at least ₹ 100 Crore 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.

Q18. After the Initial Public Offer, the equity capital of promoters group holding in a listed company is ₹ 160 Crore. The post issue equity capital of the company is ₹ 600 Crore. The promoters group holding includes (acquired during previous year):

- (i) ₹ 20 Crore equity capital allotted in consideration of transfer of Technical knowhow by the promoters.

(ii) ₹ 10 Crore equity capital pledged with bank.

Whether the promoters group is satisfying minimum promoters contribution requirement as per SEBI regulations? Explain.

[Dec. 2019 (5 Marks)]

Ans.: As per Regulation 14 of the SEBI (ICDR) Regulations, 2018, the promoters of the issuer shall hold at least 20% of the post-issue capital.

Since post issue capital of the company is ₹ 600 Crore, the promoters shall hold ₹ 120 Crore equity share capital of the company. [₹ 600 Crore × 20% = ₹ 120 Crore]

As per Regulation 15, for the computation of minimum promoter's contribution, the following specified securities shall not be eligible:

(a) Securities acquired during the preceding 3 years, if these are acquired for consideration other than cash and revaluation of assets or capitalization of intangible assets is involved in such transaction.

(b) Securities pledged with any creditor.

Thus, ₹ 20 Crore equity capital allotted in consideration of transfer of technical knowhow and ₹ 10 Crore equity capital pledged with bank is ineligible for minimum promoter's contribution.

Eligible promoters contribution = ₹ 160 Crore – ₹ 20 Crore – ₹ 10 Crore = ₹ 140 Crore.

Short fall = ₹ 140 Crore – ₹ 110 Crore = ₹ 30 Crore.

Q19. As per Regulations 16 and 115 of the SEBI (ICDR) certain number of pre-issue securities of promoters is not transferrable for a certain period of time. By referring to the above regulations, state the minimum lock-in period in following cases:

(i) If the majority of the issue proceeds invested in purchase of plant and machinery.

(ii) Promoter's holding 40% of post-issue capital.

[Dec. 2023 (5 Marks)]

Ans.: Lock-in of specified securities held by the promoters [Regulations 16(1) & 115 of the SEBI (ICDR) Regulations, 2018]:

The specified securities held by the promoters shall not be transferable for the periods as stipulated below:

(a) Minimum promoter's contribution including contribution made by alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with IRDA, shall be locked-in for a period of 18 months from the date of allotment in the initial public offer.

However, in case the majority of the issue proceeds excluding the portion of offer for sale is proposed to be utilized for capital expenditure, then

the lock-in period shall be 3 years from the date of allotment in the initial public offer.

(b) Promoter's holding in excess of minimum promoter's contribution shall be locked-in for a period of 6 months from the date of allotment in the initial public offer.

However, in case the majority of the issue proceeds excluding the portion of offer for sale is proposed to be utilized for capital expenditure, then the lock-in period shall be 1 year from the date of allotment in the initial public offer.

Explanation: "Capital Expenditure" shall include civil work, miscellaneous fixed assets, purchase of land, building and plant and machinery, etc.

Considering above provisions, answer to given case is as follows:

(i) If the majority of the issue proceeds invested in purchase of plant and machinery then the lock-in period shall be 3 years from the date of allotment in the initial public offer.

(ii) If promoter's holding is 40% of post-issue capital, excess of minimum promoter's contribution [i.e. 20% (40% – 20%)] shall be locked-in for a period of 6 months from the date of allotment in the initial public offer. In case the majority of issue proceeds excluding the portion of offer for sale are proposed to be utilized for capital expenditure, then the lock-in period shall be 1 year from the date of allotment in the initial public offer.

DISCLOSURES & FILING OF OFFER DOCUMENTS

Q20. State the disclosures required to be made in the "draft offer document" and "offer document" pursuant to Regulation 24 of the SEBI (ICDR) Regulations, 2018.

Ans.: Disclosures in the draft offer document and offer document [Regulation 24]:

- (1) The draft offer document and offer document shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision.
- (2) The red-herring prospectus, and prospectus shall contain: (a) disclosures specified in the Companies Act, 2013 and; (b) disclosures specified in Part A of Schedule VI.
- (3) The lead manager shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft offer document and the offer document.
- (4) The lead manager shall call upon the issuer, its promoters and its directors or in case of an offer for sale, also 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 these regulations.

- (5) The lead manager shall ensure that the information contained in the draft offer document and offer document and the particulars as per restated audited financial statements in the offer document are not more than 6 months old from the issue opening date.

Q21. State the compliance required to be made for making available "Draft Offer Document" and "Offer Document" to be available to the public.

Ans.: Draft offer document and offer document to be available to the public [Regulation 26]:

- (1) The draft offer document filed with the SEBI shall be made public for comments, if any, for a period of at least 21 one days from the date of filing, by hosting it on the websites of the issuer, the SEBI, stock exchanges where specified securities are proposed to be listed and lead managers associated with the issue.
- (2) The issuer shall, within two days of filing the draft offer document with the 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 the SEBI and inviting the public to provide their comments to the SEBI, the issuer or the lead managers in respect of the disclosures made in the draft offer document.
- (3) The lead manager shall, after expiry of stipulated period, file with the SEBI, details of the comments received by them or the issuer from the public, on the draft offer document, during that period and the consequential changes, if any, that are required to be made in the draft offer document.
- (4) The issuer and the lead manager 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.
- (5) The lead manager 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

Q22. Technopoly Ltd., an unlisted public company, having a paid-up equity share capital of ₹ 3.00 Crore consisting of 30,00,000 equity shares of ₹ 10 each fully paid-up proposes to reduce the denomination of equity shares to less than ₹ 10 per share and make the initial public offer of equity shares at a premium. Whether it is possible for the company to issue shares at a denomination of less than ₹ 10? Based on the above

facts, you are required to state the minimum issue price, with reference to the provisions of SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2018. [Dec. 2018 (4 Marks)]

Ans.: Par value means face value of shares. It is the value per unit of shares disclosed in memorandum of the company.

Face value of equity shares [Regulation 27]: Norms relating to 'face value' are as follows:

- (a) Face value can be below ₹ 10. However, face value should be in multiple of Rupee i.e. ₹ 2, ₹ 3, ₹ 5 etc. Face value should not be in decimal of a rupee.
- (b) Face value and statement about the issue price being "X" time of the face value should be included in offer document and application form in identical size as that of issue or price band.

Thus, Technopoly Ltd. can reduce the denomination of equity shares less than ₹ 10 per share.

Q23. Write a short note on: Price and Price Band

[June 2017 (4 Marks)]

Or

Explain the term 'Price Band' associated with public offering of equity shares. [June 2013 (4 Marks)]

Ans.: Price: There is no restriction on the price at which shares can be issued. The pricing can be decided by the issuer and Lead Merchant Banker. They can charge any price which they feel market can bear, but justification for price is required to be given in offer document.

Price band: 'Price Band' is a value-setting method in which a seller indicates an upper and lower cost range, between which buyers are able to place bids. The price band's floor and cap provides guidance to the buyers. This type of auction pricing technique is often used with IPOs.

Regulation 29 of the SEBI (ICDR) Regulations, 2018 provides that the issuer may mention a 'price' or a 'price band' in the offer document (in case of a fixed price issue) and a floor price or a 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 ROC.

However, the prospectus filed with the ROC shall contain only one price or the specific 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**. [For example, price band of ₹ 100 – ₹ 120 is allowed but not ₹ 100 – ₹ 121]

However, the cap of the price band shall be at least 105% of the floor price.

Q24. Can issuer company offer specified securities at different prices? What are the conditions laid down under the SEBI investor protection regulations with regard to differential pricing of securities?

[Dec. 2012 (4 Marks)]

Or

Explain the following term 'Differential Pricing' associated with public offering of equity shares.

[June 2013 (4 Marks)]

Or

A company cannot offer shares at different prices to different sets of people in a particular public issue. Comment.

[Dec. 2013 (4 Marks)], [Dec. 2015 (5 Marks)]

Or

Can a company issue shares at differential price in a public issue? If yes, to whom and under what circumstances the shares can be issued at differential price?

[Dec. 2016 (4 Marks)]

Ans.: Issue Price: There is no restriction on the price at which shares can be issued. The pricing can be decided by the issuer and Lead Merchant Banker. They can charge any price which they feel market can bear, but justification for price is required to be given in offer document.

When a specific category is offered shares at a price different than the other categories, it is called as differential pricing.

Differential Pricing [Regulation 30]: The issuer may offer its specified securities at different prices, subject to the following:

- Retail individual investors or retail individual shareholders or employees entitled for reservation 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, excluding anchor investors.
- In case of a book built issue, the price of the specified securities offered to the anchor investors shall not be lower than the price offered to other applicants.
- In case the issuer opts for the alternate method of book building process, the issuer may offer the specified securities to its employees at a price not lower than by more than 10% of the floor price.

As per Regulation 128, in case of Further Public Offer which is part of a composite issue, the price of specified securities offered in 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.

Discount, if any, shall be expressed in rupee terms in the offer document.

Q25. Write a short note on: Price and Price Band

[June 2017 (4 Marks)]

Or

Explain the term 'Price Band' associated with public offering of equity shares.

[June 2013 (4 Marks)]

Ans.: Price: There is no restriction on the price at which shares can be issued. The pricing can be decided by the issuer and Lead Merchant Banker. They can charge any price which they feel market can bear, but justification for price is required to be given in offer document.

Price band: 'Price Band' is a value-setting method in which a seller indicates an upper and lower cost range, between which buyers are able to place bids. The price band's floor and cap provides guidance to the buyers. This type of auction pricing technique is often used with IPOs.

Regulation 29 of the SEBI (ICDR) Regulations, 2018 provides that the issuer may mention a 'price' or a 'price band' in the offer document (in case of a fixed price issue) and a floor price or a 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 ROC.

However, the prospectus filed with the ROC shall contain only one price or the specific 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**. [For example price band of ₹ 100 – ₹ 120 is allowed but not ₹ 100 – ₹ 121]

However, the cap of the price band shall be at least 105% of the floor price.

Q26. A company is planning for Initial Public Offer of its equity shares. It has decided differential pricing for Retail Individual Investors (RII) and QIBs and Non-Institutional Investors (NIIs). The proposed price for RII is ₹ 250 and for QIB and NII is ₹ 300. Examine the validity of proposal of the company in light of SEBI regulations. What will be your answer if company is proposing ₹ 280 to anchor investors in book building issue? Explain.

[Dec. 2019 (4 Marks)], [June 2022 (5 Marks)]

Ans.: Differential Pricing [Regulation 30]: Please refer to answer of Question No. 23.

Considering above provisions, answer to given case is as follows:

- Price offered to Qualified Institutional Buyer (QIB) and Non-Institutional Investors (NII) is ₹ 300. Thus, company can offer lower price to retail individual investors (RII) by 10% i.e. ₹ 270. It cannot offer price at ₹ 250.

Price of the securities offered to the anchor investors shall not be lower than the price offered to other applicants. As other applicants (QIB and FII) are offered price of ₹ 300, the company cannot offer price of ₹ 280 to anchor investors.

ISSUANCE CONDITIONS & PROCEDURE

Q27. Briefly explain provisions related to "Issue-related advertisements".
[June 2011] (2 Marks)]

Ans.: Issue-related advertisements [Regulation 43]:

- (1) 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 ROC, 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.
- (2) The pre-issue advertisement shall be in the format and shall contain the disclosures specified in Part A of Schedule X. 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 pursuant to Regulation 29(4).
- (3) 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.
- (4) 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.

Q28. Write a short note on: Period of subscription
[Dec. 2011 (4 Marks)]

Or

Explain the term 'period of subscription' associated with public offering of equity shares.
[June 2013 (4 Marks)]

Ans.: Period of subscription [Regulation 46]:

- (1) An initial public offer shall be kept open for at least **3 working days** and not more than **10 working days**.
- (2) 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 3 working days.
- (3) In case of *force majeure*, banking strike or similar circumstances, the issuer may, for reasons to be recorded in writing, extend the bidding 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 3 working days.

Q29. Nischal Finance Ltd. floated IPO for 10 Crore equity shares. Due to impending war like situation. Secondary market started falling due to weak market sentiment. As a result IPO was subscribed only to the extent of 80% on the closure date (i.e. 20/06/2023).

The Company has refunded the application money on 28.6.2023. Based on the SEBI regulation, Is company action of refunding application money is justifiable?
[Dec. 2013 (5 Marks)]

Ans.: Minimum Subscription: of the SEBI (ICDR) Regulations, 2018, the minimum subscription to be received in a issue shall be at least 90% of the offer through the offer document, except in case of an offer for sale of specified securities:

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 [Regulation 46]:

- (1) An initial public offer shall be kept open for at least **3 working days** and not more than **10 working days**.
- (2) 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 **3 working days** subject to the provisions of clause (1).
- (3) In case of *force majeure*, banking strike or similar 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 **3 working days**, subject to the provisions of clause (1).

As per facts given in case, due to impending war like situation (*force majeure*), IPO was subscribed only to the extent of 80% on the closure date i.e. 20.6.2023 and hence availing the relaxation under Regulation 46(3) as stated above, the issued period can be extended by 3 working days i.e. up to 23.3.2023 (*assuming that the total period of subscription is not exceeding 10 working days*).

Thus, the new closure date will be 23.3.2023 and as per Regulation 45 the company must refund application money on or before 27.6.2023 if issue does not achieve minimum subscription. However, the company has refunded money on 28.6.2023 and hence action of refunding application money by the company is not justifiable.

Q30. Write short note on: ASBA [Dec. 2011 (4 Marks)]

Or

Explain the concept of ASBA in an IPO. [June 2012 (5 Marks)]

Ans.: ASBA: 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.

As per Regulations 35 & 132 of the SEBI (ICDR) Regulations, 2018, the issuer shall accept bids using only the ASBA facility in the manner specified by the SEBI.

Benefits of ASBA:

- ◆ The investor need not pay the application money by cheque rather block his bank account to the extent of the application money, thus continue to earn interest on application money.
- ◆ The investor does not have to bother about refunds, as in ASBA only an amount proportionate to the securities allotted is taken from the bank account when his application is selected for allotment after the basis of allotment is finalised.
- ◆ The application form is simpler.
- ◆ The investor deals with the known intermediary i.e. his own bank.
- ◆ No loss of interest, since the application amount is not debited to the savings account on application.
- ◆ Since the amount is available in the account, it is considered for calculation of the Average Quarterly Balance (AOB).
- ◆ Customer can revise or withdraw the bid before the end of the issue in the prescribed format with the bank.

UPI as a substitute of ASBA: SEBI vide its circular dated November 1, 2018 has introduced UPI in a phased manner as an alternate option for retail investors 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 3 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.

Q31. Write a short note on: Basis of Allotment [June 2012 (4 Marks)]

Ans.: Person responsible for basis of allotment: In a public issue of securities, the Executive or Managing Director of the Designated Stock Exchange along with the post issue Lead Merchant Banker and the Registrars to the Issue shall

be responsible to ensure that the basis of allotment is finalised in a *fair and proper* manner in accordance with the SEBI (ICDR) Regulations, 2018.

Allotment procedure and basis of allotment [Regulation 49]:

- (1) The issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than **1,000**.
- (2) 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. However, in case of oversubscription, an allotment of not more than **1% of the net offer to public** may be made for the purpose of making allotment in minimum lots.
- (3) 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. The value of specified securities allotted to any person, except in case of employees, shall not exceed **₹ 2 lakh** for retail investors or up to **₹ 5 lakh** for eligible employees.
- (4) 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.
- (5) 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.
- (6) The authorized employees of the designated stock exchange, along with the lead manager and registrars to the issue, shall ensure that the basis of allotment is finalized in a fair and proper manner in accordance with the procedure as specified in Part A of Schedule XIV.

Q32. What do you mean by 'reservation on competitive basis'? Who are the persons eligible in case of issue made through book building process? [June 2015 (5 Marks)]

Ans.: Reservation on a competitive basis [Regulation 33(1)]: The issuer may make reservations on a competitive basis out of the issue size excluding promoters contribution in favour of the following categories of persons:

- (a) Employees
- (b) 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 managers, registrar, syndicate members, their promoters, directors and employees and for the group or associate companies of the lead managers, registrar and syndicate members and their promoters, directors and employees.

Conditions for reservations on competitive basis [Regulation 33(2)]: The reservations on a competitive basis shall be subject to following conditions:

- (a) 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 ₹ 2 lakh.
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 ₹ 2 lakh, subject to the total allotment to an employee not exceeding ₹ 5 lakh.
- (b) Reservation for shareholders shall not exceed 10% of the issue size.
- (c) No further application for subscription in the net offer can be made by persons (except an employee and retail individual shareholder) in favour of whom reservation on a competitive basis is made.
- (d) 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.
- (e) 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 offer.

An applicant in any reserved category may make an application for any number of specified securities, but not exceeding the reserved portion for that category.

Q33. XYZ Ltd. is proposing to make a public issue of 400 Crore equity shares through the book building mechanism where 50% of the issue size is required to be allotted to Qualified Institutional Buyers. Determine the following:

- (i) The quantum available for allocation to anchor investors.
- (ii) The quantum reserved for domestic mutual funds in the anchor investor portion, if any.
- (iii) The amount, if any, required to be brought in by the anchor investors given:
 - (a) The price at which allocation is made to anchor investors is ₹ 855 per share.
 - (b) The price fixed as a result of book building is ₹ 858 per share. [Dec. 2017 (5 Marks)]

Ans.: As per Regulation 32(1) of the SEBI (ICDR) Regulations, 2018, if an issue is made through the book building process under regulation 6(1), the allocation in the net offer category shall be as follows:

- Not less than **35%** to **retail individual investors**;
- Not less than **15%** to **non-institutional investors**;
- Not more than **50%** to **qualified institutional buyers**, 5% of which shall be allocated to **Mutual Funds**.

The unsubscribed portion in either of the categories specified in clause (a) or (b) may be allocated to applicants in any other category.

In addition to 5% allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for Qualified Institutional Buyers.

Provisions of the Schedule XIII:

- ◆ Up to 60% of the portion available for allocation to qualified institutional buyers shall be available for allocation/allotment to the anchor investors.
- ◆ 1/3rd of the anchor investor portion shall be reserved for domestic mutual funds.
- ◆ The anchor investors shall pay on application the same margin which is payable by other categories of investors and the balance, if any, shall be paid within two days of the date of closure of the issue.
- ◆ If the price fixed as a result of book building is higher than the price at which the allocation is made to the anchor investors, the anchor investors shall pay the additional amount. However, if the price fixed as a result of book building is lower than the price at which the allocation is made to the anchor investors, the excess amount shall not be refunded to the anchor investors and the anchor investor shall be allotted the securities at the same price at which the allocation was made to it.
- ◆ **Margin Money:** The entire application money shall be payable as margin money by all the applicants. Payment accompanied with any revision of bid, shall be adjusted against the payment made at the time of the original bid or the previously revised bid.

Keeping in view above provisions, answer to given problem is as follows:

It assumed that an issue is made through the book building process under Regulation 6(1).

Allocation to QIBs = 400 Crore × 50% = 200 Crore.

Allocation to anchor investors = 200 Crore × 60% = 120 Crore.

Allocation to domestic mutual funds = 120 Crore × 1/3 = 40 Crore

Amount to required to be brought in by the anchor investor (assuming full amount is payable and allocation is made as stated above) = 120 Crore × 855 = ₹ 1,02,600 Crore.

Since the price fixed as a result of book building is higher than the price at which allocation is made to anchor investor, hence the anchor investor shall be required to bring in the additional amount *Le.* ₹ 3 per equity share allocated. [858 – 855]

Additional amount ₹ 858 = 120 Crore × ₹ 3 = ₹ 360 Crore.

Q34. What do you understand by Application Supported by Blocking Amount (ASBA)? How does it work in Initial Public Offer (IPO)? Describe.
[June 2018 (5 Marks)]

Ans.: ASBA: 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.

ASBA Process: In ASBA investor submits an application physically or electronically to the bank with whom the bank account to be blocked is maintained. Such bank is called "Self Certified Syndicate Bank" (SCSB). The bank then blocks the application money on the basis of an authorization.

The application money remains blocked till finalisation of the basis of allotment or till withdrawal/failure of the issue.

Thereafter, the application data uploaded by the bank in the electronic bidding system through a web enabled interface provided by the Stock Exchanges.

Once the basis of finalized allotment, the Registrar to the Issue sends request to the bank for unblocking the accounts and to transfer the requisite amount to the issuer's account.

In case of withdrawal or failure of the issue, the amount shall be unblocked by the bank on receipt of information from the pre-issue merchant bankers.

Q35. Shaurya Ltd. a company dealing with glass molding and peripherals has plans to go public and raise ₹ 1,000 Crore. They appoint CFO financial Services as their lead managers. The company's directors having no knowledge of rules and regulations argue with the lead managers that 40% of shares are to be allotted to public, 40% to QIBs, 10% to HNI clients and balance to be taken by underwriters. As a Company Secretary, explain to the directors the Regulations 40 and 136 of underwriting.
[Dec. 2019 (5 Marks)]

Ans.: Regulations 40 & 136 of the SEBI (ICDR) Regulations, 2018 deals with provisions relating to underwriting in "initial public offer" & "further public offer" respectively.

Underwriting [Regulations 40 & 136]:

Condition if issuer makes initial public offer other than through the book building process:

- (1) If the issuer making IPO/FPO, *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 the 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.
- (2) The issuer making IPO/FPO, *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 the 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.
- (3) If the issuer makes a public issue *through the book building process*:
 - (a) The issue shall be underwritten by lead managers and syndicate members. However, at least 75% of the net offer proposed to be compulsorily allotted to QIBs 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(s) and syndicate member(s), 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(s) and syndicate member(s) 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 members fail to fulfil their underwriting obligations, the lead managers shall fulfil the underwriting obligations.
 - (e) The lead managers and syndicate members shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.

- (f) In case of every underwritten issue, the lead managers shall undertake minimum underwriting obligations as specified in 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.

Q36. Hope Ltd. makes an issue worth ₹ 125 Crore to the public, out of which ₹ 20 Crore was for sale by existing shareholders. Explain the provisions regarding the utilization of proceeds and state whether any exception is available. [Dec. 2020 (5 Marks)]

Ans.: Monitoring Agency [Regulation 41]: The role of Monitoring Agency is to track the end use of proceeds of IPO.

- If the issue size, excluding the size of offer for sale by selling shareholders, exceeds ₹ 100 Crore, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by credit rating agency registered with SEBI. However, this provision 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 in the 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 45 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 on which its equity shares are listed.

In the given case, the issue exceeds ₹ 100 Crore *i.e.* excluding ₹ 20 Crore by selling shareholders and hence, a monitoring agency should be appointed to track the issue proceeds. Further the monitoring agency shall submit its report to the issuer in the specified format on a quarterly basis, till at least 95% of the proceeds of the issue excluding the proceeds raised for general corporate purposes, have been utilized.

The Board of Directors and the management of the issues shall provide their comments on the findings of the monitoring agency.

The issuer shall, within 45 days from the end of the 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 exchanges on which its equity shares are listed.

Q37. X Ltd. wants to issue 1,000 shares through a book built offer within a Price Band of ₹ 130 to ₹ 150. Bids are received as follows:

Sl. No.	Bid Price	No. of Shares	Total Demand
1	₹ 150	200	200

Sl. No.	Bid Price	No. of Shares	Total Demand
2	₹ 140	300	500
3	₹ 138	500	1,000
4	₹ 130	1,000	2,000

- 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?
- What would be the allocation pattern, presuming the company fulfils the eligibility criteria regarding net tangible assets, average operating profit, net worth etc.?
- What would be allocation pattern, if the company does not meet the criteria as mentioned above in question No. (b) as above

[June 2022 (5 + 5 + 5 = 15 Marks)]

Ans.: Keeping in view provisions of the SEBI (ICDR) Regulations, 2018, answer to given case is as follows:

- Arrange the data given in problem from 'high price bid' to 'low price bid' as shown below.

Bid	Bid Price	Demand (No. of shares)	Cumulative Demand
1	150	200	200
2	140	500	500
3	138	1,000	1,700
4	130	2,000	3,700

The total bids from Bidders 1 to 3 ensure all 1,000 shares will be sold (200 + 500 + 300 (out of 1,000 shares)). The cut-off price is therefore Bid 3 price = ₹ 138.

Bidders 1 to 2 will get full allotment of 200 shares and 500 shares respectively.

Bidder 3 will get proportionate allotment of 300 shares out 1,000 share applied by him.

On allotment, the extra amount paid will be refunded to the investor. Since the cut-off price is ₹ 138, the Bidder 1 who applied 200 shares will be allotted shares at cut-off price at ₹ 27,600 (200 × ₹ 138). The balance ₹ 2,400 (200 × ₹ 12) will be refunded to the investor. Bidders 2 will get the refund accordingly.

The company may decide the cut-off price at a price lower than the price at which the issue is subscribed for the benefit of the investors. Book built issue may also have a clause which allows allotment to retail investors at a price, which is at a discount to the cut off price, which cannot, however

exceed 10% of the price at which shares are allotted to the other category of investors.

(b) As per Regulation 32(1) of the SEBI (ICDR) Regulations, 2018, if an issue is made through the book building process under Regulation 6(1), the allocation in the net offer category shall be as follows:

- Not less than **35%** to **retail individual investors**;
- Not less than **15%** to **non-institutional investors**;
- Not more than **50%** to **qualified institutional buyers**, 5% of which shall be allocated to **Mutual Funds**.

The unsubscribed portion in either of the categories specified in clause (a) or (b) may be allocated to applicants in any other category.

In addition to 5% allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for Qualified Institutional Buyers.

(c) As per Regulation 32(2) of the SEBI (ICDR) Regulations, 2018, if an issue is made through the book building process under Regulation 6(2), the allocation in the net offer category shall be as follows:

- Not more than **10%** to **retail individual investors**
- Not more than **15%** to **non-institutional investors**
- Not less than **75%** to **qualified institutional buyers**, 5% of which shall be allocated to **Mutual Funds**.

The unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

In addition to 5% allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for Qualified Institutional Buyers in accordance with the conditions specified in this regard in **Schedule XIII**.

Q38. What are the amended allocation criterion in the non-institutional investors category, if an issue is made through book-building process?

[Dec. 2022 (4 Marks)]

Ans.: Regulation 32 of the SEBI (ICDR) Regulation, 2018 makes following provisions in relation to "allocation in the net offer":

(1) **If an issue is made through the book building process under Regulation 6(1):** The allocation in the net offer category shall be as follows:

- (a) Not less than **35%** to **retail individual investors**
- (b) Not less than **15%** to **non-institutional investors**
- (c) Not more than **50%** to **qualified institutional buyers**, 5% of which shall be allocated to **Mutual Funds**.

The unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in any other category.

In addition to 5% allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for Qualified Institutional Buyers.

(2) **If an issue is made through the book building process under Regulation 6(2):** The allocation in the net offer category shall be as follows:

- Not more than **10%** to **retail individual investors**
- Not more than **15%** to **non-institutional investors**
- Not less than **75%** to **qualified institutional buyers**, 5% of which shall be allocated to **Mutual Funds**.

The unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

In addition to 5% allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for Qualified Institutional Buyers in accordance with the conditions specified in this regard in **Schedule XIII**.

(3) **Allocation to Anchor Investors:** 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.

(4) **Allocation in non-institutional investors category:** In an issue made through book building process, the allocation in the non-institutional investors category shall be as follows:

- (a) 1/3rd of the portion available to non-institutional investors shall be reserved for applicants with application size of more than ₹ 2 lakh and up to ₹ 10 lakh.
- (b) 2/3rd of the portion available to non-institutional investors shall be reserved for applicants with application size of more than ₹ 10 lakh.

However, the unsubscribed portion in either of the sub-categories (a) or (b), may be allocated to applicants in the other sub-category of non-institutional investors.

Q39. Is there any mechanism for monitoring of use of proceeds raised through public issue? Explain briefly.

[Dec. 2022 (4 Marks)]

Ans.: **Monitoring Agency [Regulation 41]:** The role of Monitoring Agency is to track the end use of proceeds of IPO.

- (1) If the issue size, excluding the size of offer for sale by selling shareholders, exceeds ₹ **100 Crore**, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by credit rating agency registered with SEBI. *However, this provision shall not apply to an issue of specified*

securities made by a bank or public financial institution or an insurance company.

- (2) The monitoring agency shall submit its report to the issuer in the on a quarterly basis, till 100% of the proceeds of the issue, have been utilized.
- (3) The board of directors and the management of the issuer shall provide their comments on the findings of the monitoring agency.
- (4) The issuer shall, within 45 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 on which its equity shares are listed.

Q40. What do you understand by the term ASBA? Is it mandatory for investor to submit application for "Right Issue" through ASBA?

[June 2023 (5 Marks)]

Ans.: Application Supported by Blocked Amount (ASBA): ASBA stands for "Application Supported by Blocked Amount" which is a mechanism whereby an application is made 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 blocked in applicant's own bank account and if the shares are allotted to him in IPO, same is released to the issuer company.

The concept of ASBA was introduced by SEBI through the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (now SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018). The advantage is that until the money moves out of the investor's account, the investor continues to earn interest, which was not the case earlier since the money used to move out of the investor's account to that of the issuer.

SEBI vide its circular dated January 22, 2020 made it mandatory that Application for a rights issue shall be made using ASBA facility.

EXIST OPPORTUNITY FOR DISSENTING SHAREHOLDERS

Q41. XYZ Ltd. made a public issue of equity shares in September, 2014 and sought listing of BSE and NSE. Soon, thereafter, the promoters of the company started contemplating a change in the Objects Clause mentioned in the prospectus. To give effect to the same the company convened an extraordinary general meeting of shareholders in November 2015. Though the resolution was passed by the company there were nevertheless, the dissenting shareholders too. The promoters decide to provide an exit opportunity to the dissenting shareholders. In the light of the above, answer the following questions:

- (i) Is this act of the promoters justified? Highlight the relevant regulatory legal framework for the same?

(ii) Who are the dissenting shareholders?

- (iii) Enumerate the conditions required to be complied with to give effect to this recourse which was availed by the promoters. **[Dec. 2017 (6 Marks)]**

Or

Define "Dissenting shareholders". What are the conditions for applicability of Exit offers by dissenting shareholders according to SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2018?

[Dec. 2018 (4 Marks)]

Ans.: As per Section 13(8) of the Companies Act, 2013, a company which has raised money from public through prospectus and still has any unutilized amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and —

- (i) The details in respect of such resolution shall also be published in the newspapers (*one in English and one in vernacular language*) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, indicating the justification for such change.
- (ii) The dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the SEBI.

As per Section 27 of the Companies Act, 2013 a company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except subject to the approval of, or except subject to an authority given by the company in general meeting by way of special resolution.

The details, as may be prescribed, of the notice in respect of such resolution to shareholders, shall also be published in the newspapers (*one in English and one in vernacular language*) in the city where the registered office of the company is situated indicating clearly the justification for such variation. Such company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the SEBI by making regulations in this behalf.

Post-listing exit opportunity for dissenting shareholders [Regulation 59]:

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. However, the exit offer shall not apply where there are neither any identifiable promoters nor any shareholders in control of the issuer.

Provisions of Schedule XX of the SEBI (ICDR) Regulations, 2018 are discussed below:

Dissenting Shareholders: Dissenting shareholders means those shareholders who have voted against the resolution for change in objects or variation in terms of a contract relating to objects, referred to in the offer document of the issuer.

Frequently traded shares: Frequently traded shares shall have the same meaning as assigned to it in the SEBI (SAST) Regulations, 2011.

Conditions for exit offer: The promoter or the shareholders in control, as the case may be, shall make an exit offer to the dissenting shareholders in following cases:

- 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.
- If 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.

Manner of providing exit to dissenting shareholders:

- ◆ Notice proposing the passing of special resolution for changing the objects of the issue and varying the terms of contract relating to objects, referred to in the offer document, shall also contain information about the provision for an exit offer to the dissenting shareholders.
- ◆ A statement to the effect that the promoter/shareholders in control shall provide an exit opportunity to the dissenting shareholders shall 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 stock exchange, in terms of the provisions of the SEBI (LODR) Regulations, 2015.
- ◆ The issuer shall also submit the list of dissenting shareholders, as certified by its compliance officer, to the stock exchanges.
- ◆ The promoter/shareholders in control, as the case may be, shall appoint a merchant banker and finalize the exit offer price in accordance with these regulations.
- ◆ The issuer shall intimate the stock exchange about the exit offer to dissenting shareholders and the price at which such offer is being given.

- ◆ The stock exchange shall, on receipt of such intimation, disseminate the same to the public within 1 working day.
- ◆ To ensure security for performance of their obligations, the promoter or shareholders in control, as the case may be, shall create an escrow account which may be interest-bearing and deposit the aggregate consideration in the escrow account at least 2 working days prior to opening of the tendering period.
- ◆ The tendering period shall start not later than 7 working days from the passing of the special resolution and shall remain open for 10 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 promoter/shareholders in control, as the case may be, shall facilitate tendering of shares by the shareholders and settlement of the same through the stock exchange mechanism as specified by SEBI for the purpose of takeover, buy-back and delisting.
- ◆ The promoter/shareholders in control, as the case may be, shall, within a period of 10 working days from the last date of the tendering period, make payment of the consideration to the dissenting shareholders who have accepted the exit offer.
- ◆ Within a period of 2 working days from the payment of the consideration, the issuer shall furnish to the stock exchange, disclosures giving details of aggregate number of shares tendered, accepted, payment of the consideration and the post-offer shareholding pattern of the issuer and a report by the lead manager that the payment has been duly made to all the dissenting shareholders whose shares have been accepted in the exit offer.

Offer not to exceed maximum permissible non-public shareholding: In the event the shares accepted in the exit offer it has to be ensured that public shareholding does not fall below the minimum permissible public shareholding under the Securities Contracts (Regulation) Rules, 1957.

Q42. M/s Highspeed Ltd. manufacturing a car components for leading car manufacturer. Its public issue of ₹ 500 Crore was fully subscribed. The public issue money ought to be utilized for setup an assembly-line for the existing business. Out of ₹ 500 Crore, the company spent ₹ 400 Crore for assembly-line. The management consultant, hired for Business Process re-engineering has suggested to invest balance amount to setup bike components manufacturing unit. You, being company secretary of the company, advise on the opinion of management consultant by referring provisions of SEBI Regulations. [June 2019 (4 Marks)]

Ans.: As per Section 13(8) of the Companies Act, 2013, a company which has raised money from public through prospectus and still has any unutilized

amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and –

- (i) The details in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, indicating the justification for such change.
- (ii) The dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the SEBI.

The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the SEBI by making regulations in this behalf.

Conditions for exit offer: The promoter or the shareholders in control, as the case may be, shall make an exit offer to the dissenting shareholders in following cases:

- (a) 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.
- (b) If 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).

As per facts given in case, Highspeed Ltd. made a public issue of ₹ 500 Crore. Out of ₹ 500 Crore, ₹ 400 Crore (80% of issue amount) was utilized by the company for set-up an assembly line for existing business. The company intends use remaining money for investing in setup of 'bike components manufacturing unit'.

Thus, if the object clause of company does not cover 'investment in setup of bike components manufacturing unit', the company must pass special resolution as required by Section 13(8) of the Companies Act, 2013. However, no exit opportunity is required to be given as per the SEBI (ICDR) Regulations, 2018 because the amount to be utilized for the objects for which the offer document was issued is more than 75% of the amount raised.

Q43. Karuna Ltd. made an Initial Public Offer (IPO) of equity shares in March, 2020 and was granted listing on stock exchange. Soon, thereafter, the promoters of the company started contemplating a change in the objects clause mentioned in the offer document. To give effect to the same, the company convened an extraordinary general meeting of shareholders in April 2020. Though the requisite resolution was passed by the

company, there were, nevertheless, the dissenting shareholders too. The promoters decided to provide an exit opportunity to the dissenting shareholders. In the light of the above, answer the following

- (i) Who are the dissenting shareholders?
- (ii) What is the eligibility of shareholders for availing the exit offer?
- (iii) Enumerate the conditions required to be complied with to give effect to this recourse which was availed by the promoters.
- (iv) How the exit offer price will be determined?

[June 2021 (7 Marks)]

Ans.: Please refer to answer of Question No. 41.

Q44. Mono Auto Limited raised ₹ 100 Crore through an IPO with manufacturing of cars as one of its main objects. However due to economic downturn, the Company wants to change its objects to designing and supply of spare parts. Some of the shareholders have voted against this resolution for change in objects. Can the Company give such shareholders an option to exit. If so, what should be the exit price to be offered?

[Dec. 2021 (3 Marks)]

Ans.: Post-listing exit opportunity for dissenting shareholders [Regulation 59]: 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. However, the exit offer shall not apply where there are neither any identifiable promoters nor any shareholders in control of the issuer.

Provisions of Schedule XX of the SEBI (ICDR) Regulations, 2018 are discussed below:

Dissenting Shareholders: Dissenting shareholders means those shareholders who have voted against the resolution for change in objects or variation in terms of a contract relating to objects, referred to in the offer document of the issuer.

Frequently traded shares: Frequently traded shares shall have the same meaning as assigned to it in the SEBI (SAST) Regulations, 2011.

Conditions for exit offer: The promoter or the shareholders in control, as the case may be, shall make an exit offer to the dissenting shareholders in following cases:

- (a) 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.
- (b) If 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).

Exit Price: The 'Exit Price' payable to the dissenting shareholders shall be the highest of the following:

- Volume-weighted average price paid or payable for acquisitions, whether by the promoters or by any person acting in concert with them, during the 52 weeks immediately preceding the relevant date.
- Highest price paid or payable for any acquisition, whether by the promoter or by any person acting in concert with them, during the 26 weeks immediately preceding the relevant date.
- Volume-weighted average market price of such shares for a period of 60 trading days immediately preceding the relevant date as traded on the 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.
- Where the shares are not frequently traded, the price determined by the promoter or shareholders having control and the lead manager 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.

RIGHTS ISSUE

Q45. Which entities are not eligible to make a rights issue under the SEBI (ICDR) Regulations, 2018?

Ans.: Entitles not eligible to make a rights issue [Regulation 61]: An issuer shall not be eligible to make a rights issue of specified securities in following cases:

- If the issuer, any of its promoters, promoter group or directors of the issuer are debarred from accessing the capital market by the SEBI.
- 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 the SEBI.
- If any of its promoters or directors is a fugitive economic offender.

Explanation: The restrictions under (a) and (b) above will not apply to the persons or entities mentioned therein who were debarred in the past by the SEBI and the period of debarment is already over as on the date of filing of the draft letter of offer with the SEBI.

Q46. ABC Ltd. is considering a right issue by issuing one share against two shares to raise funds to finance a new project requiring ₹ 4.5 Crore. The Floatation cost will be 10% of funds raised. The Company currently has 18 Lakh shares outstanding and the current price of its share is ₹ 100. The subscription price has been fixed at ₹ 50 per share.

Calculated the value of a right. [Dec. 2020 (5 Marks)]

Ans.:

Market value of 2 shares already held by a shareholder (2 × 100)	200
(+) Price required to be paid for acquiring one more share	50
Total price of 3 shares	250

$$\text{Average price of one share after right issue} = \frac{250}{3} = 83.33$$

Market Value – Average Price = Value of right

$$100 - 83.33 = 16.67$$

An alternative formula is:

$$\frac{\text{Right shares}}{\text{Total shares after right issue}} \times (\text{Cum rights price} - \text{New issue price})$$

$$\frac{1}{3} \times (100 - 50) = 16.67$$

Q47. Sunlight Solar Ltd. decides to issue six right shares for every eleven shares held. The right shares are priced at ₹ 561 each and the present cum-right price of the company's share traded in the NSE/BSE is ₹ 785. Average Floating Cost of each right share is ₹ 10. Calculate the fair value of the right. [June 2022 (5 Marks)]

Ans.:

Market value of 11 shares already held by a shareholder (11 × 785)	8,635
(+) Price required to be paid for acquiring six more share (6 × 561)	3,366
Total price of 3 shares	12,001

$$\text{Average price of one share after right issue} = \frac{12,001}{17} = 705.94$$

Market Value – Average Price = Value of right

$$785 - 705.94 = 79.06$$

An alternative formula is:

$$\frac{\text{Right shares}}{\text{Total shares after right issue}} \times (\text{Cum rights price} - \text{New issue price})$$

$$\frac{6}{17} \times (785 - 561) = 79.06$$

Q48. SEBI issued a circular recently for streamlining the process of "Rights Issue". Explain the need of this circular and the changes made therein for the process of Rights Issue. [Dec. 2022 (5 Marks)]

Ans.: SEBI circular streamlining the process of Right Issue: SEBI has streamlined the rights issue process and provided that the trading in Right Entitlements (REs) on the secondary market platform of stock exchanges commence along with the opening of the right issue and has to be closed at least 3 working days (earlier requirement of four days) prior to the closure of the rights issue. SEBI received representation from the market that in case there are trading holidays between the last date of REs trading date and issue closure, the provision of the minimum gap of 4 days may not always ensure that there are adequate days for settlement, as minimum 2 working days are required for the settlement of REs traded on last day of REs trading window. REs traded on the exchange platform have T + 2 rolling settlement.

FURTHER PUBLIC OFFER

Q49. Turnkey Ltd. is a listed company, manufacturing auto ancillary components. One of the directors of the company is a fugitive offender. The company wants to bring Further Public Offer (FPO). You being the Company Secretary of the company, advise whether the company can issue FPO. State the general conditions and the eligibility requirements for FPO under the relevant SEBI Regulations.

Ans.: As per Regulation 102 of the SEBI (ICDR) Regulation, 2018, an issuer shall not be eligible to make further public offer if any of its promoters or directors is a fugitive economic offender. Thus, Turnkey Ltd. is not eligible to make further public offer.

Eligibility requirements for Further Public Offer (FPO) [Regulation 103]:

- (1) An issuer shall be eligible to make FPO, if it has not changed its name in the last one year period immediately preceding the date of filing the relevant offer document.

However, if an issuer has changed its name in the last one year period immediately preceding the date of filing the relevant offer document, such an issuer shall make FPO if at least 50% of the revenue for the preceding one full year has been earned by it from the activity indicated by its new name.

- (2) An issuer not satisfying the above condition, shall make 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 QIBs and to refund full subscription money if it fails to make the said minimum allotment to QIBs.

General conditions [Regulation 104]:

- (1) An issuer making FPO shall ensure following:

- (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, in terms of Schedule XIX.
- (b) It has entered into an agreement with a depository for dematerialization of specified securities already issued and proposed to be issued.
- (c) All its existing partly paid-up equity shares have either been fully paid-up or have been forfeited.
- (d) It has made firm arrangements of finance through verifiable means towards 75% of the stated means of finance for the 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.

(2) 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.

(3) The amount for:

- (i) general corporate purposes, and
- (ii) such objects where the issuer company has not identified acquisition/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.

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.

FAST TRACK ISSUE

Q50. Whether fast track issue can be proceeded just like an IPO or, are any other conditions to fast track issue? Explain. [Dec. 2015 (8 Marks)]

Or

Define: Fast Track Issue

[Dec. 2016 (3 Marks)]

Or

Write short note on: Fast Track Issue

[June 2018 (4 Marks)]

Or

What are the eligibility conditions for making a Fast Track Issue (FTI)?
[June 2013 (5 Marks)]

Or

Explain the eligibility conditions for the Fast Track Follow-on Public Offer (FPO).
[June 2022 (5 Marks)]

Or

Jupitter Ltd. Got its equity shares listed on 1st April, 2020 and the management of the company wishes to issue further shares and raise capital through Fast Track in the Financial Year 2022–2023. Can the company issue shares through Fast Track FPO?

Explain the eligibility criteria and conditions for issuing shares under Fast Track FPO process.
[Dec. 2022 (5 Marks)]

Ans.: Making public issue is very time consuming and costly affair. The company has to make lot of compliance under the SEBI Regulations. To overcome this difficulty, SEBI has provided Fast Track Route to already listed companies who are coming with public issue and rights issues.

The fast-track route is an alternative to access public funds by way of further capital offerings. The facility of Fast Track Route is available to well established and compliant listed companies.

Eligibility conditions for 'Fast Track Further Public Offer' [Regulation 155]: Sub-regulations (1), (2), (3), (4), (5) and (9) of Regulation 123 [i.e. provisions relating to filing of the draft offer document and offer documents] shall not apply if the issuer satisfies the following conditions for making a further public offer through the fast track route:

- (1) **Minimum listing period:** 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.
- (2) **Shareholding of promoter group is in dematerialized form:** Entire shareholding of the promoter group of the issuer is held in dematerialized form on the reference date.
- (3) **Market Capitalization:** Average market capitalization of public shareholding of the issuer is at least ₹ 1,000 Crore in case of public issue.
- (4) **Annualized trading turnover:** Annualized trading turnover of the equity shares of the issuer during 6 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 6 months period. However, for issuers, whose public shareholding is less than 15% of its issued equity capital, the annualized 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 6 months period. [Free float shares is not defined in

the SEBI (ICDR) Regulations, 2018. Generally it means portion of shares of company that are held by public investors]

- (5) **Annualized delivery-based trading turnover:** Annualized delivery-based trading turnover of the equity shares during 6 calendar months immediately preceding the month of the reference date has been at least 10% of the annualized trading turnover of the equity shares during such 6 months period.
- (6) **Compliance with listing agreement:** The Issuer has been in compliance with the equity listing agreement or the SEBI (LODR) Regulations, 2015, as applicable, for a period of at least 3 years immediately preceding the reference date. However, if the issuer has not complied with the provisions of the listing agreement or the SEBI (LODR) Regulations, 2015, relating to composition of board of directors, for any quarter during the last 3 years immediately preceding the reference date, but is compliant with such provisions at the time of filing of red-herring prospectus, and adequate disclosures are made in the red-herring prospectus about such non-compliances during the 3 years immediately preceding the reference date, it shall be deemed as compliance with the condition. Imposition of only monetary fines by stock exchanges on the issuer shall not be a ground for ineligibility for undertaking issuances under this regulation.
- (7) **Grievances Redressed:** 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.
- (8) **No pending prosecution:** No show-cause notices, excluding proceedings for imposition of penalty, have been issued by the SEBI and pending against the issuer or its promoters or whole time directors as on the reference date.

In cases where against the issuer or its promoters or whole time directors,

- (i) show-cause notice has been issued by the SEBI or the Adjudicating Officer, in a proceeding for imposition of penalty; or
- (ii) prosecution proceedings have been initiated by the SEBI;

necessary disclosures in respect of such actions along with its potential adverse impact on the issuer shall be made in the offer document.

- (9) **Violation of securities laws:** 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 SEBI 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.
- (10) **No suspension of trading of equity shares:** Equity shares of the issuer have not been suspended from trading as a disciplinary measure during last 3 years immediately preceding the reference date.

- (11) **No conflict of interest:** There shall be no conflict of interest between the lead manager and the issuer or its group companies in accordance with the applicable regulations.
- (12) **Audit Qualifications:** 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.

PREFERENTIAL ISSUE

Q51. Preferential issue is not for retail investors. Comment.

[Dec. 2012 (4 Marks)]

Ans.: Preferential issue means issuance of equity shares to promoter group or selected investors. It covers allotment of convertible debentures or any other financial instruments that could be converted into equity shares at a later date. The investors could be institutional investors, private equity investors, high net-worth individuals, or companies.

Preferential issue is one of the key sources of funding for companies. One of the biggest advantages of a preferential issue is that the company can raise money quickly and cheaply compared with other means of raising money, say IPO or issue of shares on a rights basis.

Preferential issues and private placement is only for selected class of investors and not for the retail investors. It is like a wholesale market, where institutions with financial clout are allowed to participate.

Q52. Discuss the rules for preferential issue of shares by existing listed companies.

[Dec. 2011 (5 Marks)]

Or

Discuss briefly the SEBI Regulations for preferential issue of shares by listed companies.

[Dec. 2012 (5 Marks)]

Ans.: **Preferential Issue [Regulations 2(1)(m):** 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** 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.

To whom preferential issue cannot be made [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:

Conditions for preferential issue [Regulation 160]: A listed issuer making a preferential issue of specified securities shall ensure that:

- 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 equity shares held by the proposed allottees in the issuer are in dematerialized form before an application seeking in-principle approval is made by the issuer to the stock exchanges 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 stock exchange where the equity shares of the issuer are listed and the SEBI (LODR) Regulations, 2015, and any circular or notification issued by the SEBI thereunder.
- The issuer has obtained the Permanent Account Numbers 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.
- The issuer has made an application seeking in-principle approval to the stock exchanges, 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.

Q53. Atshwarya Ltd. proposes to make preferential issue of 10,00,000 equity shares to eligible investors. Traded turnover of equity shares of the Atshwarya Ltd. on recognized stock exchange during 240 trading days preceding the relevant date is 14% of the total number of shares.

Following share price data is made available to you by the company:

- Closing price in the market on the relevant date: ₹ 340
- 90 trading days volume weighted average price of the related equity shares quoted on the recognized stock exchange preceding the relevant date: ₹ 354
- 10 trading days volume weighted average prices of the related equity shares quoted on a recognized stock exchange preceding the relevant date: ₹ 350.

You are required answer the following:

- State the minimum price at which preferential issue of equity shares can be made by the company.
- The Articles of Association of the Atshwarya Ltd. provide for a method of determination which results in a floor price of ₹ 375. Can the same shall be considered as the floor price for the preferential issue? [Dec. 2013 (5 Marks)]

Ans.: Traded turnover of equity shares of the Aishwarya Ltd. on recognized stock exchange during 240 trading days preceding the relevant date is more than 10% of the total number of shares and equity shares of the Aishwarya Ltd. are frequently traded shares.

As per Regulation 164 of the SEBI (ICDR) Regulation, 2018, the price of equity shares which have been listed on a recognized stock exchange for a period of 90 trading days or more, the price of the equity shares to be allotted pursuant to the preferential issue shall be **not less than** higher of the following:

- (1) 90 trading days volume weighted average price of the related equity shares quoted on the recognized stock exchange preceding the relevant date: ₹ 354
- (2) 10 trading days volume weighted average prices of the related equity shares quoted on a recognized stock exchange preceding the relevant date: ₹ 350

Thus, price equity shares in preferential issue should not be less than ₹ 354 per share.

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. Thus in such case Aishwarya Ltd. can make preferential issue at a price of ₹ 375.

Q54. Distinguish between: Private Placement and Preferential Allotment [Dec. 2019 (5 Marks)]

Ans.:

Points	Private Placement	Preferential Allotment
Meaning	When an issuer makes an issue of securities to a select group of persons it is called private placement.	When a listed issuer issues shares or convertible securities, to a select group of persons it is called a preferential allotment.
Section	Private Placement is governed by section 42 of the Companies Act, 2013.	Preferential Allotment is governed by section 62(1)(c) of the Companies Act, 2013.
Offer to investors	Private placement offer letter is sent to the investors for inviting them to subscribe for shares.	No such offer document is issued to investors.
Receipt of application money	In private placement, application money can be received through cheques, demand draft or any other banking modes but not cash.	In preferential allotment in money is received in cash or kind.
Keeping of application money	In private placement, the application money is kept in the separate bank account of a scheduled commercial bank.	No such account is required in case of preferential allotment.

Points	Private Placement	Preferential Allotment
Authorization from articles	Private placement must be authorized by the articles of association of the company.	No such authorization is required in case of preferential allotment.

QUALIFIED INSTITUTIONS PLACEMENT

Q55. What do you understand by Qualified Institutions Placement (QIP)? [June 2013 (5 Marks)]

Ans.: **Qualified Institutions Placement [Regulation 2(1)(ii):** Qualified Institutions Placement means issue of eligible securities by a listed issuer to qualified institutional buyers on a private placement basis and includes an offer for sale of specified securities by the promoters or promoter group on a private placement basis, in terms of the SEBI (ICDR) Regulations, 2018.

Eligibility Conditions [Regulation 172(1): A listed issuer may make a qualified institutions placement of eligible securities if it satisfies following conditions:

- (a) **Special Resolution:** A special resolution approving QIP has been passed by its shareholders, and the special resolution shall, among other relevant matters, specify that the allotment is proposed to be made through qualified institutions placement and the relevant date referred to in Regulation 171(b).

Allotment pursuant to the special resolution shall be completed within a period of 365 days from the date of passing of the resolution.

No shareholders resolution will be required in case 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.

- (b) **Equity share of same class are already listed on stock exchange:** The equity shares of the same class, which are proposed to be allotted through QIP or 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.

- (c) **Persons related to fugitive economic offense cannot make QIP:** An issuer shall be eligible to make QIP if any of its promoters or directors is not a fugitive economic offender.

Listing of shares issued through QIP on stock exchange [Regulation 172(2): All eligible securities issued through QIP shall be listed on the recognized stock exchange where the equity shares of the issuer are listed.

Time gap between two QIP [Regulation 172(3): The issuer shall not make any subsequent QIP until the expiry of two weeks from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

ISSUE OF SECURITIES BY SMES

Q56. What do you understand by SME Exchange? State the provisions of the SEBI (ICDR) Regulations, 2018 relating to issue of securities by Small & Medium Enterprises (SMEs).

Ans.: SME Exchange [Regulation 2(1)(ddd)]: SME Exchange means a trading platform of a recognized stock exchange having nationwide trading terminals permitted by the Board to list the specified securities issued in accordance with Chapter IX [Regulations 228 to 281] and includes a stock exchange granted recognition for this purpose but does not include the Main Board:

SME not eligible to make IPO [Regulation 228]: SME shall not be eligible to make an initial public offer:

- If the issuer, any of its promoters, promoter group or directors or selling shareholders are debarred from accessing the capital market by the SEBI.
- 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 the SEBI.
- If the issuer or any of its promoters or directors is a wilful defaulter.
- If any of its promoters or directors is a fugitive economic offender.

Eligibility requirements for an initial public offer by SME [Regulation 229]:

- An issuer shall be eligible to make an initial public offer only if its post-issue paid-up capital is less than or equal to ₹ 10 Crore.
- An issuer, whose post issue face value capital is more than ₹ 10 Crore and up to ₹ 25 Crore, may also issue specified securities.
- An issuer may make an initial public offer, if it satisfies track record and/or other eligibility conditions of the SME Exchange on which the specified securities are proposed to be listed.

General Conditions [Regulation 230]: The SME making an initial public offer shall ensure that:

- It has made an application to one or more SME exchanges for listing of its specified securities on such SME exchanges and has chosen one of them as the designated stock exchange.
- It has entered into an agreement with a depository for dematerialization of its specified securities already issued and proposed to be issued.
- All its existing partly paid-up equity shares have either been fully paid-up or forfeited.
- All specified securities held by the promoters are in the dematerialized form.
- It has made firm arrangements of finance through verifiable means towards 75% of the stated means of finance for the project proposed to be funded

from the issue proceeds, excluding the amount to be raised through the proposed public offer 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.

Q57. PQR Ltd. is listed on SME platform. The company has excellent performance in terms of turnover and profit during last few years. It is interested in migrating to the Main Board. Prepare a note on the same.

[June 2021 (5 Marks)]

Ans.: Option to migration to main board [Regulation 277]: An issuer, whose specified securities are listed on SME Exchange and whose post-issue face value capital is more than ₹ 10 Crore and up to ₹ 25 Crore, may migrate its specified securities to the main board of the stock exchanges if its shareholders approve such a migration by passing a special resolution through postal ballot to this effect and if such issuer fulfils the eligibility criteria for listing laid down by the Main Board.

However, the special resolution shall be acted upon if and only if the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.

Compulsory migration to main board [Regulation 280(2)]: Where the post-issue face value capital of an issuer listed on SME exchange is likely to increase beyond ₹ 25 Crore by virtue of any further issue of capital by the issuer by way of rights issue, preferential issue, bonus issue, etc. the issuer shall migrate its specified securities listed on SME Exchange to the Main Board and seek listing of the specified securities proposed to be issued on the Main Board subject to the fulfilment of the eligibility criteria for listing of specified securities laid down by the Main Board.

However, no further issue of capital by the issuer shall be made unless –

- The shareholders of the issuer have approved the migration by passing a special resolution through postal ballot wherein the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.
- The issuer has obtained an in-principle approval from the Main Board for listing of its entire specified securities on it.

INNOVATORS GROWTH PLATFORM

Q58. Startup companies have now come up with an Initial Public offer with relaxation of many conditions applicable for Initial Public Offer. In this context, briefly, explain about the "Institutional Trading Platform (ITP)" and eligibility for listing.

[Dec. 2018 (4 Marks)]

Or

Explain the eligibility criteria for listing on Innovators Listing Growth platform. [Dec. 2019 (5 Marks)]

Ans.: Innovators Growth Platform¹ means the trading platform for listing and trading of specified securities of issuers that comply with the eligibility criteria specified in regulation 283.

¹ Substituted by the SEBI (ICDR) (Second Amendment) Regulations, 2019. Prior to its substitution, it read as "Institutional Trading Platform" means the trading platform for listing and trading of specified securities of issuers that comply with the specified eligibility criteria.

Eligibility [Regulation 283]: Following entities are eligible for listing on Innovators Growth Platform:

- (1) An issuer which is intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition shall be eligible for listing on the innovators growth platform, provided that as on the date of filing of draft information document or draft offer document with the SEBI, as the case may be, 25% of the pre-issue capital of the Issuer Company for at least a period of 2 years, should have been held by:
 - I. Qualified Institutional Buyers;
 - II. Family trust with net-worth of more than ₹ 500 Crore, as per the last audited financial statements.
 - III. Accredited Investors for the purpose of Innovators Growth Platform.
 - IV. Following regulated entities:
 - (a) Category-III Foreign Portfolio Investor.
 - (b) An entity meeting all the following criteria:
 - (i) It is a pooled investment fund with minimum assets under management of **₹150 million**.
 - (ii) It is registered with a financial sector regulator in the jurisdiction of which it is a resident.
 - (iii) It is resident of 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 Bilateral Memorandum of Understanding with the SEBI.
 - (iv) It is not resident in a country identified in the public statement of Financial Action Task Force as:
 - ◆ a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of

Terrorism deficiencies to which counter measures apply; or

- ◆ 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.

Explanation:

- (a) Following entities shall be eligible to be considered as accredited investors for the purpose of innovators growth platform:
 - (i) Any individual with total gross income of ₹ 50 lakh annually and who has minimum liquid net worth of ₹ 5 Crore.
 - (ii) Any body corporate with net worth of ₹ 25 Crore.
 - (b) Not more than 10% of the pre-issue capital may be held by Accredited Investors.
 - (c) For the purpose of accreditation: The persons/corporate bodies who wish to get accreditation for the purpose of innovators growth platform, shall approach the stock exchanges or depositories and follow the procedures prescribed by the Board and / or such stock exchange or depository for the purpose of accreditation as an Accredited Investor, from time to time.
- (2) An issuer shall be eligible for listing on the institutional trading platform if none of the promoters or directors of the issuer company is a fugitive economic offender.

Q59. Can an entity, pursue listing of its specified securities without making a public issue? Give the exemptions, if any. [June 2019 (3 Marks)]

Ans.: Listing without a public issue [Regulation 284]:

- (1) An issuer seeking listing of its specified securities without making a public offer, shall file a draft information document along with the necessary documents with the SEBI in accordance with these regulations along with the fee as specified in Schedule III of these regulations.
- (2) Draft information document shall contain disclosures as specified in Part A of Schedule VI.
- (3) The regulations relating to the following as stated under the Chapter of Initial Public Offer on Main Board shall not be applicable:
 - (i) Allotment
 - (ii) Issue opening or closing
 - (iii) Advertisements
 - (iv) Underwriting

- (v) Regulation 5(2)
 - (vi) Pricing
 - (vii) Dispatch of issue material
 - (viii) Other such provisions related to offer of specified securities to the public.
- (4) The issuer shall obtain an in-principle approval from the stock exchanges on which it proposes to get its specified securities listed.
- (5) The issuer shall list its specified securities on the recognized stock exchange within 30 days:
- (a) From the date of issuance of observations by the SEBI; or
 - (b) From the expiry of the period stipulated in Regulation 25(4), if the SEBI has not issued any such observations.

Q60. Neel Bio Tech Limited whose specified securities are traded on the "Innovators Growth Platform" (IGP) pursuant to an Initial Public Offer (IPO) would like to exit from IGP. Explain in brief the conditions under which the company can exit from the "Innovators Growth Platform" as per SEBI (ICDR) (Second Amendment) Regulations, 2021.

[June 2022 (5 Marks)]

Ans.: Regulation 290A which deals with "Exit of issuers whose securities are listed and trading on the Innovators Growth Platform pursuant to an initial public offer" has been omitted by SEBI (ICDR) (Amendment) Regulations, 2022 w.e.f. 14.1.2022. Hence, Question is not relevant for Dec. 2022 and onward exams.

Q61. Give answer with reasons with reference to SEBI regulations on minimum application size for listing in SME and Innovators Growth Platform.

[Dec. 2023 (2 Marks)]

Ans.: Minimum application size for listing in SME and Innovators Growth Platform is as under:

SME Platform	:	₹ 1 lakh
Innovators Growth Platform	:	₹ 2 lakh

This is kept higher than a regular non SME issue so that very small investors do not invest in the primary markets in these issues.

SOCIAL STOCK EXCHANGE

Q62. SEBI has recently introduced the concept of Social Stock Exchange by amending SEBI (ICDR) Regulations, 2018. In this connection, you are required to answer the following –

- (i) What do you understand by Social Stock Exchange?
- (ii) Who can access to Social Stock Exchange?

(iii) Who is required to constitute Social Stock Exchange Governing Council?

(iv) What are the requirements relating to registration for Not for Profit Organization?

(v) How Social Enterprise may raise funds on a Social Stock Exchange?

Ans.: **Social Stock Exchange [Regulation 292A(i)]:** Social Stock Exchange means a separate segment of a recognized stock exchange having nationwide trading terminals permitted to register Not for Profit Organizations and list the securities issued by Not for Profit Organizations in accordance with provisions of SEBI (ICDR) Regulations, 2018.

Access to Social Stock Exchange [Regulation 292C]: A Social Stock Exchange shall be accessible to institutional investors, non-institutional investors and retail investors.

Social Stock Exchange Governing Council [Regulation 292D]: Every Social Stock Exchange shall constitute a Social Stock Exchange Governing Council to have an oversight on its functioning.

The composition and terms of reference for such Governing Council shall be specified by the SEBI from time to time.

Requirements relating to registration for a Not for Profit Organization [Regulation 292F]:

- (1) A Not for Profit Organization shall mandatorily seek registration with a Social Stock Exchange before it raises funds through a Social Stock Exchange. However, a Not for Profit Organization may choose to register on a Social Stock Exchange and not raise funds through it.
- (2) The minimum requirements for registration of a Not for Profit Organization on a Social Stock Exchange shall be specified by the SEBI from time to time.
- (3) The Social Stock Exchange may specify the eligibility requirements for registration of a Not for Profit Organization in addition to the minimum requirements specified by the SEBI.

Fund raising by Social Enterprises [Regulation 292G]: A Social Enterprise may raise funds through following means:

- (a) A Not for Profit Organization may raise funds on a Social Stock Exchange through:
 - (i) Issuance of Zero Coupon Zero Principal Instruments to eligible investors.
 - (ii) Donations through Mutual Fund schemes as specified by the SEBI.
 - (iii) Any other means as specified by the SEBI from time to time.

(b) A For Profit Social Enterprise may raise funds through:

- (i) Issuance of equity shares on the main board, SME platform or innovators growth platform or equity shares issued to an Alternative Investment Fund including Social Impact Fund.
- (ii) Issuance of debt securities.
- (iii) Any other means as specified by the SEBI from time to time.

Explanation: Securities issued by For Profit Social Enterprises shall be listed and traded under the applicable segment of the stock exchange with an identifier stating that the scrip is that of a For Profit Social Enterprise and such For Profit Social Enterprises shall meet the eligibility criteria for the main board, SME Platform or innovators growth platform, as applicable, in addition to the other applicable criteria.

Q63. What are the eligibility conditions for being identified as "Social Enterprises" under Chapter X of SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2018? [June 2023 (5 Marks)]

Ans.: Eligibility conditions for being identified as Social Enterprise [Regulation 292E]:

- (1) 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.
- (2) In order to establish the primacy of its social intent, such Social Enterprise shall meet the following eligibility criteria:
 - (a) The Social Enterprise shall be indulged in at least one of the following activities:
 - 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.
 - Training to promote rural sports, nationally recognized sports, Paralympic sports and Olympic sports.
 - Supporting incubators of Social Enterprises.

- Supporting other platforms that strengthen the non-profit ecosystem in fundraising and capacity building.
 - Promoting livelihoods for rural and urban poor including enhancing income of small and marginal farmers and workers in the non-farm sector.
 - Slum area development, affordable housing and other interventions to build sustainable and resilient cities.
 - Disaster management, including relief, rehabilitation and reconstruction activities.
 - Promotion of financial inclusion.
 - Facilitating access to land and property assets for disadvantaged communities.
 - Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection.
 - Promoting welfare of migrants and displaced persons.
 - Any other area as identified by the SEBI or Government of India from time to time.
- (b) The Social Enterprise shall target underserved or less privileged population segments or regions recording lower performance in the development priorities of central or state governments.
 - (c) The Social Enterprise shall have at least 67% of its activities, qualifying as eligible activities to the target population, to be established through one or more of the following:
 - (i) At least 67% of the immediately preceding 3-year average of revenues comes from providing eligible activities to members of the target population.
 - (ii) At least 67% of the immediately preceding 3-year average of expenditure has been incurred for providing eligible activities to members of the target population.
 - (iii) Members of the target population to whom the eligible activities have been provided constitute at least 67% of the immediately preceding 3-year average of the total customer base and/or total number of beneficiaries.
 - (3) Corporate foundations, political or religious organizations or activities, professional or trade associations, infrastructure and housing companies, except affordable housing, shall not be eligible to be identified as a Social Enterprise.

PROCEDURE & DOCUMENTATION IN CASE OF IPO/FPO

Q64. Ajanta Car Care Ltd. successfully completed its Initial Public Offer (IPO). List out the documents to be submitted on T + 2 days for listing of IPO. [June 2022 (5 Marks)]

Ans.: List of documents to be submitted on (T + 2 days) for listing of IPO are as under:

- ◆ All due diligence certificates filed with SEBI by Merchant banker.
- ◆ Observation Letter issued by SEBI pursuant to filing of draft offer document.
- ◆ List of authorized signatories along with their specimen signatures.
- ◆ Confirmation from Lead Managers that devolvement notices have been sent to underwriters (applicable if the issue has devolved).
- ◆ Certificate from the BRLM(s) that the issue has received minimum subscription as specified under Regulation 45(1) of the SEBI (ICDR) Regulations, 2018.
- ◆ Confirmation from the company regarding the email ID for Investor Grievances as per Regulation 46 of the SEBI (LODR) Regulations, 2015.
- ◆ Copies of all advertisements published in connection with the issue up to T + 1 stage.
- ◆ Confirmation from the company stating that they have obtained authentication for SCORES from SEBI as per Regulation 13 of the SEBI (LODR) Regulations, 2015.

GREEN SHOE OPTIONS

Q65. A listed company, Nishan Hitech Ltd. issued 10 lakh equity shares at a price of ₹150 per share. The company provided Green shoe option for stabilizing the post listing price of the shares. On the day of listing of shares, the news of trade war between the two developed countries flashes and the price of shares of company fall to ₹110. Decide how many shares can be purchased by the stabilizing agent to control the price? State the provisions for balance money lying in the special account for green shoe option. [Dec. 2018 (5 Marks)]

Ans.:

As per Green Shoe concept as contained in SEBI (ICDR) Regulation, 2018, the stabilizing agent has to enter an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size, which shall not be in excess of **15% of the issue size**.

As per facts given in case, the Nishan Hitech Ltd. issued 10 lakh shares. Stabilizing agent will borrow 15% of issued shares i.e. 1.5 lakh shares. In public issue total 11.5 lakh shares will be allotted to public.

Total proceeds received in IPO = ₹1,725 lakh (11.5 lakh shares × 150)

Out of total proceeds of ₹1,725 lakh –

- (a) Amount of ₹1,500 lakh (10 lakh shares × 150) will be remitted to the Nishan Hitech Ltd.
- (b) Amount received from the Green Shoe Shares ₹ 225 lakh (1.5 lakh shares × 150) will be parked in a special escrow bank account i.e. Green Shoe Escrow Account.

Price has been fallen to ₹110. Thus, out of the money in Escrow Account the stabilizing agent will start to buy shares at ₹110 or above so that price increases or stabilizes.

(Here simple principle of economics will apply as Stabilizing Agent starts to buy shares demand increases and thus it will lead to increase price or at least it will stop falling share price)

From the promoters stabilizing agent has borrowed 1.5 lakh shares and hence stabilizing agent can buy up 1.5 lakh shares only.

Any monies left in the special bank account after remittance of monies to the issuer and deduction of expenses incurred by the stabilizing agent for the stabilization process shall be transferred to the 'Investor Protection & Education Fund' established by the SEBI and the special bank account shall be closed soon thereafter.

Q66. Raman Ltd. issued 50 Lakh equity shares at a price of ₹ 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 ₹ 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) State the amount to be transferred to Investor Protection & Education Fund. [Dec. 2020 (5 Marks)]

Ans.:

As per Green Shoe concept as contained in the SEBI (ICDR) Regulation, 2018, the stabilizing agent has to enter an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them, specifying

therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size, which shall not be in excess of **15% of the issue size**.

As per facts given in case, the Raman Ltd. issued 50,00,000 shares.

Stabilizing agent will borrow 15% of issued shares i.e. 7,50,000 shares.

In public issue total 57,50,000 shares will be allotted to public.

Total proceeds received in IPO = ₹ 1,15,00,00,000 (57,50,000 shares × 200)

Out of total proceeds of ₹ 1,15,00,00,000 –

(a) Amount of ₹ 1,00,00,00,000 (50,00,000 shares × 200) will be remitted to the Raman Ltd.

(b) Amount received from the Green Shoe Shares ₹ 15,00,00,000 (7,50,000 shares × 200) will be parked in a special escrow bank account i.e. Green Shoe Escrow Account.

Any monies left in the Escrow Account after remittance of monies to the issuer and deduction of expenses incurred by the stabilizing agent for the stabilization process shall be transferred to the 'Investor Protection & Education Fund' established by the SEBI and the Escrow Account shall be closed soon thereafter.

Q67. Good Luck Finance Ltd., a listed company issued 20 lakh equity shares of ₹ 180 each. The Company provided Green Shoe Option and Nishan was nominated as Stabilizing Agent. On the date of listing, Corona Virus threat spread across the globe.

Consequently post listing, the share price of the company fall to ₹ 150. From the above:

(i) Compute the quantum of shares that can be bought by Nishan.

(ii) State the provisions for balance of shares lying in the special account for Green Shoe Option. [June 2021 (5 Marks)]

Ans.:

As per Green Shoe concept as contained in the SEBI (ICDR) Regulation, 2018, the stabilizing agent has to enter an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size, which shall not be in excess of **15% of the issue size**.

As per facts given in case, the Good Luck Ltd. issued 20 lakh shares.

Stabilizing agent will borrow 15% of issued shares i.e. 3 lakh shares.

In public issue total 23 lakh shares will be allotted to public.

Total proceeds received in IPO = ₹ 4,140 lakh (23 lakh shares × 180)

Out of total proceeds of ₹ 4,140 lakh –

(a) Amount of ₹ 3,600 lakh (20 lakh shares × 180) will be remitted to the Good Luck Ltd.

(b) Amount received from the Green Shoe Shares ₹ 540 lakh (3 lakh shares × 180) will be parked in a special escrow bank account i.e. Green Shoe Escrow Account.

Price has been fallen to ₹ 150. Thus, out of the money in Escrow Account the stabilizing agent will start to buy shares at ₹ 150 or above so that price increases or stabilizes.

(Here simple principle of economics will apply as Stabilizing Agent starts to buy shares demand increases and thus it will lead to increase price or at least it will stop falling share price)

From the promoters stabilizing agent has borrowed 3 lakh shares and hence stabilizing agent can buy up 3 lakh shares only.

Q68. PRAKS Ltd. is planning for an IPO of 2,00,000 shares, at a book-bult price of ₹ 100 each resulting in an IPO size of ₹ 2,00,00,000. As per the ICDR Regulations, the over-allotment component under the Green Shoe mechanism could be up to 15% of the IPO. Prior to the IPO, the stabilizing 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 2,30,000 shares. IPO proceeds received from the investors for the IPO shares, i.e., ₹ 2,00,00,000 being 2,00,000 shares at the rate of ₹ 100 each, are remitted to the Issuer Company, while the proceeds from the Green Shoe Shares are parked in a special escrow bank account, i.e. Green Shoe Escrow Account. During the price stabilization period, if the share price drops below ₹ 100, the stabilizing agent would utilize 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, examine all situations given below with reference to the role of stabilizing agent.

(a) Where the stabilizing agent manages to buy-back all of the Green Shoe Shares, i.e., 30,000 shares.

(b) Where the stabilizing agent manages to buy-back none of the Green Shoe Shares.

(c) Where the stabilizing agent manages to buy-back some of the Green Shoe Shares, say 20,000 shares. [June 2024 (5 + 5 + 5 = 15 Marks)]

Ans.:

As per Green Shoe concept as contained in the SEBI (ICDR) Regulation, 2018, the stabilizing agent has to enter an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them, specifying therein the maximum number of specified securities that may be borrowed for

the purpose of allotment or allocation of specified securities in excess of the issue size, which shall not be in excess of **15% of the issue size**.

As per facts given in case, the PRAKS Ltd. issued 2,00,000 shares.

Stabilizing agent will borrow 15% of issued shares i.e. 30,000 shares.

In public issue total 2,30,000 shares will be allotted to public.

Total proceeds received in IPO = ₹ 2,30,00,000 (2,30,000 shares × 100)

Out of total proceeds of ₹ 2,30,00,000 –

- (a) Amount of ₹ 2,00,00,000 (2,00,000 shares × 100) will be remitted to the PRAKS Ltd.
- (b) Amount received from the Green Shoe Shares ₹ 30,00,000 (30,000 shares × 100) will be parked in a special escrow bank account i.e. Green Shoe Escrow Account.

Situation 1: Where the Stabilizing Agent manages to buy-back all of the Green Shoe Shares, i.e. 30,000 shares: In this situation, funds in the Green Shoe Escrow Account (₹ 2,00,00,000, in this case) would be deployed by the stabilizing agent towards buying shares from the open market. Given that the prices prevalent in the market would be less than the issue price of ₹ 100, the stabilizing agent would have sufficient funds lying at his disposal to complete this operation.

Having bought back all of the 30,000 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 stabilization period.

Situation 2: Where the Stabilizing Agent manages to buy-back none of the Green Shoe Shares: This situation would arise in the (very unlikely) event that the share prices have fallen below the Issue Price, but the stabilizing 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 stabilizing agent to indulge in price stabilization activities.

In either of the above-said situations, the stabilizing agent is under a contractual obligation to return the 30,000 shares that had initially been borrowed from the lending shareholders. Towards meeting this obligation, the issuer company would allot 30,000 shares to the stabilizing agent into the Green Shoe Demat Account (the consideration being the funds lying in the Green Shoe Escrow Account), and these shares would then be returned by the stabilizing agent to the lending shareholders, thereby squaring off his responsibilities.

Situation 3: Where the Stabilizing Agent manages to buy-back some of the Green Shoe Shares, 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 stabilization period, but recover towards the latter stages.

In this situation, the stabilizing agent has a responsibility to return 30,000 shares to the lending shareholders, whereas the stabilizing activities have yielded only 2,000 shares.

Similar to the instance mentioned in Situation 2 above, the issuer company would allot the differential 10,000 shares into the Green Shoe Demat Account to cover up the shortfall, and the stabilizing agent would discharge his obligation to the lending shareholders by returning the 30,000 shares that had been borrowed from them.

Both in Situations 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 monies left in the special bank account after remittance of monies to the issuer and deduction of expenses incurred by the stabilizing agent for the stabilization process shall be transferred to the 'Investor Protection & Education Fund' established by the SEBI and the special bank account shall be closed soon thereafter.

MISCELLANEOUS TOPICS RELATING TO PUBLIC ISSUE

Q69. Discuss various factors to be considered by the management of a company for a successful Road Show while preparing for marketing of an IPO.
[June 2024 (5 Marks)]

Ans.:

At road shows, generally series of information presentations are organized 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.

Management needs to prepare for proposed Road shows and Investor Meets in advance. Adequate representation of promoters & key managerial person should be available for various meets, Road shows etc. Often there is a need to undergo training for the representatives of the Company about their conduct & behaviour during these road shows. IPO bound Companies prepare a 'Corporate Film' which includes brief about the Company, its past and also take investors through the present set up, practices followed by the Company, overview of proposed expansion, brief information of management, financials of the Company including various financial ratios & parameters and basis of IPO price. Besides this a short and concise Press Note about the Company and its IPO is required to be released for publications.

The Road show generally comprises of a press meet and meeting with Brokers and Investors/Analysts. Press Conference is aimed at giving information to the press for publication in their papers/newspapers for dissemination of information to the investors whereas 'Brokers, Investors/Analysts Meet' aims at giving

detailed information to the market participants about the Company enabling them to understand the details and take it further to the ultimate investors. Many a times IPO bound Companies also organize site/plant visit for the market participants enabling them to take a view of manufacturing facilities and other administrative set up of the Company. Managements are required to take into consideration all the above factors while preparing for marketing of an IPO.

mpron08074@digdy.com 28-07-2024
09:38

TAXMANN

9

REAL ESTATE INVESTMENT TRUSTS

CHAPTER

FEATURES & BENEFITS OF REITs

Q1. Write short note on: Benefits of REITs [Dec. 2022 (3 Marks)]

Or

An investor can invest in real estate without buying any physical property by way of Investment in Real Estate Investment Trusts (REITs). Explain REITs and its benefits. [June 2023 (5 Marks)]

Ans.: REIT – Meaning: REIT is an acronym for Real Estate Investment Trust. REITs refer to companies that operate, own or finance income-producing real estate properties. REITs are modeled on the lines of mutual funds, wherein you can invest in a part of real estate rather than the entire property, which may be unaffordable for retail investors.

Benefits of Investing in REITs: Following are some key benefits of investing in REITs:

- (1) **Less Capital Intensive:** Direct investment in real estate property is very capital intensive. But each share of REITs will be comparatively more affordable. It does not require large capital outflows.
- (2) **Diversification:** REITs allow you to diversify your investment portfolio through exposure to Real Estate without the hassles related to owning and managing commercial property. This diversification allows you to go beyond the usual asset classes of Equity, Debt & Gold as part of your overall Asset Allocation Strategy.
- (3) **Small Initial Investment:** One of the key problems associated with making Real Estate investments is the large ticket size especially in the case of commercial properties. REITs require a much smaller initial investment to provide similar portfolio diversification benefits.
- (4) **Transparency:** REITs are listed in stock market; hence details will be available on public domain.

- (5) **Professional Management:** Properties owned by a REIT are managed professionally. This ensures smooth operations and with no effort on your part towards managing Commercial Real Estate.
- (6) **Regular Income Generation:** REITs generate income from rental collections and are required to mandatorily distribute 90% of income to investors as dividends and interest payments. In this way, REITs provide regular income to investors.
- (7) **Tax Free:** Dividend earned by the investors of REIT will be tax free.
- (8) **Fast Capital Appreciation:** Capital appreciation can be phenomenal.
- (9) **Easy to buy:** Investment in REITs easier than investment in Real Estate properties.

Q2. State the salient features of the SEBI (Real Estate Investment Trusts) Regulations, 2014.

Ans.: mpare@074@digdy.com 26-07-2024

- (1) **Governing Code:** SEBI (Real Estate Investment Trusts) Regulations, 2014.
- (2) **Legal Structure:** Trust set-up under the Indian Trusts Act, 1882.
- (3) **Parties to the REITs:** Sponsor Group, Inducted Sponsor, Manager and Trustee.
- (4) **Maximum number of sponsors & Unit holding obligations:**
- ◆ Each sponsor shall hold or propose to hold minimum 5% of units of REITs on post-initial offer basis.
 - ◆ Collectively to hold minimum of 15% of the total units of the REIT for a period of at least 3 years from the date of listing of such units pursuant to initial offer on a post issue basis.
 - ◆ Any holding of the sponsors and sponsor groups exceeding the minimum holding, shall be held for a period of at least one year from the date of listing of such units.
- (5) **Eligibility for Trustee:** Trustee has to be registered under the SEBI (Debtenture Trustee) Regulations, 1993 and shall not be an associate of Sponsor/Manager.
- (6) **Listing requirement:** Listing is mandatory for units.
- (7) **Investment conditions:** At least 80% of the value of the REIT assets needs to be invested in completed and revenue generating properties.
- (8) **Other Permissible Investments:** Not more than 20% of value of the REIT assets can be invested in:
- (i) Developmental properties.

- (ii) Listed or unlisted debt of companies/body corporate in real estate sector.
- (iii) Mortgage backed securities.
- (iv) 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.
- (v) Government securities.
- (vi) Unutilized FSI of a project.
- (vii) TDR acquired for the purpose of Utilization.
- (viii) Money market instruments or Cash equivalents.
- (9) **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/updating.
- (10) **Distribution of Income:** At least 90% of the net distributable income after tax of the REIT/Holdco shall be distributed as dividend to the unit holders at least on half-yearly basis and shall be made not later than 15 days.
- (11) **Mode of Investment in properties:** Directly or through SPVs holding at least 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.
- (12) **Initial offer restrictions:** Minimum offer size should be at least ₹ 250 Crore.
- (13) **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 ₹ 10,000 to ₹ 15,000.
- 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 Trading lot shall be one unit.
- (14) **Borrowings and Deferred Payments:** The aggregate consolidated borrowings and deferred payments of the REIT 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.
- (15) **Value of Assets:** Value of Assets by REIT shall be at least ₹ 500 Crore.
- (16) **Minimum Unit holders:** Minimum number of unit holders other than sponsors, its related parties and its associates forming part of public shall be at least 200.

Q3. Explain the term REIT. State the major difference between REIT and Mutual Funds. [June 2023 (5 Marks)]

Ans.:

Points	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 estate related stocks through REITs.	Mutual funds, however, allow you to diversify your portfolio by investing in various sectors.
Regulation	The SEBI (Real Estate Investment Trusts) Regulations, 2014 applies to REITs.	The SEBI (Mutual Funds) Regulations, 1996 applies to Mutual Funds.

DEFINITIONS

Q4. Explain the meaning of 'Special Purpose Vehicle' as mentioned in the SEBI (Real Estate Investment Trusts) Regulations, 2014.

Ans.: **Special Purpose Vehicle [Regulation 2(1)(zs)]:** Special Purpose Vehicle or SPV means any company or LLP:

- In which either the REIT or the Holdco holds or proposes to hold not less than 50% of the equity share capital or interest.
- Which holds not less than 80% of its assets directly in properties and does not invest in other special purpose vehicles.
- Which is not engaged in any activity other than holding and developing property and any other activity incidental to such holding or development.

Q5. Explain the terms 'Strategic Investor' with reference to the public issue of REITs and InvITs [Dec. 2019 (3 Marks)]

Or

Explain guidelines issued by SEBI on participation by the strategic investors in InvITs and REITs vide its circular dated 18th January, 2018. [Dec. 2020 (5 Marks)]

Or

Explain the meaning of 'Strategic Investor' as mentioned in the SEBI (Real Estate Investment Trusts) Regulations, 2014.

[Dec. 2021 (5 Marks)]

Or

Explain in brief about Strategic Investor and participation by the Strategic Investor in the public issues of REITs. [Dec. 2023 (5 Marks)]

Ans.: **Strategic Investor [Regulation 2(1)(zfb)]:** Strategic Investor means following entities 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 the SEBI, subject to the compliance with the applicable provisions of the FEMA and the Rules or Regulations or Guidelines made thereunder –

- Infrastructure finance company registered with RBI as NBFC.
- Scheduled Commercial Bank.
- Multilateral and/or bilateral development financial institution.
- Systemically important NBFC registered with RBI.
- Foreign portfolio investor.
- Insurance company registered with IRDA.
- Mutual fund.

Participation by strategic investors in public issue of 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.

Holding Requirements	Issue price of units & utilization of funds	Lock-in-period
Holding by strategic investors -Minimum 5% -Maximum 25%	Price at which units are offered to the strategic investors must not be less than the price determined in the public issue.	Units 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 public issue.
Holding by public (other than strategic investors & sponsors): -Minimum 25%.	It must be ensured that the subscription amount is kept in the separate account until the public issue is opened.	
Holding by sponsor: -Minimum 5%. -Maximum 70%.		

REGISTRATION OF REAL ESTATE INVESTMENT TRUSTS

Q6. What is a Real Estate Investment Trust (REIT)? What are the eligibility criteria for granting a certificate to an applicant to act as REIT as per the SEBI (Real Estate Investment Trusts) Regulations, 2016 in this regard? [Dec. 2016 (8 Marks)]

Or

"No person shall act as a Real Estate Investment Trust (REIT), unless it is registered with SEBI under the REIT Regulations". Structure a REIT with due consideration to eligibility and basic conditions to be fulfilled under SEBI (REIT) Regulations, 2014. [June 2022 (5 Marks)]

Ans.: REIT – Meaning: REIT is an acronym for Real Estate Investment Trust. REITs refer to companies that operate, own or finance income-producing real estate properties.

REIT or Real Estate Investment Trust shall mean a trust registered as such under the SEBI (Real Estate Investment Trusts) Regulations, 2016. [Regulation 2(1)(zm)]

Eligibility: In a REIT structure, the following parties are involved:

- ◆ REIT Applicant (Trust which holds the underlying properties)
- ◆ Sponsor (like a promoter in case of a listed company)
- ◆ Trustee of the REIT
- ◆ Manager (A company or an LLP which manages assets and investments of the REIT and undertakes operational activities of the REIT)

Eligibility Criteria [Regulation 4]: For the purpose of grant of certificate to the trust, SEBI shall consider all matters relevant to the activities as Real Estate Investment Trust.

The SEBI shall consider the following, namely –

- (a) Registration under Registration Act, 1908:** The applicant is the sponsor on behalf of 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) Objective of REIT and responsibilities of Trustee:** The trust deed has its main objective as undertaking activity of REIT and includes responsibilities of the Trustee.
- (c) Designated persons are separate entities:** Persons have been designated as sponsor(s), manager and trustee and all such persons are separate entities.
- (d) Eligibility criteria for sponsor:**
 - (i) Each sponsor shall hold or propose to hold not less than 5% of the number of units of the REIT on post-initial offer basis.

- (ii) Each sponsor and sponsor group shall be clearly identified in application of registration and in offer document/placement memorandum. However, for each sponsor group not less than one person shall be identified as a sponsor.

Only following entities may be considered as sponsor group:

1. A person or entity who is directly or indirectly holding an interest or shareholding in any of the assets or SPVs or Holdcos proposed to be transferred to the REIT.
2. A person or entity who is directly or indirectly holding units of the REIT on post-issue basis.
3. A person or entity whose experience is being utilized by the sponsor for meeting with the eligibility conditions required under Regulation 4(2)(d)(iii).

- (iii) The sponsor(s), on a **collective basis**, have a **net worth** of not less than ₹ **100 Crore**. However, **each sponsor** has a **net worth** of not less than ₹ **25 Crore**.

- (iv) The sponsor or its associate(s) has not less than 5 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.

(e) Eligibility criteria for Manager:

- (i) The manager has a net worth of not less than ₹ **10 Crore** if the manager is a body corporate or a company or net tangible assets of value not less than ₹ **10 Crore** in case the manager is LLP.
- (ii) The manager or its associate has not less than **5 years experience** in fund management or advisory services or property management in real estate industry or in development of real estate.
- (iii) The manager has not less than two **key personnel** who each have not less than **5 years experience** in fund management or advisory services or property management in the real estate industry or in development of real estate.
- (iv) The manager has 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.
- (v) The manager has entered into an investment management agreement with the trustee which provides for the responsibilities of the manager.

(f) Eligibility criteria for trustee:

- (i) The trustee is registered with the SEBI under the SEBI (Debenture Trustees) Regulations, 1993 and is not an associate of the sponsor(s) or manager.

(ii) The trustee has such wherewithal with respect to infrastructure, personnel, etc. to the satisfaction of the SEBI and in accordance with circulars or guidelines as may be specified by the SEBI.

- (g) **Unit holders:** No unit holder of the REIT enjoys 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.

Unit holders 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, in the manner 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 unit holder who nominated such nominee director or the associate of such unit holder is a party.

Any unit holder holding not less than 10% of the total outstanding units of the REIT shall comply with the Stewardship Code specified in Schedule IX.

- (h) **Disclosure of activities of REIT:** Applicant shall clearly describe at the time of application for registration, details pertaining to proposed activities of the REIT.
- (i) **Fit and proper person criteria:** 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.
- (j) **Rejection of previous application:** The SEBI shall take into consideration the fact the whether any previous application for grant of certificate by the REIT or the parties to the REIT or their directors/members of governing board has been rejected by it.
- (k) **Disciplinary action:** The SEBI shall take into consideration whether any disciplinary action has been taken by the 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.

RIGHTS AND RESPONSIBILITIES OF PARTIES TO THE REIT, VALUER & AUDITOR

Q7. State any eight rights and responsibilities of trustee to the REIT as contained under the SEBI (Real Estate Investment Trust) Regulations, 2014.

Ans.: Rights and responsibilities of trustee [Regulation 9]:

- (1) The trustee shall hold the REIT assets in trust for the benefit of the unit holders in accordance with the trust deed and these regulations.
- (2) The Trustee shall enter into an investment management agreement with the manager on behalf of the REIT.
- (3) The trustee shall oversee activities of the manager in the interest of the unit holders, ensure that the manager complies with Regulation 10 and shall obtain compliance certificate from the manager in the form as may be specified on a quarterly basis.
- (4) The trustee shall ensure that the manager complies with the reporting and disclosures requirements in these regulations and in case of any delay or discrepancy, require the manager to rectify the same on an urgent basis.
- (5) The trustee shall review the transactions carried out between the manager and its associates and where the manager has advised that there may be a conflict of interest, shall obtain confirmation from a practicing chartered accountant or a valuer, as applicable, that such transaction is on arm's length basis.
- (6) The trustee shall periodically review the status of unit holders' complaints and their redressal undertaken by the manager.
- (7) The trustee shall make distributions in accordance with Regulation 18(16) and ensure that the manager makes timely declaration of distributions to the unit holders.
- (8) The trustee may require the manager to set up such systems and submit such reports to the trustees, as may be necessary for effective monitoring of the performance and functioning of the REIT.
- (9) The trustee shall ensure that subscription amount is kept in a separate bank account in name of the REIT and is only utilized for adjustment against allotment of units or refund of money to the applicants till the time such units are listed.
- (10) The trustee shall ensure that the remuneration of the valuer is not linked to or based on the value of the asset being valued.
- (11) The trustee shall ensure that the manager convenes meetings of the unit holders in accordance with these regulations and oversee the voting by unit holders and declare outcome of the voting.
- (12) The trustee may take up with the SEBI or with the designated stock exchange, any matter which has been approved in an annual meeting or special meeting, if the matter requires such action.
- (13) In case of any change in manager due to removal or otherwise –
 - (a) Prior to such change, the trustee shall obtain approval from unit holders in accordance with Regulation 22 and approval from the SEBI.

- (b) The trustee shall appoint the new manager within three months from the date of termination of the earlier investment management agreement.
- (c) The previous manager shall continue to act as such at the discretion of trustee till such time as new manager is appointed.
- (d) The trustee shall ensure that the new manager shall stand substituted as a party in all the documents to which the earlier manager was a party.
- (e) The trustee shall ensure that the earlier manager continues to be liable for all its acts of omissions and commissions notwithstanding such termination.
- (14) The trustee shall obtain prior approval from the unit holders in accordance with regulation 22 and from the SEBI in case of change in control of the manager.
- (15) The trustee of the REIT shall be substituted shall not invest in units of the REIT in which it is designated as the trustee.
- (16) The trustee shall ensure that the activity of the REIT is being operated in accordance with the provisions of the trust deed, these regulations, the offer document and if any discrepancy is noticed, shall inform the same to the SEBI immediately in writing.
- (17) The trustee shall provide to the SEBI and to the designated stock exchange such information as may be sought by the SEBI or by the designated stock exchange pertaining to the activity of the REIT.
- (18) The trustee shall immediately inform to the SEBI in case any act which is detrimental to the interest of the unit holders is noted.

Q8. Who is the sponsor of a Real Estate Investment Trust? What are the provisions with respect to the holding of units by the sponsor in the REIT? [Dec. 2017 (7 Marks)]

Ans.: Sponsor [Regulation 2(1)(zf)]: Sponsor means any person who set-up the REIT and designated as such at the time of application made to the SEBI and shall include an inducted sponsor.

Sponsor Group [Regulation 2(1)(zf)]: Sponsor Group includes:

- (i) The sponsor(s).
- (ii) In case the sponsor is a body corporate:
- (a) Entities or persons which are controlled by such body corporate.
- (b) Entities or persons who control such body corporate.
- (c) Entities or persons which are controlled by persons as referred in 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).
- (b) Entities or persons which are controlled by such individual.

Provisions relating to holding of units by sponsors and sponsor groups [Regulation 11(3)]:

The sponsors and sponsor groups shall collectively hold not less than –

- (i) 15% of the total units of the REIT, for 3 years from the date of listing of units in the initial offer. However, any holding by the sponsors and sponsor groups exceeding 15% shall be held for a period of not less than one year from the date of listing of units issued in the initial offer.
- (ii) 5% of the total units of the REIT, from the beginning of 4th year and till the end of 5th year from the date of listing of the units issued in the initial offer.
- (iii) 3% of the total units of the REIT, from the beginning of 6th year and till the end of 10th year from the date of listing of the units issued in the initial offer.
- (iv) 2% of the total units of the REIT, from the beginning of 11th year and till the end of 20th year from the date of listing of the units issued in the initial offer.
- (v) 1% of the total units of the REIT, after completion of the 20th year from the date of listing of units issued in the initial offer.

The maximum value of the units to be held by the sponsors and sponsor groups for compliance with clauses (i) to (v) shall not exceed ₹ 500 Crore or such other value as may be decided by the SEBI from time to time and such valuation shall be based on the latest available net asset value of the REIT.

An assessment of compliance of requirements under clauses (i) to (v) shall be done at the time of each fresh issuance of units and at the beginning of change in threshold of the percentage for minimum unit holding requirement.

For REITs that have already issued units pursuant to an initial offer as on the date of coming into effect of the SEBI (Real Estate Investment Trusts) (Second Amendment) Regulations, 2023, the provisions contained in clauses (i) to (v) shall be applicable only for the additional units issued by the REIT after such date and the units that are locked in at the time of initial offer shall continue to be locked in till the completion of 3 years from the date of listing of units in such initial offer.

Lock-in of units [Regulation 11(3A)]: The units required to be held shall be locked in and shall not be encumbered. Any encumbrance created on units held to comply with the minimum unit holding requirement applicable before the date of coming into effect of the SEBI (Real Estate Investment Trusts) (Second

Amendment) Regulations, 2023, may continue if the encumbrance exist on such date.

Q9. Regulation 11 of the SEBI (Real Estate Investment Trust) Regulations, 2014 provides for rights and responsibilities of sponsors. Explain.

[Dec. 2018 (5 Marks)]

Ans.: Rights and responsibilities of sponsors and sponsor groups [Regulation 11]

- (1) **Set-up of the REIT and appoint trustee [Regulation 11(1)]:** The sponsors and sponsor groups shall set up the REIT and appoint the trustee of the REIT.
- (2) **Transfer of entire shareholding of the sponsors and sponsor group to REIT [Regulation 11(2)]:** The sponsors and sponsor groups shall transfer or undertake to transfer, subject to a binding agreement and adequate disclosures in the initial offer document, their entire shareholding or interest and rights in the Holdco and/or SPV or entire ownership of the real estate assets to the REIT prior to allotment of units of the REIT to the applicants.

However, this provision shall not apply to the extent of any mandatory holding of shares or interest and rights in the Holdco and/or SPV by the sponsors and sponsor groups as required under any Act or regulations or circulars or guidelines of government or regulatory authority as specified from time to time.

- (3) **holding of units by sponsors and sponsor groups [Regulation 11(3)]:**

The sponsors and sponsor groups shall collectively hold not less than –

- (i) 15% of the total units of the REIT, for 3 years from the date of listing of units in the initial offer. However, any holding by the sponsors and sponsor groups exceeding 15% shall be held for a period of not less than one year from the date of listing of units issued in the initial offer.
- (ii) 5% of the total units of the REIT, from the beginning of 4th year and till the end of 5th year from the date of listing of the units issued in the initial offer.
- (iii) 3% of the total units of the REIT, from the beginning of 6th year and till the end of 10th year from the date of listing of the units issued in the initial offer.
- (iv) 2% of the total units of the REIT, from the beginning of 11th year and till the end of 20th year from the date of listing of the units issued in the initial offer.
- (v) 1% of the total units of the REIT, after completion of the 20th year from the date of listing of units issued in the initial offer.

The maximum value of the units to be held by the sponsors and sponsor groups for compliance with clauses (ii) to (v) shall not exceed ₹ 500 Crore

or such other value as may be decided by the SEBI from time to time and such valuation shall be based on the latest available net asset value of the REIT.

An assessment of compliance of requirements under clauses (ii) to (v) shall be done at the time of each fresh issuance of units and at the beginning of change in threshold of the percentage for minimum unit holding requirement.

For REITs that have already issued units pursuant to an initial offer as on the date of coming into effect of the SEBI (Real Estate Investment Trusts) (Second Amendment) Regulations, 2023, the provisions contained in clauses (i) to (v) shall be applicable only for the additional units issued by the REIT after such date and the units that are locked in at the time of initial offer shall continue to be locked in till the completion of 3 years from the date of listing of units in such initial offer.

- (4) **Lock-in of units [Regulation 11(3A)]:** The units required to be held shall be locked in and shall not be encumbered. Any encumbrance created on units held to comply with the minimum unit holding requirement applicable before the date of coming into effect of the SEBI (Real Estate Investment Trusts) (Second Amendment) Regulations, 2023, may continue if the encumbrance exist on such date.

ISSUE & LISTING OF UNITS REIT

Q10. State the provisions relating to 'initial offer' of its units and 'subsequent issue' of units by the REIT as contained in the SEBI (Real Estate Investment Trust) Regulations, 2014.

Ans.: Provisions relating to initial offer of its units and subsequent issue of units by the REIT are contained in Regulation 14(1) to (3) of the SEBI (Real Estate Investment Trust) Regulations, 2014

Initial offer by way of public issue [Regulation 14(1)]: A REIT shall make an initial offer of its units by way of public issue only.

Conditions for making initial offer [Regulation 14(2)]: No initial offer of units by the REIT shall be made unless –

- (a) **Registration:** REIT is registered with the SEBI.
- (b) **Value of assets:** Value of the REIT assets is not less than ₹ 500 Crore.
- (c) **Minimum unit holders:** Minimum number of unit holders other than sponsors, its related parties and its associates forming part of public shall be not less than 200.
- (d) **Maximum subscription from any investor:** Maximum subscription from any investor other than sponsors, its related parties and its associates shall not be more than 25% of the total unit capital.
- (e) **Offer size:** Offer size is not less than ₹ 250 Crore.

Minimum Public Shareholding [Regulation 14(21A)]: The requirement of ownership of assets and size of REIT 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 parties that such requirements shall be fulfilled prior to such allotment of units and, a declaration to the SEBI and to the designated stock exchanges to that effect and adequate disclosures in this regard in the offer document.

For REIT raising funds through an initial offer, the units proposed to be offered to the public through such initial offer –

- 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 ₹ 1,600 Crore.
- Shall be of the value of at least ₹ 400 Crore, if the post issue capital of the REIT calculated at offer price is equal to or more than ₹ 1,600 Crore and less than ₹ 4,000 Crore.
- 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 ₹ 4,000 Crore.

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.

Any listed REIT which has public holding below 25%, such REIT shall increase its public holding to at least 25%, within a period of 3 years from the date of listing pursuant to initial offer.

Subsequent issue of units by the REIT [Regulation 14(3)]: 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 the SEBI.

Summary of provisions relating to issue by REIT:

Initial offer of units	Only by Public Issue	
Further offer of units	By any means (Public Issue/Right Issue/QIP etc.)	
Minimum value of assets	₹ 500 Crore	
Minimum unit holders	200	
Minimum offer size for Initial issue of units	₹ 250 Crore	
Minimum Public Holding	Post Issue Capital	Minimum Public Shareholding
	Less than ₹ 1,600 Crore	At least 25% of the total of the outstanding units of the REIT
	₹ 1,600 Crore and more but less than ₹ 4,000 Crore	At least ₹ 400 Crore
	₹ 4,000 Crore and more	At least 10% of the total of the outstanding units

Q11. State the provisions relating to 'subscriptions' and 'allotment of units' & 'refund of application money' as contained in the SEBI (Real Estate Investment Trust) Regulations, 2014. Also state how much amount can be used by REIT for general purpose.

Ans.: Relevant provisions are contained in Regulation 14(12) to (22) which are discussed below:

Eligibility for subscription and allotment: The REIT 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.

Application to accompany by abridged version of offer document: 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.

Minimum subscription amount: The minimum subscription amount from any investor in initial and follow-on offer shall fall in the range of ₹ 10,000 to ₹ 15,000.

Subscription period: Initial offer and follow-on offer shall not be open for subscription for a period of more than 30 days.

Proportionate allotment in case of over-subscriptions: 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.

Time limit for allotment of units and refund application money: The REIT shall allot units or refund application money, as the case may be, within twelve working days from the date of closing of the issue.

Issue in dematerialized form: The REIT shall issue units only in dematerialized form to all the applicants.

Price discovery: The price of REIT units issued by way of public issue shall be determined through the book building process or any other process in accordance with the circulars or guidelines issued by the SEBI and in the manner as may be specified by the SEBI.

Refund of application money: The REIT shall refund money –

- 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.
- To applicants to the extent of oversubscription in case the money received is in excess of the extent of over-subscription as specified in the offer document.

Right to retain such over subscription cannot exceed 25% of the issue size.

The offer document shall contain adequate disclosures towards the utilization of such oversubscription proceeds, if any, and such proceeds retained on account of oversubscription shall not be utilized 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.

Interest on delay: 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% p.a., 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.

Amount for general purposes: The amount for general purposes, as mentioned in objects of the issue in the draft offer document filed with the SEBI, shall not exceed 10% of the amount raised by the REIT by issuance of units.

Q12. Discuss briefly provisions relating to listing and trading of units of the REIT as per the SEBI (Real Estate Investment Trust) Regulations, 2014.

Ans.: Listing and trading of units [Regulation 16]:

- (1) **Time limit for listing of initial offer:** After the initial offer it shall be mandatory for all units of REITs to be listed on a recognized stock exchange having nationwide trading terminals within a period of 12 working days from the date of closure of the offer.
- (2) **Listing shall be as per listing agreement:** 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) **Procedure in case permission of listing is not granted:** In the event of non-receipt of listing permission from the stock exchange or withdrawal of Observation Letter issued by the 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% p.a. from the date of allotment.
- (4) **Trading, clearance and settlement of units of REIT:** 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 the SEBI.
- (5) **Trading lot:** Trading lot for the purpose of trading of units of the REIT shall consist of one unit.
- (6) **When units of REIT can be redeemed:** The REIT shall redeem units only by way of a buy-back or at the time of delisting of units.
- (7) **Units of REIT remains listed unless delisted:** The units of REIT shall be remain listed on the designated stock exchange unless delisted under regulation 17.

- (8) **Delisting of units if there is breach in conditions relating to minimum public holding:** The minimum public holding for the units of the listed REIT shall be in accordance with Regulation 14(2A), 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 17.

However, in case of breach of the conditions, the trustee may provide a period of 6 months to the manager to rectify the same, failing which the manager shall apply for delisting under Regulation 17.

- (9) **Period of holding of units acquired prior to initial offer:** Any person other than the sponsors holding units of the REIT prior to initial offer shall hold the units for a period of not less than 1 year from the date of listing of the units subject to circulars or guidelines as may be specified by the SEBI.

- (10) **Observance of guidelines or circulars specified by SEBI and designated stock exchanges:** The SEBI and designated stock exchanges may specify any other requirements pertaining to listing and trading of units of the REIT by issuance of guidelines or circulars.

Q13. As a Practicing Company Secretary advise as to provisions relating to delisting of units of REIT as specified in the SEBI (Real Estate Investment Trust) Regulations, 2014.

Ans.: Delisting of units [Regulation 17]:

- (1) The manager shall apply for delisting of units of the REIT to the SEBI and the designated stock exchanges in following cases -
 - (a) If the public holding falls below the specified limit under sub-regulation (7) of regulation 16.
 - (b) If there are no projects or assets remaining under the REIT for a period exceeding 6 months and REIT does not propose to invest in any project in future. However, the period may be extended by further 6 months, with the approval of unit holders as per Regulation 22.
 - (c) The SEBI or the designated stock exchanges require such delisting for violation of the listing agreement or these regulations or SEBI Act, 1992.
 - (d) The sponsors or trustee requests such delisting and such request has been approved by unit holders in accordance with Regulation 22(6).
 - (e) If unit holders apply for such delisting in accordance with Regulation 22.
 - (f) The SEBI or the designated stock exchanges require such delisting for violation of the listing agreement, these regulations or SEBI Act, 1992 or in the interest of the unit holders.

- (2) The 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) The SEBI, instead of requiring delisting of the units, if it deems fit, may provide additional time to the REIT or parties to the REIT to comply with regulations.
- (4) The SEBI may reject the application for delisting and take any other action, as it deems fit, for violation of the listing agreement under these regulations or the SEBI Act, 1992.
- (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 the SEBI and by the designated stock exchanges from time to time.
- (6) The SEBI may require the REIT to wind-up and sell its assets in order to redeem units of the unit holders for the purpose of delisting of units and the 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 the 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, RELATED PARTY TRANSACTIONS, BORROWING & VALUATION OF ASSETS

Q14. Mindspace Business Parks, a registered Real Estate Investment Trust requires your opinion on following aspect under the SEBI (Real Estate Investment Trust) Regulations, 2014:

- (i) Investment in vacant land and agricultural land.
- (ii) Investment in mortgage backed securities.
- (iii) Conditions for investment in completed and rent/income generating properties.
- (iv) Investment in units of other REITs.

Ans.: Considering provisions of the SEBI (Real Estate Investment Trust) Regulations, 2014, answer to given case is as follows:

- (i) As per Regulation 18(2), the REIT shall not invest in vacant land or agricultural land or mortgages other than mortgage backed securities. Thus, Mindspace Business Parks cannot make investment in vacant land or agricultural land.

- (ii) As per Regulation 18(2), the REIT shall not invest in vacant land or agricultural land or mortgages other than mortgage backed securities. Thus, Mindspace Business Parks can make investment in mortgage backed securities.
- (iii) As per Regulation 18(4), 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 Holdco/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/SPVs shall be considered under this regulation and the remaining portion shall be included under regulation 18(5).
 - (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 under this regulation and the remaining portion including any contiguous land as specified under proviso to Regulation 14(2) shall be included under Regulation 14(5)(a).
- (iv) As per Regulation 18(12), REIT shall not invest in units of other REITs. Thus, Mindspace Business Parks cannot make investment in units of other REITs.

Q15. Discuss briefly provisions relating to valuation of assets of REIT under the SEBI (Real Estate Investment Trust) Regulations, 2014.

Ans.: Valuation of assets [Regulation 21]:

- (1) The valuer shall not be an associate of the sponsor or manager or trustee and shall have not less than five years of experience in valuation of real estate.
- (2) Full valuation includes a detailed valuation of all assets by the valuer including physical inspection of every property by the valuer.
- (3) Full valuation report shall include the mandatory minimum disclosures as specified in Schedule V to the regulations.
- (4) A full valuation shall be conducted by the valuer at least once in every financial year. Such full valuation shall be conducted at the end of the financial year ending March 31st within 3 months from the end of such year.
- (5) A half yearly valuation of the REIT assets shall be conducted by the valuer for the half-year ending on September 30 for incorporating any key changes in the previous 6 months and such half yearly valuation report shall be prepared within 45 days from the date of end of such half year.
- (6) Valuation reports received by the manager shall be submitted to the designated stock exchange and unit holders within fifteen days from the receipt of such valuation reports.

(7) Prior to any issue of units to the public and any other issue of units, the valuer shall undertake full valuation of all the REIT assets and include a summary of the report in the offer document. Such valuation report shall not be more than 6 months old at the time of such offer.

This provision shall not apply in cases where full valuation has been undertaken not more than 6 months prior to such issue and no material changes have occurred thereafter.

(8) For any transaction of purchase or sale of properties, whether directly or through Holdco/SPVs –

(a) If the transaction is a related party transaction, the valuation shall be in accordance with Regulation 19.

(b) If the transaction is not a related party transaction –

(i) A full valuation of the specific property shall be undertaken by the valuer.

(ii) Approval of the unit holders shall be obtained in accordance with Regulation 22 in following cases:

(1) In case of a purchase transaction, if the property is proposed to be purchased at a value greater than 110% of the value of the property as assessed by the valuer.

(2) In case of a sale transaction, if the property is proposed to be sold at a value less than 90% of the value of the property as assessed by the valuer.

(9) No valuer shall undertake valuation of the same property for more than 4 years consecutively: Provided that the valuer may be reappointed after a period of not less than 2 years from the date it ceases to be the valuer of the REIT.

(10) In case of any material development that may have an impact on the valuation of the REIT assets, then manager shall require the valuer to undertake full valuation of the property under consideration within not more than two months from the date of such event and disclose the same to the trustee, investors and the Designated Stock Exchanges within 15 days of such valuation.

(11) The valuer shall not value any assets in which it has either been involved with the acquisition or disposal within the last twelve months other than such cases where valuer was engaged by the REIT for such acquisition or disposal.

Q16. A Real Estate Investment Trust (REIT) is having ₹ 600 Crore assets in its portfolio. The asset mixes are as under:

(i) Completed project : ₹ 300 Crore

(ii) Property on rent : ₹ 100 Crore

(iii) Government securities: ₹ 150 Crore

(iv) Money market instrument : ₹ 50 Crore

By referring the SEBI regulations, advise the company on the asset mix and suggest any changes, if required. [Dec. 2023 (4 Marks)]

Ans.: As per Regulation 18(4) of the (Real Estate Investment Trusts) Regulations, 2014, not less than 80% of value of the REIT assets shall be invested in completed and rent and/or income generating properties.

As per Regulation 18(5), not more than 20% of value of the REIT assets shall be invested in assets other than as provided in Regulation 18(4) and such other investment shall only be in –

(a) Properties, whether directly or through a company or LLP, which are:

(i) Under-construction properties which shall be held by the REIT for not less than 3 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 3 years after completion.

(iii) Completed and not rent generating properties which shall be held by the REIT for not less than 3 years from date of purchase.

(b) 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.

(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 the previous financial year.

(e) 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 (a).

(f) Government securities.

(g) Unutilized FSI of a project where it has already made investment.

(h) TDR acquired for the purpose of utilization with respect to a project where it has already made investment.

(i) Money market instruments or cash equivalents.

As per facts given in case –

A Real Estate Investment Trust (REIT) has ₹ 600 Crore assets in its portfolio.

REIT assets that shall be invested as per Regulation 18(4):

₹ 600 Crore × 80% = ₹ 480 Crore

Actual investment under this category is ₹ 400 Crore (₹ 300 Crore + ₹ 100 Crore). Hence, Investment criteria under Regulation 18(4) is not fulfilled. There is shortfall of investment of ₹ 80 Crore.

REIT assets that shall be invested as per Regulation 18(5):

₹ 600 Crore × 20% = ₹ 120 Crore

Actual investment under this category is ₹ 200 Crore (₹ 150 Crore + ₹ 50 Crore). Hence, Investment criteria under Regulation 18(5) is not fulfilled. There is excess investment of ₹ 80 Crore.

Suggestion: Real Estate Investment Trust (REIT) should reduce its investment under Regulation 18(5) by ₹ 80 Crore and it should make additional investment as specified in Regulation 18(4).

RIGHTS OF UNIT HOLDERS, GENERAL OBLIGATIONS, DISCLOSURES & REPORTING

Q17. IIFL is registered REIT with SEBI. It requires your advice on following matters:

- How resolution of unit holders shall be passed?
- Mode of voting.
- Notice period of meeting of unit holders.
- Vote consideration of related party and their associates
- Who is responsible for conducting of meeting of the unit holders?

Ans.: As per Regulation 22(2) of the SEBI (Real Estate Investment Trust) Regulations, 2014, 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 this regulation, of the votes cast against.
- The voting may also be done by postal ballot or electronic mode.
- A notice of not less than 21 days either in writing or through electronic mode 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 persons shall not be considered on the specific issue.
- Manager shall be responsible for all the activities pertaining to conducting of meeting of the unit holders, subject to overseeing by the trustee.

In respect of issues pertaining to the manager such as change in manager including removal of the manager or change in control of the manager, Trustee shall convene and handle all activities pertaining to conduct of the meetings.

In respect of issues pertaining to the trustee such as change in the trustee, the trustee shall not be involved in any manner in the conduct of the meeting.

Q18. State the provisions of the SEBI (Real Estate Investment Trust) Regulations, 2014 relating to annual meeting of unit holders.

Ans.: As per Regulation 22(3) of the SEBI (Real Estate Investment Trust) Regulations, 2014, 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.

As per Regulation 22(4), 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 –

- 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 under Regulation 22(6).

For any issue taken up in annual meeting which require approval from the unit holders, votes cast in favour of the resolution shall be more than the votes cast against the resolution.

OBLIGATIONS OF MANAGER

Q19. State the provisions as applicable to Manger to the REIT in respect following matter as provided in the SEBI (Real Estate Investment Trust) Regulations, 2014:

- Composition of board of directors.
- Quorum for meeting of the Board of Directors.
- Review of compliance reports.
- Minimum information required to be placed before the Board of Directors.
- Person responsible for providing compliance certificate to the Board of Directors.

Ans.: Considering provisions of Regulation 26B of the SEBI (Real Estate Investment Trust) Regulations, 2014, advice to Manger to the REIT is as follows:

- Composition of board of directors:** 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) **Quorum for meeting of the Board of Directors:** The quorum for every meeting of the Board of Directors of the Manager shall be 1/3rd of its total strength or 3 directors, *whichever is higher*, including at least one independent director.

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) **Review of compliance reports:** 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) **Minimum information required to be placed before Board of Directors:** The minimum information as specified in Part A of Schedule VIII shall be placed before the Board of Directors of the Manager.

(5) **Person responsible for providing compliance certificate:** 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 Part B of Schedule VIII along with supporting evidence thereof.

Q20. Describe the provisions relating to obligation of Manager to REIT with respect to following matters:

- (i) Vigil Mechanism
- (ii) Secretarial Compliance Report
- (iii) Quarterly Compliance Report on Corporate governance
- (iv) Grievance Redressal Mechanism

Ans.: Vigil Mechanism [Regulation 26C]:

- (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 or employee 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 [Regulation 26D]:

- (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 60 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 [Regulation 26E]:

- (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 within 21 days from the end of each quarter.
- (2) The report on governance shall be signed either by the compliance officer or the chief executive officer of the Manager.

Grievance Redressal Mechanism [Regulation 26F]:

- (1) The Manager shall redress investor grievances promptly but not later than 21 calendar days from the date of receipt of the grievance and in a manner as may be specified by the SEBI.
- (2) 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.

INSPECTION & PROCEDURE FOR ACTION IN CASE OF DEFAULT

Q21. Discuss briefly provisions relating to inspection of REIT, parties to the REIT and other associate persons under the SEBI (Real Estate Investment Trust) Regulations, 2014

Ans.: Right of SEBI to Inspect [Regulation 27]: The SEBI may *suo motu* or upon receipt of information or complaint appoint one or more persons as inspecting officers to undertake inspection of the books of accounts, records and documents relating to activity of the REIT or Holdco or SPVs or parties to the REIT for any of the following reasons –

- (a) To ensure that the books of account, records and documents are being maintained by the REIT or parties to the REIT in the manner specified in these regulations.
- (b) To inspect into complaints received from unit holders, clients or any other person, on any matter having a bearing on the activities of the REIT.
- (c) To ascertain whether the provisions of the Act and these regulations are being complied with by the REIT and parties to the REIT.
- (d) To inspect *suo motu* into the affairs of the REIT, in the interest of the securities market or in the interest of investors.

Notice before inspection [Regulation 28]:

- (1) Before ordering an inspection under regulation 27, the SEBI shall give not less than 10 days notice to the trustee of the REIT.
- (2) Where the SEBI is satisfied that in the interest of the investors no such notice should be given, it may, by an order in writing, direct that the inspection of the affairs of the REIT be taken up without such notice.

- (3) During the course of an inspection, the REIT against whom the inspection is being carried out and parties to the REIT shall be bound to discharge their obligations.

Obligation of REIT, parties to the REIT and any other associate persons on inspection [Regulation 29]:

- (1) It shall be the duty of every REIT in respect of whom an inspection has been ordered under the regulation 27, parties to the REIT and any other associate person who is in possession of relevant information pertaining to conduct and affairs of such REIT, including representative of REIT, if any, to produce to the inspecting officer such books, accounts and other documents in his custody or control and furnish him with such statements and information as the inspecting officer may require for the purposes of inspection.
- (2) It shall be the duty of every REIT, parties to the REIT and any other associate person who is in possession of relevant information pertaining to conduct and affairs of the REIT to give to the Inspecting Officer all such assistance and to extend all such co-operation as may be required in connection with the inspection and to furnish such information as may be sought by the inspecting officer in connection with the inspection.
- (3) The inspecting officer shall, for the purposes of inspection, have power to examine on oath and record the statement of any employees and directors of the REIT or parties to the REIT or Holdco or SPVs or any person responsible for or connected with the activities of REIT or any other associated person having relevant information pertaining to such REIT.
- (4) The inspecting officer shall, for the purposes of inspection, have power to obtain authenticated copies of documents, books, accounts of REIT, from any person having control or custody of such documents, books or accounts.

Submission of report to SEBI [Regulation 30]: The inspecting officer shall, as soon as possible, on completion of the inspection submit an inspection report to the SEBI. However, if directed to do so by the SEBI, he may submit an interim report.

Communication of findings etc. to the REIT [Regulation 31]: The SEBI may after consideration of the inspection report and after giving reasonable opportunity of hearing to the REITs or parties to the REIT or its representatives or any such person, issue such directions as it deems fit in the interest of securities market or the investors in the nature of –

- (a) Requiring the REIT to delist its units from the designated stock exchanges and surrender its certificate of registration.
- (b) Requiring the REIT to sell its assets.

- (c) Requiring the REIT or parties to the REIT to take such action as may be in the interest of the investors.
- (d) Prohibiting the REIT or parties to the REIT from operating in the capital market or from accessing the capital market for a specified period.

integrity@274@ibgpub.com 26-07-2024
11:39

TAXMANN

10

CHAPTER

INFRASTRUCTURE INVESTMENT TRUSTS

FEATURES & IMPORTANCE OF INVITS

Q1. What do you understand by Infrastructure Investment Trusts? Also state the important elements of Infrastructure Investment Trusts?

Or

Discuss the role of key stakeholders in InvIT Structure?

Ans.: 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.

Objectives of InvITs: 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.

Registration: An InvIT is established as a trust and is registered with the SEBI.

Important elements of InvITs: Infrastructure investment trust comprises four elements:

- (1) Trustee:** They are required to be registered with SEBI as debenture trustees. Also, they are required to invest at least 80% into infra assets that generate steady revenue.
- (2) Sponsor:** Typically, a body corporate, LLP, promoter or a company with a net worth of at least ₹ 100 Crore classifies as a sponsor. Further, they must hold at least 15% of the total InvITs with a minimum lock-in period of 3 years or as notified by any regulatory requirement. When it comes to a public-private partnership or PPP projects, sponsors serve as a Special Purpose Vehicle (SPV).
- (3) Investment Manager:** As a body corporate or LLP, an investment manager supervises all the operational activities surrounding InvITs.

- (4) **Project Manager:** The authority is mostly responsible for executing projects. However, in the case of PPP projects, it serves as an entity that also supervises ancillary responsibilities.

Q2. An investor can invest in infrastructure projects to earn a small portion of the income as return. Explain InvITs and its benefits.

Ans.:- InvIT – Meaning: 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.

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.

Benefits/advantages of Investing in InvITs: Infrastructure Investment Trusts (InvITs) have emerged as an attractive investment avenue, providing investors with an opportunity to participate in India's infrastructure growth story. InvITs offer a range of benefits that make them compelling investment options for individuals and institutions alike. Following are the key benefits of investing in InvITs:

- (1) Stable Income Streams:** InvITs are designed to generate stable and predictable income streams for investors. The infrastructure assets held by InvITs, such as toll roads, power transmission lines, or renewable energy projects, often generate consistent cash flows through long-term contracts or regulatory mechanisms. This stability in income can provide investors with a reliable source of returns over time.
- (2) Portfolio Diversification:** Investing in InvITs allows for portfolio diversification. Infrastructure assets have low correlation with traditional asset classes like equities and bonds, making InvITs an effective way to diversify investment portfolios. By including InvITs, investors can reduce their overall portfolio risk and potentially enhance risk-adjusted returns.
- (3) Professional Management:** InvITs are managed by professional investment managers who possess expertise in infrastructure investments. These managers actively monitor and manage the assets, ensuring efficient operations, maintenance, and capital deployment. Investors can benefit from the knowledge and experience of these professionals, allowing them to access high-quality infrastructure assets and specialized management capabilities.
- (4) Potential Capital Appreciation:** Apart from stable income, InvITs offer the potential for capital appreciation. As infrastructure projects mature and generate income, the value of the underlying assets may appreciate over

time. This can lead to an increase in the unit price of the InvIT, providing investors with capital gains in addition to regular income distributions.

- (5) Transparency & Governance:** InvITs are regulated by the SEBI and are subject to stringent disclosure requirements and corporate governance standards. This ensures a higher level of transparency and accountability for investors. Regular reporting, audits, and adherence to regulatory norms contribute to the investor's confidence in the operations and financial performance of the InvIT.
- (6) Access to Infrastructure Assets:** Investing in InvITs provides individuals and retail investors with access to large-scale infrastructure assets that were traditionally available only to institutional investors or government entities. This democratization of infrastructure investments allows smaller investors to participate in the growth potential of the sector and benefit from the income generated by these assets.
- (7) Potential for Inflation Hedging:** Infrastructure assets, such as toll roads and power transmission lines, often have revenue streams linked to inflation or price escalation clauses. This feature can provide a natural hedge against inflation as the income generated by these assets tends to increase with inflation, helping investors preserve their purchasing power over the long term.

Moreover, the transparency, governance, and regulatory oversight associated with InvITs enhance investor confidence in these investment instruments. As India continues to invest in its infrastructure development, InvITs provide a unique opportunity for investors to participate in the growth and income potential of the sector. However, it is important for investors to conduct thorough research, assess risks, and review the specific characteristics of each InvIT before making investment decisions. By harnessing the benefits of InvITs, investors can potentially enhance their portfolio returns and contribute to the development of the nation's critical infrastructure.

Q3. Distinguish between: REITs and InvITs

Or

Distinguish between Real Estate Investment Trusts (REITs) and Infrastructure Investment Trust (InvITs) with reference to brieg concept, growth prospect, income stability and associated risks.

[Dec. 2022 (5 Marks)]

Ans.:

Points	REITs	InvITs
Meaning	A REIT is a corporation, trust, or association that invests directly in real estate through properties or mortgages. They trade on stock exchange and are bought and sold like stocks.	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

Points	REITs	InvITs
		projects to earn a small portion of the income as returns.
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.

Q4. Discuss briefly Parties and Intermediaries involved in an InvIT.

Ans.: 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, at least ₹ 100 Crore classifies as a sponsor. When it comes to a public-private partnership projects, sponsors serve as 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: Project Manager is responsible for the execution of an infrastructure project and achieving project milestones in accordance with project documents or concession agreement.

Compliance Officer: Compliance Officer 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: Custodian means a person registered under the SEBI (Custodian of Securities) Regulations, 1996.

Merchant Banker: Merchant Banker looks after the entire process of issue of units.

Auditor: Auditor conducts the audit of accounts of InvIT.

Valuer: Valuer undertakes valuation of the assets.

SPV: 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.

Unit holders: Unit holders are the one who holds units of the InvIT.

DEFINITIONS

Q5. What do you understand by "completed and revenue generating project" under the SEBI (Infrastructure Investment Trusts) Regulations, 2014?

Ans.: Completed and revenue generating project [Regulation 2(1)(f)]: 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 –

- 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.
- The infrastructure project has received all the requisite approvals and certifications for commencing operations.
- The infrastructure project has been generating revenue from operations for a period of not less than one year.

Q6. Explain the meaning of 'Special Purpose Vehicle' as mentioned in the SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Ans.: Special Purpose Vehicle [Regulation 2(1)(zy)]: "SPV" or "special purpose vehicle" means any company or LLP –

- In which either the InvIT or the Holdco 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 under proviso to Regulation 12(3).
- Which holds not less than 90% of its assets directly in infrastructure projects and does not invest in other SPVs.
- Which is not engaged in any other activity other than activities pertaining to and incidental to the underlying infrastructure projects.

Q7. Explain the meaning of 'Strategic Investor' as mentioned in the SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Ans.: Strategic Investor [Regulation 2(1)(zza)]: Strategic Investor means following entities who invest, either jointly or severally, not less 51% of the total

offer size of the InvIT or amount specified by the SEBI, subject to the compliance with the applicable provisions, of the Foreign Exchange Management Act, 1999 and the Rules or Regulations or Guidelines made thereunder –

- (i) An infrastructure finance company registered with RBI as NBFC.
- (ii) Scheduled Commercial Bank.
- (iii) Multilateral/bilateral development financial institution.
- (iv) Systemically important NBFC registered with RBI.
- (v) Foreign portfolio investors.
- (vi) Insurance company registered with the IRDA.
- (vii) Mutual fund.

REGISTRATION OF INVITS

Q8. "No person shall act as Infrastructure Investment Trust (InvITs), unless it is registered with SEBI under the InvIT Regulations". Structure InvIT with due consideration to eligibility and basic conditions to be fulfilled under the SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Ans.: Registration of Infrastructure Investment trusts [Regulation 3]:

- (1) No person shall act as an InvIT unless it has obtained a certificate of registration from the SEBI.
- (2) An application for grant of certificate of registration as InvIT shall be made by the sponsor on behalf of the trust in Form A as specified in the Schedule I and shall be accompanied by a non-refundable application fee as specified in Schedule II.
- (3) The SEBI may, in order to protect the interests of investors, appoint any person to take charge of records, documents of the trust and for this purpose, also determine the terms and conditions of such an appointment.
- (4) The SEBI shall take into account requirements as specified in these regulations for the purpose of considering grant of registration.

Eligibility Criteria [Regulation 4]: For the purpose of the grant of certificate to a trust, the SEBI shall consider all matters relevant to the activities as an InvIT. The SEBI shall consider the following, mandatory requirements –

- (a) **Registration under Registration Act, 1908:** The applicant is the sponsor 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) **Objective of InvIT and responsibilities of Trustee:** The trust deed has its main objective as undertaking activity of InvIT and includes responsibilities of the trustee.

(c) **Designated persons are separate entities:** Persons have been designated as sponsors, investment manager and trustee and all such persons are separate entities.

(d) **Eligibility criteria for sponsor:**

- (i) 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.

Only following entities may be considered sponsor group:

- (a) A person or entity who is directly or indirectly holding an interest or shareholding in any of the assets or SPVs or Holdco(s) proposed to be transferred to the InvIT.
- (b) A person or entity who is directly or indirectly holding units of the InvIT 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 Regulation 4(2)(iii).

(ii) Each sponsor has –

1. Net worth of not less than ₹ 100 Crore if it is a body corporate or a company.
2. Net tangible assets of value not less than ₹ 100 Crore in case it is LLP.

(iii) Whether the sponsor or its associate has a sound track record in development of infrastructure or fund management in the infrastructure sector.

Explanation: 'Sound track record' means experience of at least 5 years and where the sponsor is a developer, at least two projects of the sponsor have been completed.

(e) **Eligibility criteria for Investment Manager:**

- (i) The investment manager has a net worth of not less than ₹ 10 Crore if the investment manager is a body corporate or a company or net tangible assets of value not less than ₹ 10 Crore in case the investment manager is a limited liability partnership.
- (ii) The investment manager has not less than 5 years of experience in fund management or advisory services or development in the infrastructure sector or the 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.

For computing the combined experience, only the experience of the directors/partners/employees with more than 5 years of experience in fund management or advisory services or development in the infrastructure sector shall be considered.

- (iii) The investment manager has not less than two employees who have at least 5 years experience each, in fund management or advisory services or development in the infrastructure sector.
- (iv) The investment manager has not less than one employee who has at least 5 years experience in the relevant sub-sectors in which the InvIT has invested or proposes to invest.
- (v) The investment manager has not less than half of its directors in case of a company or members of the governing board in case of LLP as independent and not directors or members of the governing board of an Investment Manager of another InvIT.
- (vi) The investment manager has an office in India from where the operations pertaining to the InvIT is proposed to be conducted.
- (vii) 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 Regulation 10.

(f) Project Manager: The project manager has been identified and shall be appointed in terms of the project implementation/management agreement. The project implementation agreement/management agreement shall be submitted along with the draft offer document or the placement memorandum.

(g) Eligibility criteria for Trustee:

- (i) The trustee is registered under SEBI (Debenture Trustees) Regulations, 1993 and is not an associate of the sponsors or investment manager.
- (ii) The trustee has such wherewithal with respect to infrastructure, personnel, etc. to the satisfaction of the SEBI and in accordance with circulars or guidelines as may be specified by the SEBI.

(h) Unit holders: No unit holder of the InvIT enjoys superior voting or any other rights over another unit holder and there shall not be multiple classes of units of InvITs. 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.

Unit holders holding not less than 10% of the total outstanding units of the InvIT, either individually or collectively, shall be entitled to nominate one director on the board of directors of the Investment Manager, in the manner as may be specified by the SEBI.

The director so nominated shall recuse from voting on any transaction where such nominee director or associate of such nominee director or the unit holder who nominated such nominee director or associate of such unit holder is a party.

Any unit holder holding not less than 10% of the total outstanding units of the InvIT shall comply with Stewardship Code specified in Schedule VIII.

- (f) Disclosure of activities of REIT:** The applicant has clearly described at the time of registration, details pertaining to proposed activities of the InvIT;
- (f) Fit and proper person criteria:** The InvIT and parties to the InvIT are fit and proper persons based on the criteria as specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008.
- (k) Rejection of previous application:** The SEBI shall take into consideration the fact the whether any previous application for grant of certificate by the InvIT or the parties to the InvIT or their directors/members of governing board has been rejected by it.
- (f) Disciplinary action:** Whether any disciplinary action has been taken by the 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.

RIGHTS AND RESPONSIBILITIES OF PARTIES TO THE INVIT, VALUER & AUDITOR

Q9. State any eight rights and responsibilities of trustee to the InvIT as contained under the SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Ans.: Rights & Responsibilities of Trustee: Regulation 9(1) to (22) makes provisions for rights and responsibilities of Trustee to InvIT. Some of them are discussed below:

- (1) The trustee shall hold the InvIT assets in the name of the InvIT for the benefit of the unit holders in accordance with the trust deed and these regulations.
- (2) The trustee shall enter into an investment management agreement with the investment manager on behalf of the InvIT.
- (3) The trustee shall oversee activities of the investment manager in the interest of the unit holders, ensure that the investment manager complies with Regulation 10 and shall obtain compliance certificate from the investment manager, in the form as may be specified, on a quarterly basis.
- (4) The trustee shall oversee activities of the project manager with respect to compliance with these regulations and the project implementation

- agreement/project management agreement and shall obtain compliance certificate from the Project manager, in the form as may be specified, on a quarterly basis.
- (5) The trustee shall ensure that the investment manager complies with reporting and disclosures requirements in accordance with these regulations and in case of any delay or discrepancy, require the investment manager to rectify the same on an urgent basis.
 - (6) The trustee shall review the transactions carried out between the investment manager and its associates and where the investment manager has advised that there may be a conflict of interest, shall obtain confirmation from Practising Chartered Accountant or valuer, as applicable, that such transaction is on arm's length basis.
 - (7) The trustee shall periodically review the status of unit holders' complaints and their redressal undertaken by the investment manager.
 - (8) The trustee shall make distributions and ensure that investment manager makes timely declaration of distributions to the unit holders.
 - (9) The trustee may require the investment manager to set up such systems and procedures and submit such reports to the trustees, as may be necessary for effective monitoring of the functioning of the InvIT.
 - (10) The trustee shall ensure that subscription amount is kept in a separate bank account in name of the InvIT and is only utilized for adjustment against allotment of units or refund of money to the applicants till the time such units are listed.
 - (11) The trustee shall ensure that the remuneration of the valuer is not be linked to or based on the value of the assets being valued.
 - (12) The trustee shall ensure that the investment manager convenes meetings of the unit holders in accordance with these regulations and oversee the voting by unit holders.
 - (13) The trustee shall ensure that the investment manager convenes meetings of unit holders not less than once every year and the period between such meetings shall not exceed fifteen months.
 - (14) The trustee may take up with the SEBI or with the designated stock exchange, as may be applicable, any matter which has been approved in any meeting of unit holders, if the matter requires such action.

Q10. What are the responsibilities of Trustee to the InvIT in case of any change in Investment Manager due to removal or otherwise under the SEBI (Infrastructure Investment Trusts) Regulations, 2014?

Ans.: Responsibilities of Trustee to the InvIT in case of change in Investment Manager [Regulation 11(15)]: In case of any change in investment manager due to removal or otherwise –

- (a) Prior to such change, the trustee shall obtain approval from unit holders and from the SEBI.
- (b) The trustee shall appoint the new investment manager within 3 months from the date of termination of the earlier investment management agreement.
- (c) The previous investment manager shall continue to act as such at the discretion of trustee till such time as new investment manager is appointed.
- (d) The trustee shall ensure that the new investment manager shall stand substituted as a party in all the documents to which the earlier investment manager was a party.
- (e) The trustee shall ensure that the earlier investment manager continues to be liable for all its acts of omissions and commissions notwithstanding such termination.

Q11. Discuss briefly provisions relating to responsibility of Investment Manager in relation to appointment or reappointment of Auditor of the InvIT under the SEBI (Infrastructure Investment Trusts) Regulations, 2014

Ans.: Appointment of Auditor of the InvIT [Regulation 10(6)]: The investment manager of the InvIT shall appoint an individual or a firm as the auditor, who shall hold office from the date of conclusion of the annual meeting in which the auditor has been appointed till the date of conclusion of the 6th annual meeting of the unit holders in accordance with the procedure for selection of auditors, as may be specified by the SEBI.

Responsibility of Investment Manager in relation to appointment or reappointment of Auditor [Regulation 10(6A)]: The investment manager of the InvIT shall not appoint or re-appoint –

- (a) An individual as the auditor for more than one term of 5 consecutive years.
- (b) An audit firm as the auditor for more than 2 terms of 5 consecutive years.

The individual auditor who has completed the term under clause (a) shall not be eligible for reappointment as the auditor in the same InvIT for a period of 5 years from the date of completion of the term.

The audit firm that has completed its term under clause (b), shall not be eligible for reappointment as the auditor in the same InvIT for a period of 5 years from the date of completion of its term.

Q12. Who is 'Project Manager' in relation to Infrastructure Investment Trust (InvIT)? Also state the responsibilities of project manager under the SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Ans.: Project Manager [Regulation 2(1)(zp)]: Project Manager means a company or LLP or a body corporate designated as the project manager by the InvIT, responsible for achieving execution/management of the project as specified under

regulation 11 and in case of PPP projects, shall mean the entity responsible for such execution and achievement of project milestones in accordance with the concession agreement or any other relevant project document.

Responsibilities of Project Manager [Regulation 11]:

- (1) The project manager shall undertake operations and management of the InvIT assets including making arrangements for the appropriate maintenance, as may be applicable, either directly or through the appointment and supervision of appropriate agents and as required under any project agreement including a concession agreement in the case of a PPP project.
- (2) If the InvIT invests in under construction projects, the project manager shall –
 - (a) Undertake the operations and management of the projects, either directly or through appropriate agents.
 - (b) Oversee the progress of development, approval status and other aspects of the project upto its completion, in case of appointment of agents for the purpose of execution.
- (3) The project manager shall discharge all obligations in respect of achieving timely completion of the project implementation agreement/infrastructure project, wherever applicable, implementation, operation, maintenance and management of such infrastructure project in terms of the project management agreement.

Q13. What are the provisions with respect to collective holding of units by the sponsors and sponsor groups in the InvIT?

Ans.: Collective holding of units by the sponsors and sponsor groups for 3 years from the date of listing of units in the initial offer [Regulation 12(3A)]: The sponsors and sponsor groups shall, at all times, collectively hold not less than 15% of the total outstanding units of the InvIT, for 3 years from the date of listing of units in the initial offer, subject to the following:

- (a) Sponsors and sponsor groups would be responsible for all acts, omissions, representations and covenants of the InvIT related to the formation of InvIT or sale or transfer of assets/Holdco/SPV to the InvIT.
- (b) The InvIT or the trustee of the InvIT shall also have recourse against the sponsors and sponsor groups for any breach in this regard.
- (c) Project manager of the InvIT shall be the sponsor or an associate of the sponsor and shall continue to act in such capacity for a period of minimum 3 years from the date of listing of InvIT units unless suitable replacement is appointed by the unit holders through the Trustee.

The condition as specified in clause (c) shall not be applicable where the sponsors and sponsor groups together hold not less than 25% of the total outstanding units of the InvIT after initial offer of units, at all times, during a period of first 3 years from the date of the listing of units issued in initial offer.

Any holding by sponsor and sponsor group exceeding the 15% or 25%, as the case may be, shall be held for a period of not less than one year from the date of listing of units issued in initial offer.

In case of PPP projects where the InvIT is investing in infrastructure assets through SPVs, in case such acquiring or holding is disallowed by government or under any provisions of the concession agreement or any other such agreement –

- (i) The sponsor may continue to maintain such holding at the SPV level.
- (ii) The consolidated value of all such holdings at the SPV level and the value of the units of InvIT held by the sponsor shall not be less than the value of 15% of the total units of the InvIT after initial issue of units on a post-issue basis.
- (iii) Such units of the InvIT and shares or interest in the SPV shall be held for a period of not less than 3 years from the date of the listing of units of the InvIT.
- (iv) In case such holding of sponsor in the SPV results in the InvIT not having controlling interest and not having more than 51% shareholding or interest in the SPV, the sponsor shall enter into a binding agreement with the InvIT to ensure that decisions taken by the sponsor including voting with respect to the SPV are in compliance with these regulations and not against the interest of the InvITs or the unit holders and shall be subject to further guidelines as may be specified by the SEBI.

Collective holding of units by the sponsors and sponsor groups from 4th year to 20th year [Regulation 12(3A)]: The sponsors and sponsor groups shall collectively hold not less than –

- (i) 5% of the total outstanding units of the InvIT, from the beginning of 4th year and till the end of 5th year from the date of listing of the units issued in the initial offer.
- (ii) 3% of the total outstanding units of the InvIT, from the beginning of 6th year and till the end of 10th year from the date of listing of the units issued in the initial offer.
- (iii) 2% of the total outstanding units of the InvIT, from the beginning of 11th year and till the end of 20th year from the date of listing of the units issued in the initial offer.
- (iv) 1% of the total outstanding units of the InvIT, after the completion of the 20th year from the date of listing of units issued in the initial offer.

The maximum value of units to be held by sponsors and sponsor groups for compliance with clauses (i) to (iv) shall not exceed ₹ 500 Crore or such other value as may be decided by the SEBI from time to time and such valuation shall be based on the latest available net asset value of the of the InvIT.

An assessment of compliance of requirements under clauses (j) to (iv) shall be done at the time of each fresh issuance of units and at the beginning of change in threshold of the percentage for minimum unit holding requirement.

For InvITs that have already issued units pursuant to an initial offer as on the date of coming into effect of the SEBI (Infrastructure Investment Trusts) (Second Amendment) Regulations, 2023, the provisions contained in Regulation 12(3) & (3A) shall be applicable only for the additional units issued by the InvIT after such date and the units that are locked in at the time of initial offer shall continue to be locked in till the completion of 3 years from the date of listing of units in such initial offer.

Lock-in of units [Regulation 13(5)]: The units required to be held in terms of Regulation 12(3) & (3A) shall be locked-in and shall not be encumbered.

However, any encumbrance created on units held to comply with the minimum unit holding requirement applicable before the date of coming into effect of the SEBI (Infrastructure Investment Trusts) (Second Amendment) Regulations, 2023, may continue if the encumbrance exist on such date.

Q14. What are the rights and responsibilities of the auditor under the SEBI (Infrastructure Investment Trusts) Regulations, 2014?

Ans.: Rights and responsibilities of the auditor [Regulation 13(2)]: The auditor shall comply with the following conditions at all times,—

- (a) **Audit Report:** The auditor shall conduct audit of the accounts of the InvIT and draft the audit report based on accounts examined by him and after taking into account the relevant accounting and auditing standards, specified by the SEBI.
- (b) **True and fair view:** The auditor shall, to the best of his information and knowledge, ensure that the accounts and financial statements give a true and fair view of the state of the affairs of the InvIT, including profit or loss and cash flow for the period and other specified matters.
- (c) **Right of access of books of accounts:** The auditor shall have a right of access at all times to the books of accounts and vouchers pertaining to activities of the InvIT.
- (d) **Right to obtain information and explanation:** The auditor shall have a right to require such information and explanation pertaining to activities of the InvIT as he may consider necessary for the performance of his duties as auditor from the employees of InvIT or Holdco or parties to the InvIT or Holdco or SPV or any other person in possession of such information.
- (e) **Limited review of the audit in case of consolidation:** The auditor shall undertake a limited review of the audit of all the entities or companies whose accounts are to be consolidated with the accounts of the InvIT as per the applicable Indian Accounting Standards (Ind AS) and any

addendum thereto as defined in Rule 2(1)(a) of the Companies (Indian Accounting Standards) Rules, 2015, in a manner specified by the SEBI.

Q15. What are the different rights of the unit holders in an Infrastructure Investment Trust? [June 2023 (3 Marks)]

Ans.: 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.

OFFER & LISTING OF UNITS OF INVIT

Q16. Bharat Infrastructure Investment, a registered InvIT with SEBI proposes to raise funds by making initial offer of its units. In this connection you are required to state the provisions relating to following matters:

- (i) Value of assets
- (ii) Offer size
- (iii) Minimum offer and allotment to public

Ans.: Initial offer of units by an InvIT [Regulation 14(1)]: No initial offer of units by an InvIT shall be made unless –

- (a) The InvIT is registered with the SEBI.
- (b) Value of InvIT assets is not less than ₹ 500 Crore.
- (c) Offer size is not less than ₹ 250 Crore.

The requirement of ownership of assets under clause (b) and offer size under clause (c) 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 parties that such the requirements shall be fulfilled prior to such allotment and a declaration to the 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.

Minimum offer and allotment to public [Regulation 14(1A)]: The minimum offer and allotment to public through an offer document/placement memorandum shall be –

- At least 25% of the total outstanding units of the InvIT, if the post issue capital of the InvIT calculated at offer price is less than ₹ 1,600 Crore.
- Of the value of at least ₹ 400 Crore, if the post issue capital of the InvIT calculated at offer price is equal to or more than ₹ 1,600 Crore and less than ₹ 4,000 Crore.
- At least 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 ₹ 4,000 Crore.

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.

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 3 years from the date of listing pursuant to initial offer.

Q17. What are the conditions applicable to InvIT for raising funds by way of private placement?

Ans.: Conditions applicable to InvIT for raising funds by way of private placement [Regulation 14(2)]:

- The InvIT may raise funds by way of private placement through a placement memorandum.
- Funds by way of private placement shall be raised 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.
- Minimum investment from any investor shall be ₹ 1 Crore. 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 ₹ 25 Crore.
- Such funds can be raised from not less than 5 and not more than 1,000 investors. Maximum subscription from any investor other than sponsors, its related parties and its associates, in initial offer shall not be more than 25% of the total unit capital.
- The InvIT shall file a placement memorandum with the SEBI along with the fee as specified in Schedule II, 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 exchanges.

- The InvIT shall file the final placement memorandum with the SEBI within a period of 10 working days from the date of listing of the units issued therein.

Q18. Explain the circumstances under which an Investment Manager of an Infrastructure Investment Trust (InvIT) can apply to SEBI and the designated Stock Exchange for delisting of its units.

[Dec. 2019 (5 Marks)]

Ans.: Delisting of units and winding-up of the InvIT [Regulation 17]:

- The investment manager shall apply for delisting of units of the InvIT to the SEBI and the designated stock exchanges in following cases –
 - If the public holding falls below the specified limit. [Specified limit is 25%]
 - If the number of unit holders of the InvIT falls below specified limit. [Specified limit is 5 unit holder for private placement and 20 unit holder for public issue]
 - If there are no projects or assets remaining under the InvIT for a period exceeding 6 months and InvIT does not propose to invest in any project in future. However, the period may be extended by further 6 months, with the approval of unit holders.
 - If the SEBI or the designated stock exchanges require such delisting for violation of the listing agreement or these regulations or the SEBI Act, 1992.
 - If the trustee and investment manager requests such delisting and such request has been approved by unit holders. However, exit shall be provided to dissenting unit holders.
 - If unit holders apply for delisting in accordance with Regulation 22.
 - If the SEBI or the designated stock exchanges require such delisting in the interest of the unit holders. However, if clause (a) or (b) is breached, the trustee may provide a period of 6 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.
- The SEBI and the designated stock exchange may consider such application for delisting for approval or rejection as may be appropriate in the interest of the unit holders.
- The 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 Regulation 17(1).

- (4) The SEBI may reject the application for delisting and take any other action, as it deems fit, under the regulations or the Act for violation of the listing agreement or the regulations or the Act.
- (5) 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 the SEBI and by the designated stock exchanges from time to time.
- (6) After delisting of its units, the InvIT shall surrender its certificate of registration to the SEBI and shall no longer undertake activity of an InvIT.
- (7) 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 the SEBI.

INVESTMENT CONDITIONS, RELATED PARTY TRANSACTIONS, BORROWING & VALUATION OF ASSETS

Q19. Enumerate the rules for distribution of cash flows by InvIT.

[June 2021 (5 Marks)]

Ans.: Rules for distribution of cash flows by InvIT [Regulation 18(6)]: With respect to distributions made by the InvIT and the Holdco 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 LLP 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 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 InvIT.
 - (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 InvIT.
- (d) Such distributions shall be declared and made not less than once every 6 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 fifteen days from the date of such declaration.
- (e) Subject clause (d), 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 InvIT in terms of clause (d), shall be transferred to the 'Investor

Protection & Education Fund' constituted by the SEBI. However, amount transferred to Investor Protection & Education fund shall not bear any interest.

- (g) The unclaimed or unpaid amount of a person that has been transferred to the Investor Protection and Education Fund may be claimed in manner specified by the SEBI.

Q20. Explain the provisions relating to "related party transactions" of an InvIT under the SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Ans.: Related Party Transactions [Regulation 19]:

- (1) **Related party transactions shall be on an arms-length basis:** All related party transactions shall be on an arms-length basis in accordance with relevant accounting standards, in the best interest of the unit holders, consistent with the strategy and investment objectives of the InvIT.
- (2) **Disclosure of related party transactions:** All related party transactions of an InvIT shall be disclosed,–
 - (a) In the offer document or placement memorandum with respect to any such transactions entered into prior to the offer of units and any such proposed transactions subsequent to the offer.
 - (b) To the designated stock exchanges and unit holders periodically in accordance with the listing agreement and these regulations.
- (3) **Cases in which approval of unit holders is required:** In case of following related party transactions which are entered after initial public offer, approval from the unit holders shall be obtained prior to entering into any subsequent transaction –
 - (a) Total value of all the related party transactions, in a financial year, pertaining to acquisition or sale of assets whether directly or through Holdco or through SPV, or investments into securities exceeds 5% of the value of the InvIT assets.
 - (b) Value of the funds borrowed from related parties, in a financial year, exceeds 5% of the total consolidated borrowings of the InvIT, Holdco and the SPVs.
- (4) **When transaction between two InvITs deemed to be related party transactions:** Transaction between two or more of the InvITs with a common investment manager or sponsor, shall be deemed to be related party transactions for each of the InvITs. This provision shall also apply if the investment managers or sponsors of the InvITs are different entities but are associates.
- (5) **Disclosure to designated stock exchanges of details of fees or commissions received by related party:** With respect to any related party transaction, details of any fees or commissions received or to be received

by such related party shall be adequately disclosed to the designated stock exchanges.

(6) Disclosure in offer document or placement memorandum if related party has interest in competing business: Where any of the related parties have an interest in a business which competes or is likely to compete, either directly or indirectly, with the activities of the InvIT, the following details shall be disclosed in the offer document or placement memorandum,—

- (a) Details of such business including an explanation as to how such business shall compete with the InvIT.
- (b) A declaration that the related party shall perform its duty in relation to the InvIT independent of its related business;
- (c) Declaration as to whether any acquisition of such business by the InvIT is intended and if so, details of the same thereof.

(7) Power of SEBI to specify additional guidelines: The SEBI may specify additional guidelines with respect to related party transactions, as it deems fit.

Q21. Explain the provisions relating to “borrowings and deferred payments” of an InvIT under the SEBI (Infrastructure Investment Trusts) Regulations, 2014.

Ans.: Borrowings and deferred payments [Regulation 20]:

- (1) An InvIT, whose units are listed on a recognized stock exchange, may issue debt securities in the manner specified by the SEBI. However, debt securities shall be listed on recognized stock exchange.
- (2) The aggregate consolidated borrowings and deferred payments of the InvIT, Holdco and the SPVs, net of cash and cash equivalents shall not exceed 70% of the value of InvIT assets.

Explanation 1: Investment by InvITs in overnight mutual funds, characterized by their investments in overnight securities, having maturity of one day, shall be considered as cash and cash equivalent.

Explanation 2: The amount of cash and cash equivalent shall be excluded from the value of the assets of the InvIT.

- (3) If the aggregate consolidated borrowings and deferred payments of the InvIT, Holdco and the SPVs, net of cash and cash equivalents exceed 25% of the value of the InvIT assets, for any further borrowing —
 - (a) Up to 49%, an InvIT shall —
 - (i) Obtain credit rating from a credit rating agency registered with the SEBI and
 - (ii) Seek approval of unit holders.

(b) Above 49%, an InvIT shall —

- (i) Obtain a credit rating of “AAA” or equivalent for its consolidated borrowing and the proposed borrowing, from a credit rating agency registered with the SEBI.
 - (ii) Utilize the funds only for acquisition or development of infrastructure projects.
 - (iii) Have a track record of at least six distributions, in terms of Regulation 18(6), on a continuous basis, post listing, in the years preceding the financial year in which the enhanced borrowings are proposed to be made.
 - (iv) Obtain the approval of unit holders.
- (4) If specified conditions are breached on account of market movements of the price of the underlying assets or securities, the investment manager shall inform the same to the trustee and ensure that the conditions are satisfied within 6 months of such breach.

RIGHTS OF UNIT HOLDERS, GENERAL OBLIGATIONS, DISCLOSURES & REPORTING

Q22. What rights are available to unit holders in InvITs?

Ans.: 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/semiannual financials etc.

Q23. Which type of information relating to the operation or performance of the InvIT shall disclosed by the investment manager to the designated stock exchange?

Ans.: As per Regulation 23(6) of the SEBI (Infrastructure Investment Trusts) Regulations, 2014, the investment manager shall disclose to the designated stock exchanges any information having bearing on the operation or performance of the InvIT as well as price sensitive information which includes but is not restricted to the following —

- (a) Acquisition or disposal of any projects, directly or through Holdco or SPV, value of which exceeds 5% of value of the InvIT assets.
- (b) Additional borrowing, at level of Holdco or SPV or the InvIT, exceeding 15% of the value of the InvIT assets.
- (c) Additional issue of units by the InvIT.
- (d) Details of any credit rating obtained by the InvIT and any change in such rating.
- (e) Any issue which requires approval of the unit holders.
- (f) Any legal proceedings which may have significant bearing on the functioning of the InvIT.
- (g) Notices and results of meetings of unit holders.
- (h) Any instance of non-compliance with the regulations including any breach of specified limits.
- (i) Any material issue that in the opinion of the investment manager or trustee needs to be disclosed to the unit holders.

Q24. Which type of record pertaining to the activities of the InvIT shall be maintained by the Investment Manager under the SEBI (Infrastructure Investment Trusts) Regulations, 2014?

Or

Explain the provisions relating to maintenance of records by an investment manager pertaining to the activity of the InvIT.

[Dec. 2020 (5 Marks)]

Or

Explain the provision relating to maintenance of records by an investment manager under the SEBI Infrastructure Investment Trusts (InvITs) Regulations.

[June 2024 (5 Marks)]

Ans.: Maintenance of records by the Investment Manager [Regulation 26(1)]: 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 as specified in Regulation 10(5).
- (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 the SEBI, if any.
- (n) Any other material documents.

TAXMANN

DEFINITIONS

Q1. Explain the meaning of following terms under the SEBI (Alternative Investment Funds) Regulations, 2012:

(i) Investable funds

(ii) Social impact fund @digdy.com 26-07-2024

(iii) Social venture

(iv) Venture capital fund

Ans.: Investable Funds [Regulation 2(1)(p)]: 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.

Explanation: 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.

Social Impact Fund [Regulation 2(1)(ib)]: 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 Venture [Regulation 2(1)(u)]: 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.

Venture capital fund [Regulation 2(1)(z)]: Venture capital fund means 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. It includes an angel fund.

Q2. Write short note on: Accredited Investor & Large Value Accredited Investor
[Dec. 2022 (3 Marks)]

Ans.: Accredited Investor [Regulation 2(1)(ab)]: 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:
- Annual income of at least ₹ 2 Crore or
 - Net worth of at least ₹ 7.50 Crore, out of which not less than ₹ 3.75 Crore is in the form of financial assets or
 - Annual income of at least ₹ 1 Crore and minimum net worth of ₹ 5 Crore, out of which not less than ₹ 2.50 Crore is in the form of financial assets.
- (ii) In case of a body corporate, has net worth of at least ₹ 50 Crore.
- (iii) In case of a trust other than family trust, has net worth of at least ₹ 50 Crore.
- (iv) In case of a partnership firm set-up under the Indian Partnership Act, 1932, each partner independently meets the eligibility criteria for accreditation.

Deemed to be an accredited investor: Following shall be deemed to be an accredited investor and may not be required to obtain a certificate of accreditation –

- ◆ Central Government and State Governments
- ◆ Developmental agencies set-up under the aegis of Central Government or State Governments
- ◆ Funds set-up by Central Government or State Governments
- ◆ Qualified institutional buyers
- ◆ Category-I Foreign Portfolio Investors
- ◆ Sovereign wealth funds and multilateral agencies
- ◆ Any other entity specified by the SEBI.

Large value fund for accredited investors [Regulation 2(1)(p)]: 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 ₹ 70 Crore.

Q3. Write a short note on: Alternative Investment Fund
[June 2013 (4 Marks)]

Ans.: Alternative Investment Fund [Regulation 2(1)(b)]: Alternative Investment Fund means any fund established in the form of a trust or a company or a LLP or a body corporate.

It is a privately pooled investment vehicle that collects funds from investors for investing it in accordance with a defined investment policy for the benefit of its investors.

Funds covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of the SEBI cannot be traded Alternative Investment Fund.

Following shall not be considered as Alternative Investment Fund –

- Family trusts set-up for benefit of 'relatives' as defined under the Companies Act, 2013.
- ESOP Trusts set-up under the SEBI (Share Based Employee Benefits) Regulations, 2021 or as permitted under the Companies Act, 2013.
- Employee welfare trusts or gratuity trusts set-up for the benefit of employees.
- Holding companies as defined under section 2(46) of the Companies Act, 2013.
- Other special purpose vehicles not established by fund managers, including securitization trusts, regulated under a specific regulatory framework.
- Funds managed by securitization company or reconstruction company which is registered with the RBI under section 3 of the SRFSAESI Act, 2002.
- Any such pool of funds which is directly regulated by any other regulator in India.

REGISTRATION & CATEGORIES OF ALTERNATIVE INVESTMENT FUNDS

Q4. Discuss briefly the various categories of Alternative Investment Fund (AIF).
[Dec. 2013 (5 Marks)]

Or

SEBI has classified Alternative Investment Fund (AIF) into three broad categories i.e. Category-I, Category-II and Category-III. Discuss key features of AIF categories.
[June 2018 (5 Marks)]

Or

Which categories of Alternative Investment Funds (AIF) are available for the investors to make investment? Explain. [Dec. 2022 (5 Marks)]

Ans.: Categories of Alternative Investment Fund [Regulation 3(4)]: Alternative Investment Funds shall seek registration in one of the categories mentioned below:

Category-I Alternative Investment Fund: It invests 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.

Category-II Alternative Investment Fund: It does not fall in Category-I and Category-III and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements.

Category-III Alternative Investment Fund: It employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives.

Specified Alternative Investment Fund: Specified Alternative Investment Fund under Regulation 19.

Q5. List down eligibility criteria for getting registered with the SEBI as Alternative Investment Funds. [Dec. 2014 (5 Marks)]

Ans.: Eligibility Criteria [Regulation 4]: For the purpose of the grant of certificate to an applicant, the SEBI shall consider the following conditions for eligibility —

- The memorandum of association in case of a company; or the Trust Deed in case of a Trust; or the Partnership deed in case of LLP permits it to carry on the activity of an Alternative Investment Fund.
- The applicant is prohibited by its memorandum and articles of association or trust deed or partnership deed from making an invitation to the public to subscribe to its securities.
- In case the applicant is a Trust, the instrument of trust is in the form of a deed and has been duly registered under the provisions of the Registration Act, 1908.
- In case the applicant is LLP, the partnership is duly incorporated and the partnership deed has been duly filed with the Registrar under the provisions of the LLP Act, 2008.
- In case the applicant is a body corporate, it is set up or established under the laws of the Central or State Legislature and is permitted to carry on the activities of an Alternative Investment Fund.
- The applicant, Sponsor and Manager are fit and proper persons based on the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008.
- The key investment team of the Manager of Alternative Investment Fund has —
 - At least one key personnel with relevant certification as may be specified by the SEBI.

- At least one key personnel with professional qualification in finance, accountancy, business management, commerce, economics, capital market or banking from a university or an institution recognized by the Central Government or any State Government or a foreign university, or CFA charter from the CFA institute or any other qualification as may be specified by the SEBI.
- The Manager or Sponsor has the necessary infrastructure and manpower to effectively discharge its activities.
 - The applicant has clearly described at the time of registration the investment objective, the targeted investors, proposed corpus, investment style or strategy and proposed tenure of the fund or scheme.
 - Whether the applicant or any entity established by the Sponsor or Manager has earlier been refused registration by the SEBI.

Q6. "An Alternative Investment Fund which has been granted registration under a particular category cannot change its category subsequent to registration, except with the approval of the SEBI". Enumerate the conditions for approval of SEBI. [June 2019 (5 Marks)]

Ans.: As per Regulation 7(2) of the SEBI (Alternative Investment Funds) Regulations, 2012, "An Alternative Investment Fund which has been granted registration under a particular category cannot change its category subsequent to registration, except with the approval of the SEBI."

In this regard the SEBI has issued circular CIR/IMD/DF/12/2013 dated August 7, 2013 which provides following conditions for change in category subsequent to registration.

- 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.
- Any AIF proposing to change its category shall make an application to SEBI for the same along with application fees of ₹ 1 lakh. The application shall include the updated Form A, other updated supporting documents, if any and rationale for the proposed change. Registration fees shall not apply for such applications.
- If the AIF has received commitments/raised funds prior to application for change in category, the AIF shall be required to send letters/emails to all its investors providing them the option to withdraw their commitments/funds raised without any penalties/charges. Any fees collected from investors seeking to withdraw commitments/funds shall be returned to them. Partial withdrawal may be allowed subject to compliance with the minimum investment amount required under the AIF Regulations.
- The AIF shall not make any investments other than in liquid funds/banks deposits until approval for change in category is granted by SEBI.

- (5) On approval of the request from SEBI, the AIF shall send a copy of the revised placement memorandum and other relevant information to all its investors.

INVESTMENT CONDITIONS, LISTING & RESTRICTIONS

Q7. Investment in all categories of Alternative Investment Funds shall be subject to certain conditions. Comment. [June 2017 (5 Marks)]

Or

Dollar LLC from Singapore wants to invest in an AIF fund in India and have approached you to understand how investment in AIF works in India? Can they invest in an AIF in India? [Dec. 2013 (5 Marks)]

Ans.: Investment Strategy [Regulation 9]: All Alternative Investment Funds shall state investment strategy, investment purpose and its investment methodology in its placement memorandum to the investors.

Any material alteration to the fund strategy shall be made with the consent of at least 2/3rd of unit holders by value of their investment in the Alternative Investment Fund.

Investment in Alternative Investment Fund [Regulation 10]: Investment in all categories of Alternative Investment Funds shall be subject to following conditions:

- (a) **Who can invest:** The Alternative Investment Fund may raise funds from any investor whether Indian, foreign or non-resident Indians by way of issue of units.
A social impact fund or schemes of social impact fund may also issue social units.
- (b) **Issue of units in dematerialized form:** The Alternative Investment Fund shall issue units in dematerialized form subject to the conditions specified by the SEBI.
- (c) **Corpus:** Each scheme of the Alternative Investment Fund shall have corpus of at least ₹ 20 Crore. Each scheme of the social impact fund shall have a corpus of at least ₹ 5 Crore.
- (d) **Minimum investment for investor:** The Alternative Investment Fund shall not accept from an investor, an investment of value less than ₹ 1 Crore.

In case of investors who are employees or directors of the Alternative Investment Fund or employees or directors of the Manager, the minimum value of investment shall be ₹ 25 lakh.

This clause shall not apply to an accredited investor.

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 ₹ 2 lakh.

- (e) **Investment of Manager and Sponsor:** The Manager or Sponsor shall have a continuing interest in the Alternative Investment Fund of not less than 2.5% of the corpus or ₹ 5 Crore, 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.
For Category-III Alternative Investment Fund, the continuing interest shall be not less than 5% of the corpus or ₹ 10 Crore, whichever is lower.
- (f) **Disclosure of Investment by Manager and Sponsor:** The Manager or Sponsor shall disclose their investment in the Alternative Investment Fund to the investors of the Alternative Investment Fund.
- (g) **Maximum investors:** No scheme of the Alternative Investment Fund shall have more than 1,000 investors. However, the provisions of the Companies Act, 2013 shall apply to the Alternative Investment Fund, if it is formed as a company.
- (h) **Funds can be collected by way of private placement:** The Alternative Investment Fund shall not solicit or collect funds except by way of private placement.

Thus, Dollar LLC, Singapore can invest in an AIF in India subject to compliance of above stated provisions.

Q8. Alternative Investment Fund shall raise funds through private placement by issue of Placement Memorandum. In relation to this statement state the information required to be contained in Placement Memorandum.

Ans.: Placement Memorandum [Regulation 11]: Alternative Investment Fund shall raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called.

Such information or placement memorandum shall contain all material information about the Alternative Investment Fund.

Information or placement memorandum shall contain following information:

- ◆ Information as to 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
- ◆ Affiliations with other intermediaries
- ◆ Manner of winding-up of the Alternative Investment Fund or the scheme
- ◆ Such other information as may be necessary for the investor to take an informed decision on whether to invest in the Alternative Investment Fund.

Q9. Write a short note on: Listing of Alternative Investment Fund & Units of Angel Funds

Ans.: Listing [Regulation 14]:

- (1) Units of close ended Alternative Investment Fund may be listed on stock exchange subject to a minimum tradable lot of ₹ 1 Crore.
- (2) Listing of Alternative Investment Fund units shall be permitted only after final close of the fund or scheme.

Prohibition of Listing [Regulation 19H]: Units of angel funds shall not be listed on any recognized stock exchange.

Q10. SEBI has issued guidelines for overseas investment by Alternative Investment Funds (AIFs)/Venture Capital Funds (VCFs) vide its Circular No. SEBI/Ho/AFD-1/PoD/CIR/P/2022/108 dated August 17, 2022. In reference to above referred circular, in which overseas entities, an AIF/VCF may not invest? [June 2023 (5 Marks)]

Ans.: As per the asked circular, AIFs/VCFs 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:

- (a) A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply.
- (b) 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.

ANGEL FUNDS

Q11. Explain the conditions to become an Angel Investor under the SEBI (Venture Capital Fund) Regulations, 1996. [Dec. 2020 (5 Marks)]

Ans.: Angel Fund [Regulation 19A(1)]: 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 of the AIF Regulations.

Angel Investor [Regulation 19A(2)]: Angel investor means any person who proposes to invest in an angel fund and satisfies one of the following conditions –

- (a) An individual investor who has net tangible assets of at least ₹ 2 Crore excluding value of his principal residence, and:
 - (i) Who has early stage investment experience or
 - (ii) Who has experience as a serial entrepreneur or
 - (iii) Who is a senior management professional with at least 10 years of experience.

Explanation: '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 ₹ 10 Crore.
- (c) An Alternative Investment Fund registered under these regulations or Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations, 1996.

Q12. Whether investments by Angel Funds are restricted by any specific guidelines? Discuss. [June 2021 (5 Marks)]

Ans.: Investment by Angel Funds [Regulation 19F]:

- (1) Angel funds shall invest in startups:
 - (a) Which are not promoted or sponsored by or related to an industrial group whose group turnover exceeds ₹ 300 Crore.

Explanation I: "Industrial Group" shall include a group of body corporates with the same promoters/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. *Explanation II:* "Group Turnover" shall mean combined total revenue of the industrial group.
 - (b) Which 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 ₹ 25 lakh and shall not exceed ₹ 10 Crore.
- (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 25% of the total investments under all its schemes in one venture capital undertaking. The compliance to this provision 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 RBI and the SEBI from time to time.

Q13. Bon wants to invest in Angel Funds. Explain how an investment can be made in an Angel Fund and in which type of undertakings an Angel Fund can invest. Can units of Angel Funds be listed on a stock exchange?

[Dec. 2021 (5 Marks)]

Ans.: Angel Fund [Regulation 19A(1)]: 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 of the AIF Regulations.

Angel Investor [Regulation 19A(2)]: Angel investor means any person who proposes to invest in an angel fund and satisfies one of the following conditions—

- (a) An individual investor who has net tangible assets of at least ₹ 2 Crore excluding value of his principal residence, and:
 - (i) Who has early stage investment experience or
 - (ii) Who has experience as a serial entrepreneur or
 - (iii) Who is a senior management professional with at least 10 years of experience.

Explanation: '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 ₹ 10 Crore.
- (c) An Alternative Investment Fund registered under these regulations or Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations, 1996.

Investment in angel funds [Regulation 19D]:

- (1) Angel funds shall only raise funds by way of issue of units to angel investors.
- (2) An angel fund shall have a corpus of at least ₹ 5 Crore.
- (3) Angel funds shall accept, up to a maximum period of 5 years, an investment of not less than ₹ 25 lakh from an angel investor.
- (4) Angel fund shall raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called. The provisions of the Companies Act, 2013 shall apply to the Angel Fund, if it is formed as a company.

Therefore, Bon may invest in Angel Fund if qualifies for investment as stated above.

Investment by Angel Funds [Regulation 19F]:

- (1) Angel funds shall invest in startups:
 - (a) Which are not promoted or sponsored by or related to an industrial group whose group turnover exceeds ₹ 300 Crore.
 - (b) Which 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 ₹ 25 lakh and shall not exceed ₹ 10 Crore.
- (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 25% of the total investments under all its schemes in one venture capital undertaking. The compliance to this provision 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 RBI and the SEBI from time to time.

Prohibition of Listing [Regulation 19H]: Units of angel funds shall not be listed on any recognized stock exchange.

Q14. What are the conditions to become an Angel Investor under the SEBI (Venture Capital Fund) Regulations, 1996?

[June 2024 (5 Marks)]

Ans.:

Angel Fund [Regulation 19A(1)]: 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 of the AIF Regulations.

Angel Investor [Regulation 19A(2)]: Angel investor means any person who proposes to invest in an angel fund and satisfies one of the following conditions—

- (a) An individual investor who has net tangible assets of at least ₹ 2 Crore excluding value of his principal residence, and:
 - (i) Who has early stage investment experience or
 - (ii) Who has experience as a serial entrepreneur or
 - (iii) Who is a senior management professional with at least 10 years of experience.

Explanation.— '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 ₹ 10 Crore.
- (c) An Alternative Investment Fund registered under these regulations or Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations, 1996.

SPECIAL SITUATION FUNDS

Q15. Define Special Situation Fund. What are the conditions of an investment by special situation fund? [Dec. 2023 (5 Marks)]

Or

Write a short note on: Investment by special situation funds

Ans.: Special Situation Fund [Regulation 19-I(3)]: Special Situation Fund means a Category-I 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 & Bankruptcy Code, 2016.

Investment by special situation funds [Regulation 19M]:

- (1) Special situation funds shall invest only in special situation assets and may act as a resolution applicant under the Insolvency & Bankruptcy Code, 2016. However, the special situation fund shall not invest in –
- Its associates.
 - Units of any other AIF other than the units of a special situation fund.
 - Units of special situation funds managed or sponsored by its manager, sponsor or associates of its manager or sponsor.
- (2) Any investment by a special situation fund in the stressed loan acquired under clause 58 of the Master Direction – RBI (Transfer of Loan Exposures) Directions, 2021 as amended from time to time shall be subject to lock-in period as may be specified by the SEBI. In this context, SEBI *vide* its Circular has specified the following:
- Each scheme of SSF shall have a corpus of at least ₹ 100 Crore.
 - SSF shall accept an investment of value not less than ₹ 10 Crore from an investor. In case of an accredited investor, the SSF shall accept an investment of value not less than ₹ 5 Crore. 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 ₹ 25 lakh.
 - SSF intending to act as a resolution applicant under the Insolvency & Bankruptcy Code, 2016 shall ensure compliance with the eligibility requirement provided thereunder.

Q16. 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. [Dec. 2022 (5 Marks)]

Ans.: Special Situation Fund [Regulation 19-I(3)]: Special Situation Fund means a Category-I 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 & Bankruptcy Code, 2016.

Investment in special situation funds [Regulation 19L]:

- 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.

Q17. Define special situation fund. How investment in special situation fund is made as per SEBI (AIF) Regulations, 2012 as amended? [Dec. 2022 (5 Marks)]

Ans.: Relevant provisions of the SEBI (Alternative Investment Funds) Regulations, 2012 are as follows:

Special Situation Fund [Regulation 19-I]: Special situation fund means a Category-I 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 & Bankruptcy Code, 2016.

Investment in special situation funds [Regulation 19L]:

- 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 [Regulation 19M]:

- Special situation funds shall invest only in special situation assets and may act as a resolution applicant under the Insolvency & 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.
- (2) Any investment by a special situation fund in the stressed loan acquired under clause 58 of the Master Direction – RBI (Transfer of Loan Exposures) Directions, 2021 as amended from time to time shall be subject to lock-in period as may be specified by the SEBI.

Q18. Explain the provisions relating to “Special Situation Fund” notified in SEBI (Alternative Investment Funds) (Amendment) Regulations, 2022. [June 2024 (5 Marks)]

Ans.:

Special Situation Fund [Regulation 19-I(3)]: Special Situation Fund means a Category-I 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 & Bankruptcy Code, 2016.

Registration of special situation funds [Regulation 19K]: An applicant may apply for registration as a special situation fund in accordance with the provisions of Chapter II of the Regulations.

Investment in special situation funds [Regulation 19L]:

- (1) Each scheme of a special situation fund shall have a corpus as may be specified by the SEBI.
- (2) The special situation fund shall accept from an investor, an investment of such value as may be specified by the SEBI.
- (3) 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 [Regulation 19M]:

- (1) Special situation funds shall invest only in special situation assets and may act as a resolution applicant under the Insolvency & Bankruptcy Code, 2016. However, the special situation fund shall not invest in –
 - (i) Its associates.
 - (ii) Units of any other AIF other than the units of a special situation fund.
 - (iii) Units of special situation funds managed or sponsored by its manager, sponsor or associates of its manager or sponsor.
- (2) Any investment by a special situation fund in the stressed loan acquired under clause 58 of the Master Direction – RBI (Transfer of Loan Exposures) Directions, 2021 as amended from time to time shall be subject to lock-in period as may be specified by the SEBI. In this context, SEBI *vide* its Circular has specified the following:

- (a) Each scheme of SSF shall have a corpus of at least ₹ 100 Crore.
- (b) SSF shall accept an investment of value not less than ₹ 10 Crore from an investor. In case of an accredited investor, the SSF shall accept an investment of value not less than ₹ 5 Crore. 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 ₹ 25 lakh.
- (c) SSF intending to act as a resolution applicant under the Insolvency & Bankruptcy Code, 2016 shall ensure compliance with the eligibility requirement provided thereunder.

GENERAL OBLIGATIONS, RESPONSIBILITIES & TRANSPARENCY

Q19. All Alternative Investment Funds shall ensure transparency and disclosure of information to investors. Comment.

[Dec. 2018 (5 Marks)]

Ans.: Transparency [Regulation 22]: All Alternative Investment Funds shall ensure transparency and disclosure of information to investors on the following:

- (a) Financial, risk management, operational, portfolio, and transactional information regarding fund investments shall be disclosed periodically to the investors.
- (b) Any fees ascribed to the Manager or Sponsor; and any fees charged to the Alternative Investment Fund or any investee company by an associate of the Manager or Sponsor shall be disclosed periodically to the investors.
- (c) Any inquiries/legal actions by legal or regulatory bodies in any jurisdiction, as and when occurred.
- (d) Any material liability arising during the Alternative Investment Fund's tenure shall be disclosed, as and when occurred.
- (e) Any breach of a provision of the placement memorandum or agreement made with the investor or any other fund documents, if any, as and when occurred.
- (f) Change in control of the Sponsor or Manager or Investee Company.
- (g) Alternative Investment Fund shall provide at least on an annual basis, within 180 days from the year end, reports to investors including following information:-
 - A. Financial information of investee companies.
 - B. Material risks and how they are managed which may include:
 - (i) Concentration risk at fund level.
 - (ii) Foreign exchange risk at fund level.
 - (iii) Leverage risk at fund and investee company levels.

- (iv) Realization risk (i.e. change in exit environment) at fund and investee company levels.
 - (v) Strategy risk (i.e. change in or divergence from business strategy) at investee company level.
 - (vi) Reputation risk at investee company level.
 - (vii) Extra-financial risks, including environmental, social and corporate governance risks, at fund and investee company level.
- (h) Category III Alternative Investment Fund shall provide quarterly reports to investors in respect of clause (g) within 60 days of end of the quarter;
- (i) Any significant change in the key investment team shall be intimated to all investors;
- (j) Alternative Investment Funds shall provide, when required by the SEBI, information for systemic risk purposes (including the identification, analysis and mitigation of systemic risks).

Q20. The Alternative Investment Fund shall carry out valuation of its investments as specified by the SEBI and has to provide to its investors, a description of its valuation procedure and of the methodology for valuing assets. Explain the relevant provisions of the AIF Regulation to support this statement.

Ans.: Valuation [Regulation 23]:

- (1) The Alternative Investment Fund (AIF) shall carry out valuation of its investments in the manner specified by the Board from time to time and provide to its investors, a description of its valuation procedure and of the methodology for valuing assets.
- (2) Category-I and Category-II AIF shall undertake valuation of their investments, at least once in every 6 months, by an independent valuer appointed by the Alternative Investment Fund. However, such period may be enhanced to one year on approval of at least 75% of the investors by value of their investment in the Alternative Investment Fund.
- (3) Category-III AIF shall ensure that calculation of the NAV is independent from the fund management function of the Alternative Investment Fund and such NAV shall be disclosed to the investors at intervals not longer than a quarter for close ended Funds and at intervals not longer than a month for open ended funds. For the purpose of calculation of NAV, Category-III AIF shall undertake valuation of their investment in unlisted securities and listed debt securities by an independent valuer.
- (4) The Manager shall ensure that the AIF appoints an independent valuer who satisfies the criteria specified by the SEBI from time to time.

- (5) The Manager and the KMP of the Manager shall ensure that the independent valuer computes and carries out valuation of the investments of the scheme of the AIF in manner specified by the SEBI.
- (6) The Manager shall be responsible for true and fair valuation of the investments of the scheme of the AIF.
In case the established policies and procedures of valuation do not result in fair and appropriate valuation, the Manager shall deviate from the established policies and procedures in order to value the assets or securities at a fair value and document the rationale for such deviation. Such deviation and its rationale shall be reported to the trustee or the trustee company or the Board of Directors or designated partners of the AIF and investors of the AIF.

Q21. Write a short note on: Maintenance of Records by AIF

Ans.: Maintenance of Records [Regulation 27]: The Manager or Sponsor shall be required to maintain following records describing:

- (a) 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.

Above records shall be maintained for a period of 5 years after the winding-up of the fund.

MISCELLANEOUS TOPICS

Q22. Write a short note on: Compliance Test Report (CTR)

Ans.: Compliance Test Report (CTR):

- ◆ As per SEBI Circular, 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 format as specified in the Annexure.
- ◆ The CTR shall be submitted within 30 days from the end of the financial year –
 - (i) To the trustee and sponsor, in case the AIF is a trust.
 - (ii) To the sponsor, in case of AIF set-up in the form other than a trust.
- ◆ 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.

- ◆ 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.

Q23. Discuss briefly Operational, Prudential & Reporting Norms for applicable for Alternative Investment Funds (AIFs).

Ans.: 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.

Submission of reports to SEBI: Category-I and Category-II AIFs and the Category-III AIFs which do not undertake leverage shall submit report to SEBI on a quarterly basis and Category-III AIFs which undertake leverage shall submit a report to SEBI on a monthly basis in the format as specified 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 that is to say if an AIF's NAV is ₹ 100 Crore, its exposure (Longs + shorts) after offsetting positions as permitted shall not exceed ₹ 200 Crore.

PRIVATE EQUITY & VENTURE CAPITAL

Q24. Write a short note on: Venture Capital Funds

[June 2011 (2 Marks)]

Or

"Venture capital fund invest in all type of securities". Comment.

[Dec. 2011 (3 Marks)]

Or

Explain: "Venture capital funds invest in all type of securities".

[Dec. 2015 (3 Marks)]

Ans.: Venture Capital is money provided by professionals who invest alongside investment, in young, rapidly growing companies that have the potential to develop into economic powerhouses.

A firm engaged in providing venture capital and related service is referred to a venture capitalist. Venture Capital firms are generally private partnership, or closely held private companies, funded by private pension funds. Venture Capital is also referred as **Risk Capital**.

Venture Capitalists:

- Finance new and rapidly growing companies.
- Purchases equity shares
- Assist in the development of new products or services
- Add value to the enterprise through active participation in management.

Venture Capitalists invest in:

- First generation businesses promoted by first generation entrepreneurs.
- Untried products and untested products and technology.
- High risk projects that have high risk but if successful have enormous rewards.

Stages of Venture Capital Financing: Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability. Venture capital firms usually recognize the following two main stages when the investment could be made in a venture namely:

A. Early Stage Financing

- Seed Capital & Research and Development Projects.
- Startups
- Second Round Finance

B. Later Stage Financing

- (i) Development Capital
- (ii) Expansion Finance
- (iii) Buy Outs
- (iv) Replacement Capital
- (v) Turn Around

Q25. Write a short note on: Private equity funds [Dec. 2012 (3 Marks)]

Or

Explain the categories of Private Equity Investment.

[Dec. 2019 (3 Marks)]

Or

What are the different types of Private Equity Investments?

[June 2023 (3 Marks)]

Ans.: 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 which 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:

- (a) **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.

- (b) **Venture Capital:** Venture Capital is money provided by professionals who invest alongside investment, in young, rapidly growing companies that have the potential to develop into economic powerhouses. A firm engaged in providing venture capital and related service is referred to a venture capitalist. Venture Capital firms are generally private partnership, or closely held private companies, funded by private pension funds. Venture Capital is also referred as **Risk Capital**.
- (c) **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.

Q26. Private equity fund is an unregistered investment vehicle in which investor's pool money to invest. Explain the concept of private equity fund and distinguish it from hedge fund. [June 2015 (5 Marks)]

Ans.: A private equity fund, like a hedge fund, is an unregistered investment vehicle in which investors pool money to invest. Private equity funds concentrate their investments in unregistered (and typically illiquid) securities. Like hedge funds, private equity funds also rely on the exemption from registration of the offer and sale of their securities. The investors in private equity funds and hedge funds typically include high net worth individuals and families, pension funds, endowments, banks and insurance companies. Private equity funds, however, differ from hedge funds in terms of the manner in which contribution to the investment pool is made by the investors.

Private equity investors typically commit to invest a certain amount of money with the fund over the life of the fund, and make their contributions in response to "capital calls" from the fund's general partner. Private equity funds are long term investments, provide for liquidation at the end of the term specified in the fund's governing documents and offer little, if any, opportunities for investors to redeem their investments. A private equity fund may distribute cash to its investors when it sells its portfolio investment, or it may distribute the securities of a portfolio company.

Q27. Define briefly the following in context of Indian equity private funding:

- (1) Alternative Investment Fund
- (2) Infrastructure Fund
- (3) Social Venture Fund
- (4) Sponsor
- (5) Venture Capital Fund

[Dec. 2020 (5 Marks)]

Ans.:

- 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:
 - 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
 - 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.
- Infrastructure Fund** : means an Alternative Investment Fund which invests primarily in enlisted 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 GOI from time to time.
- Social Venture Fund** : means an alternative investment fund which invests primarily in securities or units of social ventures and which satisfies social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns.
- 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
- "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.

Q28. Venture capital firms, finance both early and later stage investments to maintain a balance between risk and profitability. Explain early stage financing. [Dec. 2021 (5 Marks)]

Ans.: Early Stages Financing:

- (a) **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 commence 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 commercialized. Venture capitalists/firms/funds are always ready to undertake risks and make investments in such R & D projects promising higher returns in future.

- (b) **Startups:** The riskiest 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 tested keeping in view the various market forces. The finance required usually falls short of 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.
- (c) **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 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.

Q29. Discuss the concepts "Seed funding" and "Private Equity". [Dec. 2021 (5 Marks)]

Ans.: 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.

Q30. Distinguish between: Seed Funding and Start-up Financing [June 2022 (5 Marks)]

Ans.: Seed Funding: Please see the Answer of earlier Question.

Startup Financing: The riskiest 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 tested in the market forces. The finance required usually falls short of 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 industry experienced or corporate partner.

Q31. Explain the different stages of "Venture Capital Financing".
[Dec. 2022 (3 Marks)]

Ans.: Stages of Venture Capital Financing: Venture capital firms finance both early and later stage investments to maintain a balance between risk and profitability. Venture capital firms usually recognize the following two main stages when the investment could be made in a venture namely:

A. Early Stage Financing

- (i) Seed Capital & Research and Development Projects.
- (ii) Startups
- (iii) Second Round Finance

B. Later Stage Financing

- (i) Development Capital
- (ii) Expansion Finance
- (iii) Buy Outs
- (iv) Replacement Capital
- (v) Turn Around

FOREIGN VENTURE CAPITAL INVESTOR

Q32. Define – Foreign Venture Capital Investor as per the SEBI (Foreign Venture Capital Investor) Regulations, 2000. Also state the provisions and procedure for registration of Foreign Venture Capital Investors.

Ans.: Foreign Venture Capital Investor [Regulation 2(1)(g)]: Foreign venture capital investor means an investor incorporated and established outside India, is registered and proposes to make investment under the SEBI (Foreign Venture Capital Investor) Regulations, 2000.

Eligibility Criteria [Regulation 4]: For the purpose of the grant of a certificate to an applicant as Foreign Venture Capital Investor, the SEBI shall consider following conditions:

- (a) The applicants track record, professional competence, financial soundness, experience, general reputation of fairness and integrity.
- (b) Whether the applicant has been granted necessary approval by the RBI for making investments in India.
- (c) Whether the applicant is an investment company, investment trust, investment partnership, pension fund, mutual fund, endowment fund,

university fund, charitable institution or any other entity incorporated outside India.

- (d) Whether the applicant is an asset management company, investment manager or investment management company or any other investment vehicle incorporated outside India.
- (e) Whether the applicant is authorized to invest in venture capital fund or carry on activity as Foreign Venture Capital Investor or Alternative Investment Fund.
- (f) Whether the applicant is regulated by an appropriate foreign regulatory authority or is an income tax payer; or submits a certificate from its banker of its or its promoter's track record where the applicant is neither a regulated entity nor an income tax payer.
- (g) The applicant has not been refused a certificate by the SEBI.
- (h) Whether the applicant is a fit and proper person.

Criteria for fit and proper person [Regulation 4A]: For the purposes of determining whether an applicant or the foreign venture capital investor is a fit and proper person the SEBI may take into account the criteria specified in Schedule II of SEBI (Intermediaries) Regulations, 2008.

Furnishing of information, clarification [Regulation 5]: The SEBI may require the applicant to furnish such further information as it may consider necessary.

Consideration of application [Regulation 6]: An application which is not complete in all respects shall be rejected by the SEBI:

However, before rejecting any such application, the applicant shall be given an opportunity to remove, within 30 days of the date of receipt of communication, the objections indicated by the SEBI.

The SEBI may, on being satisfied that it is necessary to extend the period specified above may extend such period not beyond 90 days.

Procedure for grant of certificate [Regulation 7]: If the SEBI is satisfied that the applicant is eligible for the grant of certificate, it shall send intimation to the applicant.

On receipt of intimation, the applicant shall pay to the SEBI specified registration fee.

The SEBI shall on receipt of the registration fee grant a certificate of registration in Form B.

Conditions of certificate [Regulation 8]: The certificate granted to foreign venture capital investor under regulation 7 shall be *inter alia*, subject to the following conditions:

- (a) It shall abide by the provisions of the Act, and these regulations.
- (b) It shall appoint a domestic custodian for purpose of custody of securities.

- (c) It shall enter into arrangement with a designated bank for the purpose of operating a special non-resident rupee or foreign currency account.
- (d) It shall forthwith inform the SEBI in writing if any information or particulars previously submitted to the SEBI are found to be false or misleading in any material particular or if there is any change in the information already submitted.

Q33. Explain: Venture Capital Undertaking [Dec. 2018 (3 Marks)]

Ans.: Venture Capital Undertaking: As per Regulation 2(1)(m) of the SEBI (Foreign Venture Capital Investor) Regulations, 2000, Venture Capital Undertaking means a domestic company:

- (i) Which is not listed on a recognized stock exchange in India at the time of making investment; and
- (ii) Which is engaged in the business for providing services, production or manufacture of article or things.

Following activities or sectors are not Venture Capital Undertaking:

- (1) NBFCs, other than Core Investment Companies (CICs) in the infrastructure sector, Asset Finance Companies (AFCs), and Infrastructure Finance Companies (IFCs) registered with RBI.
- (2) Gold financing.
- (3) Activities not permitted under industrial policy of Government of India.
- (4) Any other activity which may be specified by the SEBI in consultation with Government of India from time to time.

Q34. The investment criteria for a foreign venture capital investor. Comment. [June 2017 (5 Marks)]

Or

What are the investment conditions for a Foreign Venture Capital Investors (FVCI)? [Dec. 2023 (3 Marks)]

Ans.: Investment Criteria for Foreign Venture Capital Investor: As per Regulation 11 of the SEBI (Foreign Venture Capital Investor) Regulations, 2000, all investments to be made by foreign venture capital investors shall be subject to the following conditions:

- (a) It shall disclose to the 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) At least 66.67% of the investible funds shall be invested in unlisted equity shares or equity linked instruments of venture capital undertaking or investee company as defined in Regulation 2(1)(o) of the SEBI (Alternative Investment Funds) Regulation, 2012.

(ii) Not more than 33.33% of the investible funds may be invested by way of:

- (A) Subscription to initial public offer of venture capital undertaking or investee company as defined in Regulation 2(1)(o) of the SEBI (Alternative Investment Funds) Regulation, 2012 whose shares are proposed to be listed.
- (B) Debt or debt instrument of venture capital undertaking or investee company as defined in Regulation 2(1)(o) of the SEBI (Alternative Investment Funds) Regulation, 2012 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.

Explanation: A financially weak company means a company, which has at the end of the previous financial year accumulated losses, which has resulted in erosion of more than 50% but less than 100% of its net worth as at the beginning of the previous financial 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 these Regulations.

Explanation: The investment conditions and restrictions stipulated in Regulation 11(c) shall be achieved by the Foreign Venture Capital Investor by the end of its life cycle.

Q35. What are the obligations of foreign venture capital investor? [Dec. 2010 (4 Marks)]

Ans.: Following are the general obligations and responsibilities of Foreign Venture Capital Investor:

Maintenance of books and records [Regulations 12]:

- (1) Every Foreign Venture Capital Investor shall maintain for a period of 8 years, books of accounts, records and documents which shall give a true and fair picture of the state of affairs of the Foreign Venture Capital Investor.
- (2) Every Foreign Venture Capital Investor shall intimate to the SEBI, in writing, the place where the books, records and documents are being maintained.

Power to call for information [Regulation 13]:

- (1) The SEBI may at any time call for any information from a Foreign Venture Capital Investor with respect to any matter relating to its activity as a Foreign Venture Capital Investor.
- (2) Where any information is called for by the SEBI it shall be furnished within specified time.

General Obligations and Responsibilities [Regulation 14]:

- (1) Foreign Venture Capital Investor or a global custodian acting on behalf of the foreign venture capital investor shall enter into an agreement with the domestic custodian to act as a custodian of securities for Foreign Venture Capital Investor.
- (2) Foreign Venture Capital Investor shall ensure that domestic custodian takes steps for –
 - (a) Monitoring of investment of Foreign Venture Capital Investors in India.
 - (b) Furnishing of periodic reports to the SEBI.
 - (c) Furnishing such information as may be called for by the SEBI.

Appointment of designated bank [Regulation 15]: Foreign Venture Capital Investor shall appoint a branch of a bank approved by RBI as designated bank for opening of foreign currency denominated accounts or special non-resident rupee account.

US-AD

TAXMANN

12

CHAPTER

RAISING OF FUNDS – NON-FUND
BASED

UNIT I

BONUS ISSUE

BONUS PROVISIONS – COMPANIES ACT, 2013

Q1. What do you understand by 'bonus shares' and what are the advantages of issuing bonus shares? [June 2006 (4 Marks)]

Ans.: A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. 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.

The bonus shares allotted to the members do not represent taxable income in their hands. [*CIT, Madras v. A.A.V. Ramchandra Chettiar*]

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 shareholdings of the members increases with increase in number of shares in the company.
- (4) Bonus share is not an income. Hence, it is not a taxable income.
- (5) Paid-up share capital increases with the issue of bonus shares.

Q2. Distinguish between bonus shares and right shares. [June 2011 (4 Marks)]

Ans.: Following are the main points of distinction between bonus shares & right shares:

Points	Bonus Shares	Right Shares
Meaning	Bonus shares are shares issued by a company free of cost to its existing shareholders on <i>apronata</i> basis out of free reserve.	When company issues further shares to existing shareholder in ratio of their holding such issue is known as right issue.
Cash flow	In case of bonus issue there is no cash flow .	In case of right issue there is cash inflow to the company.
Consideration	Company does not receive any consideration in case of bonus issue.	Company receives consideration as shares are issued against cash.
Authorization	Bonus issue is made on the recommendation of the Board and authorization from general meeting of the company.	In case of right issue authorization from members through ordinary or special resolution is necessary.
Market value	Issue of bonus shares does not affect the market value of the company.	Right issue of shares affects the market value of the company.
Section	It is governed by Section 63 of the Companies Act, 2013.	It is governed by Section 62 of the Companies Act, 2013.

Q3. Referring to the provisions of the Companies Act, 2013 state that conditions required to be fulfilled before a company can issue bonus shares to the shareholders of the company. [June 2015 (4 Marks)]

Ans.: Issue of bonus shares [Section 63(1)]: A company may issue fully paid-up bonus shares to its members out of:

- Free reserves
- Securities premium
- Capital redemption reserve

However, revaluation reserve created by the revaluation of assets cannot be used for the bonus issue.

Conditions for issue of bonus shares [Section 63(2)]: A company shall comply with following additional condition for bonus shares:

- Bonus issue is authorized by its articles.
- Bonus issue is made on the recommendation of the Board and authorization from general meeting of the company.
- Company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
- Company has not defaulted in payment of statutory dues of the employees like PF contribution, gratuity and bonus.
- Bonus issue can be made only on fully paid-up shares.
- Company also has to comply with other prescribed conditions.
- Bonus shares shall not be issued in lieu of dividend.

The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same. [Rule 14 of the Companies (Share Capital & Debentures) Rules, 2014]

Q4. An established company maintaining power projects in India, raised ₹ 11,000 Crore from Indian Stock market with an issue price of ₹ 450 (FV of ₹ 10 per share) on 15th January, 2008. Anticipate a huge returns on the share price, the issue was subscribed 27.5 times and a huge response received to the company's IPO. The company at the time of listing only owned a land for its six power projects which were to be developed for generation of electricity, and there was no revenue income at the time of listing. On 15th February, 2008 the company listed its shares but due to the stock market meltdown, the stock fell to ₹ 320 per share, i.e. a discount of ₹ 130 from its issue price of ₹ 450. Facing huge criticism from its investors, the company decided to issue bonus shares in the ratio of 3 shares for 5 shares held. A public interest litigation was filed challenging the issuance of bonus shares without any revenue income. The case was rejected and dismissed. Discuss the merits of the case and also the conditions for issue of bonus shares. [Dec. 2019 (5 Marks)]

Ans.: Conditions for issue of bonus shares [Section 63(2)]: A company shall comply with following additional condition for bonus shares:

- Bonus issue is authorized by its articles.
- Bonus issue is made on the recommendation of the Board and authorization from general meeting of the company.
- Company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
- Company has not defaulted in payment of statutory dues of the employees like PF contribution, gratuity and bonus.
- Bonus issue can be made only on fully paid-up shares.
- Company also has to comply with other prescribed conditions.
- Bonus shares shall not be issued in lieu of dividend.

The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same. [Rule 14 of the Companies (Share Capital & Debentures) Rules, 2014]

As per the facts given case, the company has complied with all conditions required to be satisfied and hence the court was correct in awarding the judgment in favour of the company.

Q5. The Board of Directors of Aakash Ltd., a listed company, in its meeting held on 1st April, 2021 announced a proposal for issue of bonus shares to all equity shareholders of the company in the ratio of 1:1. On 1st May, 2021, the directors at another meeting passed a resolution to reverse the

proposal of bonus issue announced on 1st April, 2021. Discuss the validity of the resolutions. [June 2012 (4 Marks)], [Dec. 2021 (3 Marks)]

Ans.: As per Rule 14 of the Companies (Shares Capital & Debentures) Rule, 2014, the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

Thus, a resolution passed by the director to reverse the bonus issue announced is not valid. The Board of directors of Aakash Ltd. must issue bonus shares to the shareholders.

BONUS PROVISIONS – SEBI REGULATIONS

Q6. Explain provisions pertaining to Bonus Issue under the SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015.

Ans.: Following are the provisions pertaining to bonus issue under the SEBI (LODR) Regulations, 2015:

- (a) **Prior Intimation to stock exchange:** As per Regulation 29, 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 2 working days in advance, excluding the date of the intimation and date of the meeting.
- (b) **Record Date:** As per Regulation 42, the listed entity shall intimate the record date for issue of bonus shares to all the stock exchange 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.
- (c) **Disclosure of events or information:** As per Regulation 30, the listed entity shall disclose to the Stock Exchange, 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/dispached.

Q7. Discuss the various conditions to be complied with for the issue of Bonus Shares under the SEBI (ICDR) Regulations, 2018.

[June 2010 (10 Marks)], [June 2014 (6 Marks)]

Ans.: **Conditions for bonus issue:** As per Regulation 293 of the SEBI (ICDR) Regulations, 2018, subject to the provisions of the Companies Act, 2013 or any other applicable law, a listed issuer shall be eligible to issue bonus shares to its members if:

- (a) It is authorized by its articles of association for issue of bonus shares, capitalization 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 capitalization of reserve.

- (b) It has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
- (c) It has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus.
- (d) Any outstanding partly paid shares on the date of the allotment of the bonus shares, are made fully paid-up.
- (e) Any of its promoters or directors is not a fugitive economic offender.

Q8. Financial data of Natural Energy Ltd. as on 31st March, 2018 are as under:

(i) Authorised Share Capital : ₹ 700 Crore

(ii) Paid-up Capital : ₹ 300 Crore

(iii) Free Reserves : ₹ 800 Crore

The company has pending convertible debenture of ₹ 150 Crore, due for conversion in financial year 2018-2019. The company proposes to issue bonus shares in the ratio of 1:1 after conversion of debenture. You being a company secretary, advise on the procedure to be followed by referring SEBI regulations. [June 2019 (7 Marks)]

Ans.: **Conditions for a bonus issue:** As per Regulation 293 of the SEBI (ICDR) Regulations, 2018, Subject to the provisions of the Companies Act, 2013 or any other applicable law, a listed issuer shall be eligible to issue bonus shares to its members if:

- (a) It is authorized by its articles of association for issue of bonus shares, capitalization 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 capitalization of reserve.
- (b) It has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
- (c) It has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus.
- (d) Any outstanding partly paid shares on the date of the allotment of the bonus shares, are made fully paid-up.
- (e) Any of its promoters or directors is not a fugitive economic offender.

Calculation of post bonus issue paid-up capital:

Paid-up Capital	₹ 300 Crore
Addition in share capital due conversion of debentures	₹ 150 Crore
	₹ 450 Crore
Addition in share capital due to bonus (Ratio of 1:1)	₹ 450 Crore
Paid-up capital after bonus issue	₹ 900 Crore

Paid-up capital after bonus issue will be ₹ 900 Crore, which is more than present authorized capital of ₹ 900 Crore and hence authorised capital will have to be increased by ₹ 200 Crore.

PROCEDURE & DOCUMENTATION RELATING TO BONUS ISSUE

Q9. Make a list of documents required for granting in-principle approval for listing under Regulation 28(1) of the SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 for the companies proposing bonus issue.

Ans.: Following documents are required for granting in-principle approval for listing under Regulation 28(1) of the SEBI (LODR) 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 authorized share capital, if applicable.
4. Certificate from Statutory Auditors/PCA/PCS confirming that the proposed bonus issue is being made in accordance with provisions of the SEBI (ICDR) 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.

Q10. Prepare a check list for issue of bonus shares to the shareholders of your company keeping in view the various applicable legal requirements.

Ans.: Before Issuance of Bonus Shares, following points must be ensured:

1. Check, if there is a provision in the articles permitting issue of bonus shares by capitalization of reserves, etc. If there is no such provision, alter

the articles to permit the issuance of bonus shares by passing a resolution at general meeting of the company making provisions in the articles for capitalization of reserve.

2. Check and ensure that the expanded capital after the issue is within the authorized share capital of the company. Otherwise, complete the proceedings by increasing the Authorized 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 capitalized 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.

Q11. A Z Pharma Limited proposes to issue bonus shares to its shareholders in the ratio of 2:5. As a Company Secretary of the company, prepare a brief report for board of directors of your company as to procedure to be adopted for issue of bonus shares.

Or

Discuss briefly the steps involved in the issue of bonus shares by a listed company. [June 2011 (7 Marks)]

Or

Success Ltd., a listed company with an authorized, issued and subscribed capital of ₹ 35 Crore comprising of 3.5 Crore equity shares of ₹ 10 each and paid up capital of ₹ 34 Crore decided to issue bonus shares in the ratio of 2:5. As a Company Secretary enumerate the steps involved in such an issue. [June 2017 (8 Marks)]

Ans.: Procedure/Steps 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 at least 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 an Ordinary Resolution, or a Special Resolution, if the Articles so require, to issue bonus shares.
4. Submit the outcome of Board Meeting to the stock exchange 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 necessary resolution (special/ordinary).
7. File form MGT-14 (if special resolution passed) for alteration of articles within 30 days.
8. Permission of RBI if any required under the FEMA Act, 1999 should be obtained to allot bonus shares to Non-Resident Indians if such issue does not fall under automatic route.
9. Obtain necessary listing and trading approval from the stock exchange.
10. 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 Form PAS-3 after paying the requisite fee within 30 days of the allotment of shares.
12. Submit an application to the Stock Exchange 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.

Q12. Jai Ltd. announced issue of bonus shares in the ratio of 1:3 (i.e. one share for every three shares held). At present the face value share is ₹ 10, current market price is ₹ 621. In addition, it announced split of shares by reducing the face value from ₹ 10 to ₹ 2. Calculate the share price if all other things remain constant. What would have been the situation if split would have been done before the issue of bonus shares?

[Dec. 2015 (5 Marks)]

Ans.: Calculation of share price after issue of bonus shares (without split):

$$\frac{\text{Existing shares} \times \text{Market value}}{\text{Existing shares} + \text{Bonus Shares}} = \frac{3 \times 621}{3 + 1} = 465.75$$

The company desires to split the shares from ₹ 10 to ₹ 2 per share i.e. one share will be converted into 5 shares.

Calculation of share price after issue of bonus & split:

No. of shares after split = (Existing shares + bonus shares) × Split ratio

No of shares after split = (3 + 1) × 5

No of shares after split = 20

$$\frac{465.75}{5} = 93.15$$

If split would have been done before the issue of bonus shares:

No. of shares after split = Existing shares × Split ratio

No of shares after split = 3 × 5

No of shares after split = 15

$$\text{Market price after split} = \frac{621 \times 3}{15} = 124.2$$

Calculation of share price after split & issue of bonus shares:

$$\frac{\text{Existing shares} \times \text{Market value}}{\text{Existing shares} + \text{Bonus Shares}} = \frac{15 \times 124.2}{15 + 5} = 93.15$$

UNIT II

SHARE BASED EMPLOYEE BENEFITS

INTRODUCTION, APPLICABILITY & DEFINITIONS

Q13. Write a short note on: Employees Stock Option Scheme (ESOS)
*[June 2011 (4 Marks)], [June 2013 (3 Marks)],
 [Dec. 2015 (4 Marks)], [June 2016 (4 Marks)]*

Ans.: "Employee stock option scheme or ESOS" means a scheme under which a company grants employee 'stock option' directly or through a trust.

It is the option given to employees of a company, which gives such employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price.

Example: X Ltd. grants its employee a right to subscribe 1,000 shares at ₹ 50 when its market price is ₹ 140. Employee can exercise such right after 2 years.

If after two years price of the share is ₹ 180, the employee will exercise the option and can take 1,000 shares at ₹ 50. Assume that there is no lock-in period and employee decides to sell the shares immediately. Total benefit to employee is ₹ 1,30,000 [(180 - 50) × 1,000].

If after two years price of shares is ₹ 40 then employee will not exercise the option as he will lose his money. Thus, ESOS is 'option' but not 'obligation'.

Q14. Write a short note on: Employees Stock Purchase Scheme (ESPS)
[Dec. 2012 (4 Marks)], [Dec. 2018 (4 Marks)]

Ans.: "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.

In simple words, under the Employees Stock Purchase Scheme [ESPS], employees are given an option to purchase shares on the spot at a discounted price.

Important provisions relating to ESPS are summarized below:

- ◆ The company's are free to determine the price of shares to be issued under an ESPS.
- ◆ 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.

Q15. Distinguish between: Employees Stock Option Scheme & Employees Stock Purchase Scheme
[Dec. 2012 (4 Marks)]

Ans.: Following are the main points of difference between ESOS & ESPS:

Points	Employees Stock Option Scheme	Employees Stock Purchase Scheme
Meaning	"Employee stock option scheme or ESOS" means a scheme under which a company grants employee 'stock option' 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.
Purchase of shares	Under ESOS employees are given an option to purchase shares at a later date i.e. after vesting period.	Under ESPS employees are given an option to purchase shares on the spot at a discounted price.
Lock-in	The company may specify the lock-in period for the shares issued pursuant to exercise of option.	Shares issued under an ESPS shall be locked-in for a minimum period of 1 year from the date of allotment.
Public issue	ESOS has to be approved separately by the company in general meeting by passing special resolution. It cannot be part of public issue.	Shares under ESPS can be issued as a part of a public issue.
Vesting period	Minimum vesting period for ESOS is one year.	No vesting periods for ESPS as shares are offered on the spot.
Compensation Committee	A company has to constitute Compensation Committee for administration & superintendence of the ESOS.	There is no such requirement for ESPS.

Q16. Option to participate in ESOS is not open for all employees of the company. Comment.
[Dec. 2013 (4 Marks)]

Ans.: As per the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 employees which get covered as per Regulation 2(1)(f) are eligible to participate in the scheme.

Employee [Regulation 2(1)(f)]: Employee means –

- (i) A permanent employee of the company who has been working in India or outside India or
- (ii) A director of the company, whether a whole time director or not but excluding an independent director or
- (iii) An employee as defined in clause (i) or (ii) of a subsidiary, 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 10% of the outstanding equity shares of the company.

Thus, it is correct to say that the option to participate in ESOP/ESPS is not open for all employees of the company.

Q17. What is employee stock option plan? Explain the importance of such plans in the modern time. [Dec. 2017 (5 Marks)]

Or

In a growing company, ESOPs are being used to retain talent. Discuss. [(Dec. 2020) (3 Marks)]

Ans.: Employee Stock Option Plan (ESOP) or Employee Stock Option Scheme (ESOS) is a plan or scheme under which the company grants employee stock options. Employee stock option is a contract that gives the employees of the enterprise the right, but not the obligation, for a specified period of time to purchase or subscribe the shares of the company at a fixed or determinable price which is generally lower than the prevailing market price of its shares.

The importance of these plans lies in the following advantages which accrue to both the company and the employees:

- ◆ Stock options provide an opportunity to employees to participate and contribute in the growth of the company.
- ◆ Stock option creates long term wealth in the hands of the employees.
- ◆ They are important means to attract, retain and motivate the best available talent for the company.
- ◆ It creates a common sense of ownership between the company and its employees.

Q18. Explain the Stock Appreciation Rights Scheme (SARS). [Dec. 2018 (5 Marks)]

Ans.: Stock Appreciation Rights (SARs) are additional compensation given to employees that are based on any increases in the price of company stock over a predetermined period of time. Employees benefit when the stock price rises, and are unaffected when the stock price declines. SARs can improve upon the stock option concept, since there is no requirement for employees to pay for the exercise price of the stock. The payouts under a SARS plan are usually in cash, though the plan can be reconfigured to allow for payments in stock.

Example: An employee is granted 1,000 SARs, which cover any appreciation in the stock's market price over the next 3 years. Suppose current price is ₹ 225 per share.

If at the end of 3 years, the stock price rises to ₹ 250 per share. Consequently, the employee receives a payment of ₹ 25,000 (1,000 SARs × ₹ 25 price increase per share).

Alternatively, employee can be offered 100 shares for appreciation in price of stock. (25,000 ÷ 25)

Q19. "SEBI Share Based Employee Benefits Regulations shall apply to any company, whether listed or not on any recognized stock exchanges in India and has a scheme". Comment on the statement. Discuss the scheme or purpose of the regulation. [Dec. 2021 (4 Marks)]

Ans.: An unlisted company issuing employee stock options has to comply with the provisions of the Rule 12 of the Companies (Share Capital & Debentures) Rules, 2014.

As per Regulation 1(3) of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021, the provisions of the regulations shall apply to listed company and has a Share Based Employee Benefit Scheme.

Purpose of the Regulations: A company always wants to retain the top talent in the company those working for the future success of the organization. Further, the human capital or the work force is always the vital component of a business organization and those executives who possess the potential to take the organization to newer height need to be remunerated suitably. One of the key non-financial remuneration or incentive may be issued to the employee in form of Employee Stock Option.

Taking into account the wider perspective of employee benefit scheme in India as well as overseas and with the intent to align the provisions of the extant regulations with the Companies Act, 2013, SEBI has notified the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021.

Q20. MineGame Ltd., a gaming platform of a listed company comprises various subsidiaries, joint venture companies, associates and other related party entities forming an internal part of MineGame Group. In order to retain talented human resources and to recognize the efforts of employees of these entities in the group, MineGame Group decided to grant cash based SARS linked to the share of MineGame Group to the employees of joint venture. You are required to confirm as to whether the scheme falls under the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021. [June 2022 (5 Marks)]

Ans.: **Stock Appreciation Right:** Stock appreciation right 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.

Coverage of SAR: As per Regulation 1(3), the provisions of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 shall apply to Stock Appreciation Rights Schemes (SARS).

To which types of companies the provisions of regulations applies: As per Regulation 1(4), the provisions of these regulations shall apply to listed company and has a scheme:

- (1) For direct or indirect benefit of employees.
- (2) Involving dealing in or subscribing to or purchasing securities of the company, directly or indirectly.
- (3) 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.

The Regulation 2(1)(c) of the said Regulations defines "Associate Company" as follow:

"Associate Company" shall have the same meaning as defined under Section 2(6) of the Companies Act, 2013.

Further, as per Section 2(6) of the Companies Act, 2013, the term Associate Companies includes Joint Ventures. It is therefore noted that the provisions of the Regulations shall apply to those companies whose shares are listed on any recognized stock exchanges in India and has a scheme, which is set up, funded, or guaranteed and controlled or managed by the company or any other company in its group for direct or indirect benefit of the employees.

However, in the given case of MineGame Group, the proposed scheme is being setup by MineGame Group and though the said scheme is for the benefit of the employees of joint venture but linked to the share of MineGame Group and not to listed company MineGame Ltd. Thus the said scheme does not come under the ambit of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021.

Q21. Josh Ltd. a Listed Company in the process of implementing SEBI (Share Based Employee Benefits) (SBEB) for its employees:

- (i) Can Mr. Louis an employee working outside India avail the benefit of the scheme?
- (ii) Can Mr. Ayaan, CEO and a member of the Promoter Group apply for the benefit of the scheme?
- (iii) Can Mr. Sunder, a director in the Subsidiary Company of Josh Ltd. and holding 25% shares in Josh Limited apply for scheme?

[Dec. 2023 (3 Marks)]

Ans.: A company may grant Share Based Employee Benefits to its employees. As per Regulation 2(1)(i) of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021, employee means –

- (i) A permanent employee of the company who has been working in India or outside India *or*
- (ii) A director of the company, whether a whole time director or not but excluding an independent director *or*
- (iii) An employee of a subsidiary, 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 10%** of the outstanding equity shares of the company.

Considering above provisions and definition of 'employee' as given SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021, answer to given case is as under:

- (i) Mr. Louis, who is working outside India can avail benefit of the scheme if he is permanent employee of the company.
- (ii) Mr. Ayaan, CEO and a member of the Promoter Group cannot apply for benefit of the scheme.
- (iii) Mr. Sunder, a director in the Subsidiary Company of Josh Ltd. who is holding more than 10% shares cannot apply for the scheme.

SCHEMES – IMPLEMENTATION & PROCESS

Q22. How the various share based employees benefit schemes can be implemented under the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021?

Or

Differentiate between "Direct Route for ESOP" and "Trust Route for ESOP".
[June 2021 (4 Marks)]

Ans.: Implementation of schemes [Regulation 3(1)]: A company may implement share based employees benefit schemes either:

- (a) directly *or*
- (b) by setting up an irrevocable trust.

However, 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 schemes:

If the scheme involves secondary acquisition or gift or both, then it is mandatory for the company to implement such schemes through a trust.

Share based employees benefit schemes

Direct Route

- ◆ Company forms Compensation Committee.
- ◆ Company decides the eligibility criteria of scheme.
- ◆ After vesting period employees can exercise the option.
- ◆ On exercise of option the company issues shares to employees.

Trust Route

- ◆ Company form employee's welfare trust.
- ◆ Company grants loan to the trust for subscribing shares.
- ◆ Company issue fresh shares to the trust and options to the employees.
- ◆ Employees exercise the options.
- ◆ Trust transfers the shares to the employees upon receipt of exercise price.
- ◆ Trust repays the loan to the company.

Q23. Tango Trading Ltd. is a public company which has its equity shares listed on NSE. The Company wants to implement Employee Stock Option Scheme (ESOS) for its employees. ESOP Plan will be operated through a trust in accordance with the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021. The company is willing to issue shares under ESOP scheme to one of its whole time director, Irfan.

Irfan holds 12% of the outstanding equity shares of the company. In view of the above facts, answer the following questions:

- (i) Can the company issue shares to its director, Irfan under ESOP scheme?
- (ii) Prepare a brief note on the process of implementation of ESOP scheme through Trust route. [Dec. 2020 (4 Marks)]

Ans.: Definition of employee as given in SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 does not cover a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than 10% of the outstanding equity shares of the company.

In the given case, Irfan holds more than 10% of stake in Tango Trading Ltd. Hence, he is not eligible to participate in the ESOS.

Process of Implementation of ESOS through Trust Route:

- (a) The company creates an Employee Welfare Trust specifically for the purpose of running the ESOS.
- (b) Company grants loan to the trust for subscribing its shares.
- (c) Company issues fresh shares to the trust and option to employees.
- (d) Where the employees decide to exercise the option to acquire the shares, trust transfers the shares in the name of the employees.
- (e) Trust repays the loan to the company from the proceeds on sale of shares to employee.

Q24. Yale is a nominee director on the Board of a listed company. On the proposal of ESOP in the Board meeting, he objected about his exclusion from this scheme. State the prior conditions to be fulfilled for a nominee director under the SEBI regulations for ESOP eligibility. [Dec. 2019 (5 Marks)]

Ans.: As per Regulation 2(1)(f) of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021, employee includes a director of the company, whether a whole time director or not but excluding an independent director.

Regulation 4 provides that an employee shall be eligible to participate in the schemes of the company as determined by the compensation committee.

Eligibility of Nominee Director: Where 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 schemes 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.
 - (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 a company shall file a copy of the contract or agreement with the said company, which shall, in turn file the copy with all the stock exchanges on which its shares are listed.

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.

Thus, Yale, a nominee director, is eligible for share based employee benefits schemes as he comes within the definition of 'employee' as defined in Regulation 2(1)(f). However, he can participate in share based employee benefits schemes subject to fulfilment of conditions stipulated in Regulation 4.

Q25. Honest Ltd. implemented Employee Stock Option Scheme to retain the best talent in the company. After one year of implementation of the scheme, the company desires to increase the vesting period from 2 year to 3 year. Is it possible for the company to vary the terms and condition of the option after implementation of the scheme under SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021? [Dec. 2019 (5 Marks)]

Ans.: Regulation 7 of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 provides that the company shall not vary the terms of

the schemes in any manner, which may be detrimental to the interests of the employees.

The company may by special resolution in a general meeting vary the terms of the schemes offered pursuant to an earlier resolution of the general body but not yet exercised by the employee provided such variation is not prejudicial to the interests of the employees.

Thus, company cannot make variation in ESOS by way of increasing vesting period from 2 years to 3 years.

Q26. The shares issued after the Initial Public Offering (IPO) of an unlisted company, out of options or SAR granted under any scheme prior to its IPO to its employees shall be listed immediately on exercise upon the options in all the recognized stock exchanges. However, the shares of the Company are already listed subject to compliance with the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018. You are required to explain the compliances and conditions for the same.

[June 2022 (4 Marks)]

Ans.: Regulation 10 of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 makes following provisions for listing of shares under any Share Based Employee Benefits Scheme:

In case new issue of shares is made under any scheme, shares so issued shall be listed immediately in any recognized stock exchange where the existing shares are listed. Such listing is subject to the following conditions:

- Scheme is in compliance with these regulations.
- A statement as specified by SEBI is filed and the company has obtained an in-principle approval from the stock exchanges.
- As and when an exercise is made, the company notifies the concerned stock exchange as per the statement as specified by SEBI in this regard.

Compliances and conditions [Regulation 12]:

- No company shall make any fresh grant which involves allotment or transfer of shares to its employees under any schemes formulated prior to its IPO and prior to the listing of its equity shares (Pre-IPO scheme) unless:
 - Such Pre-IPO scheme is in conformity with these regulations.
 - Such Pre-IPO scheme is ratified by its shareholders subsequent to the IPO.
- No change shall be made in the terms of Options/Shares/SAR issued under such Pre-IPO schemes, whether by re-pricing, change in vesting period or maturity or otherwise unless prior approval of the shareholders is taken for such a change, except for any adjustments for corporate actions made in accordance with these regulations.

(3) For listing of shares issued pursuant to ESOS, ESPS or SAR, the company shall obtain the in-principle approval of the stock exchanges where it proposes to list the said shares.

(4) When holding company issues Option, Share, SAR or benefits to the employee 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, both subsidiary as well as the holding company shall disclose the payment or receipt in the 'notes to accounts' to their financial statements.

(5) The company shall appoint a registered Merchant Banker for the implementation of schemes till the stage of obtaining in-principle approval from the stock exchanges.

Q27. Write a short note on: Accounting policies for employees share based benefits.

Ans.: Regulation 15 of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 provides that 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.

Q28. A listed company has granted Employee Stock Options of 1000 shares under the scheme to Niraj. He is in need of funds. Therefore against the mortgage options, he took the loan from Quick Finance Ltd., a NBFC. Is the action of employee is legally valid as per Regulation 9 of SEBI Regulations 2021? [Dec. 2023 (3 Marks)]

Ans.: Option cannot be pledged, hypothecated, etc.: As per Rule 12(8) of the Companies (Share Capital & Debentures) Rules, 2014, the option granted to employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.

The Option, SAR, or any other benefit granted to the employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.

Regulation 9 of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 also provides that the Option, SAR, or any other benefit granted to the employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.

Thus, Niraj to whom a listed company has granted 'Employee Stock Options' cannot be pledged, hypothecated, mortgaged or otherwise alienated and hence he cannot take loan from NBFC against such Employee Stock Options.

ADMINISTRATION OF VARIOUS SCHEMES

Q29. Examining the provisions of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021, answer the following:

- (i) Are any pricing norms applicable for ESOS?
- (ii) What is minimum vesting period for ESOS?
- (iii) Whether shares issued pursuant to ESOS are subject to lock-in period?
- (iv) Whether employee has right to receive dividend in respect of option granted to him?

Or

Explain the provisions of pricing, vesting period and consequence of failure to exercise Employee Stock Option Scheme (ESOS).

[Dec. 2021 (4 Marks)]

Ans.: Administration and Implementation of ESOS [Regulation 16]: The ESOS shall contain the details of the manner in which the scheme will be implemented and operated.

No ESOS shall be offered unless the disclosures, as specified by SEBI are made by the company to the prospective option grantees.

Pricing of exercise price in ESOS Scheme [Regulation 17]: The company granting option to its employees pursuant to ESOS will have the freedom to determine the exercise price subject to conforming to the accounting policies.

Vesting Period & Lock-in under ESOS Scheme [Regulation 18]:

- (1) There shall be a minimum vesting period of **1 year** in case of ESOS. However, in case where options are granted by a company under an ESOS in lieu of options held by a person under an ESOS in another company which has merged or amalgamated with that company, the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum vesting period for transferee company.
- (2) The Company may specify the lock-in period for the shares issued pursuant to exercise of option.

Rights of the option holder [Regulation 19]: The 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, till shares are issued upon exercise of option.

Consequence of failure to exercise option [Regulation 20]: The amount payable by the employee at the time of grant of option –

- (a) May be forfeited by the company if the option is not exercised by the employee within the exercise period.

- (b) 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.

Q30. Your Board of directors is contemplating to take-up the agenda to issue ESOS in next meeting. Being a Company Secretary, advise your Board of directors about brief procedure for issuing of securities under SEBI Employees Stock Option Scheme (ESOS) by a listed Company.

[June 2019 (5 Marks)]

Ans.: Procedure for Issuing ESOP by a Listed Company:

- (1) Hold a Board Meeting to consider and approve ESOP and formation of Compensation Committee.
- (2) Compensation Committee shall plan draft the scheme of ESOP.
- (3) Hold Board Meeting to adopt the final scheme, appoint the Merchant banker and approve the notice of the General meeting for shareholders approval.
- (4) Hold General Meeting for approval of shareholders.
- (5) Make an application to the stock exchange for obtaining in-principle approval of the stock exchange.
- (6) Issue of letter of grant of option to the eligible employees along with the letter of acceptance of option.
- (7) On receipt of letter of acceptance of option along with upfront payment (if any), from the employee issue the option certificates.
- (8) 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.
- (9) Receive letter of exercise from the employees.
- (10) Hold a Board Meeting at the suitable interval during the exercise period for allotment of shares on options exercised by the option grantee.
- (11) Dispatch of letter of allotment along with the share certificates or credit the shares so allotted with the Depositories.
- (12) Make an application to the Stock exchange for listing of the shares so allotted.

Q31. Discuss the rules relating to pricing and lock-in under Employees Stock Purchase Scheme (ESPS) including exception if any, thereof.

[June 2021 (3 Marks)]

Ans.: Pricing and lock-in under Employee Stock Purchase Scheme (ESPS) [Regulation 22]:

Pricing: A company may determine the price of shares to be issued under ESPS, subject to conforming to the accounting policies.

Lock-in: Shares issued under an ESPS shall be locked-in for a minimum period of one year from the date of allotment.

Exceptions to lock-in:

- In case where shares are allotted by a company under ESPS in lieu of shares acquired by the employee under 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 one year stated above.
- 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.
- 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 any lock-in.

UNIT III

SWEAT EQUITY SHARES

PROVISIONS OF THE COMPANIES ACT, 2013 RELATING TO SWEAT EQUITY SHARES

Q32. Write a short note on: Sweat equity shares [June 2014 (5 Marks)]

Or

An Indian company is planning to issue sweat equity shares of a class of shares already issued. Explain the meaning of sweat equity shares and advise the company regarding the conditions to be fulfilled to issue sweat equity? [Dec. 2014 (6 Marks)]

Or

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? [June 2019 (5 Marks)]

Ans.: Sweat Equity Shares [Section 2(88)]: Sweat equity shares means equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Issue of sweat equity shares [Section 54]: A company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

- The issue has been authorized by a **special resolution** passed by the company in the general meeting.
- Such special resolution should clearly specify:
 - Number of shares

- Current market price
- Consideration and
- Classes of directors or employees to whom such equity shares are to be issued.

- At least 1 year should have elapsed from the date on which the company was entitled to commence business. [*Deleted by the Companies (Amendment) Act, 2017*]
- A company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the **SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021**.
- A company whose shares are not so listed should comply with the **Companies (Share Capital & Debentures) Rules, 2014**.

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 and the holders of sweat equity shares shall rank *pari passu* (on an equal footing) with other equity shareholders. [**Section 54(2)**]

Register of Sweat Equity Shares [Rule 8(14)]: The company shall maintain a Register of Sweat Equity Shares in **Form SH-3** and shall forthwith enter therein the particulars of issue of sweat equity shares.

The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide.

The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose. *Independent directors are not entitled for sweat equity shares.*

Q33. Answer with reference to the Companies (Share Capital & Debentures) Rules, 2014:

- ABC Ltd., a leading software development company is having outstanding paid-up equity share capital of ₹ 20 Crore as on 31st March, 2021. On 20th April, 2021, it has issued sweat equity shares of ₹ 2 Crore to the eligible employees. To control the high attrition rate, it is planning to allot further sweat equity shares of ₹ 2 Crore during the year. Is it permissible under the law?
- Can a company allot sweat equity shares to an employee working outside India, who has been deputed outside India for last three years?
- Himanshu, the non-executive director, approached the company for allotment of sweat equity shares. Whether he is eligible?
- Whether the company is free to fix the price of sweat equity shares?

[Dec. 2022 (7 Marks)]

Ans.: Considering the provisions of the Companies (Share Capital & Debentures) Rules, 2014, answer to given case is as follows:

- (i) As per Rule 8(4), the company shall not issue sweat equity shares for more than **15% of the existing paid-up equity share capital** in a year or shares of the issue value of **₹ 5 Crore, whichever is higher**. However, the issuance of sweat equity shares in the Company shall not exceed **25% of the paid-up equity capital** of the Company at any time.

The paid-up share capital of ABC Ltd. is ₹ 20 Crore. Thus, it can issue sweat equity shares of ₹ 3 Crore during the year. [₹ 20 Crore × 15%]

Since it had already issue sweat equity shares of ₹ 2 Crore, the company can issue further sweat equity shares of ₹ 1 Crore only.

- (ii) As per Rule 8(1), sweat equity shares can be issued to permanent employee of the company who has been working in India or outside India. Thus, sweat equity shares can be issued to employee who has been deputed outside India for the last three years if he is permanent employee of the company.

- (iii) As per Rule 8(1), sweat equity shares can be issued to director who may be whole time or part time *i.e.* executive or non-executive.

Thus, Sweat equity shares can be issued to Himanshu, non-executive director of the company.

- (iv) As per Rule 8(6), the sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.

As per Regulation 32 of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021, 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 (ICDR) Regulations, 2018.

ISSUE OF SWEAT EQUITY BY LISTED COMPANY

Q34. Write a short note on: Sweat equity shares

[June 2014 (5 Marks)], [Dec. 2017 (3 Marks)]

Or

An Indian company is planning to issue sweat equity shares of a class of shares already issued. Explain the meaning of sweat equity shares and advise the company regarding the conditions to be fulfilled to issue sweat equity? [Dec. 2014 (6 Marks)]

Ans.: **Sweat Equity Shares [Section 2(88)]:** Sweat equity shares means equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Issue of sweat equity shares [Section 54]: A company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

- (a) The issue has been authorized by a **special resolution** passed by the company in the general meeting.

- (b) Such special resolution should clearly specify:

- Number of shares
- Current market price
- Consideration and
- Classes of directors or employees to whom such equity shares are to be issued.

- (c) ~~At least 1 year should have elapsed from the date on which the company was entitled to commence business. [Deleted by the Companies (Amendment) Act, 2017]~~

- (d) A company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the **SEBI (Issue of Sweat Equity) Regulations, 2002**.

- (e) A company whose shares are not so listed should comply with the **Companies (Share Capital & Debentures) Rules, 2014**.

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 and the holders of sweat equity shares shall rank *pari passu* (on an equal footing) with other equity shareholders. **[Section 54(2)]**

Register of Sweat Equity Shares [Rule 8(14)]: The company shall maintain a Register of Sweat Equity Shares in **Form SH-3** and shall forthwith enter therein the particulars of issue of sweat equity shares.

The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide.

The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

Q35. Distinguish between: Sweat equity & Issue of capital on preferential basis. [Dec. 2009 (4 Marks)]

Ans.: Following are the main points of distinction between sweat equity & issue of capital on preferential basis:

Points	Sweat Equity Shares	Issue of capital on preferential basis
Meaning	Sweat equity shares mean equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available right in the nature	A preferential issue is an issue of shares or of convertible securities by listed companies to a select group of persons under

Points	Sweat Equity Shares	Issue of capital on preferential basis
	of intellectual property rights or value additions, by whatever name called.	Section 81 which is neither a rights issue nor a public issue.
To whom issued	Sweat equity shares are issued to employees or directors.	A preferential issue is an issue to a select group of persons.
How issued	Sweat equity shares are issued at a discount or for consideration, other than cash.	A preferential issue is at par or at premium.

Q36. Distinguish between: Sweat Equity Shares & Employees Stock Option Scheme (ESOS)
[June 2015 (4 Marks)]

Ans.: Following are the main points of distinction between sweat equity shares & ESOS:

Points	Sweat Equity Shares	Employees Stock Option Scheme (ESOS)
Meaning	Sweat equity shares means equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.	Employee stock option means the option given to the whole-time directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price.
How regulated	Issue of sweat equity shares is regulated by Section 53 of the Companies Act, 2013 and the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 and the Companies (Share Capital & Debentures) Rules, 2014.	Issue of shares under employee stock option plan is regulated by Section 2(37) of the Companies Act, 2013 and the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021.
Issue	Sweat equity shares can be issued at discounted price or free for know-how and services to the company.	Employee stock options can be issued with conversion right at a pre determined price. The issue price can be less than the intrinsic value of the shares.
Consideration	The consideration can be partly cash and partly IPRs/value addition or fully non-cash consideration.	The consideration has to be paid in cash.
Purpose	Sweat equity shares are mainly intended to be issued to build up equity for directors or employees with technical capability but with meager financial resources.	Employee stock options can be used for multiple purposes – as a talent retention tool, as an incentive, as a remuneration mechanism.

Points	Sweat Equity Shares	Employees Stock Option Scheme (ESOS)
Lock-In-Period	Sweat equity shares have compulsory lock-in-period of 3 years.	The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of ESOS.

Q37. To whom sweat equity shares may be issued the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021?

Ans.: Sweat equity shares may be issued to employees & promoter [Regulation 30]: A company whose equity shares are listed on a recognized stock exchange may issue sweat equity shares in accordance with Section 54 of the Companies Act, 2013 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.

Employee means –

- A permanent employee of the company working in India or abroad.
- A Director of the company whether a whole time director or not.

Q38. State the provisions relating to passing of special resolution for issue of sweat equity shares under the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021.

Ans.: Special Resolution [Regulation 32]:

- For the purposes of passing a special resolution, 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**.
- 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.
- For passing such a resolution, voting through postal ballot or e-voting as specified under the Companies (Management & Administration) Rules, 2014 shall also be adopted.
- The promoters or promoter group shall not participate in such resolution.
- Each issue of sweat equity shares shall be voted by a **separate resolution**.
- The resolution for issue of sweat equity shares shall be valid for a period of not more than **12 months** from the date of passing of the resolution.

Authors Note: Section 54 of the Companies Act, 2013 provides that sweat equity shares can be issued by passing a **special resolution** in the general meeting of the company. Whereas Regulation 32 of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 provides that sweat equity shares can be issued to promoters by passing resolution of **simple majority** of the shareholders in General Meeting; which is doubtful.

Even otherwise, special resolution u/s 62 of the Companies Act, 2013 will also be required as right issue is not being made. Hence, in the opinion of author issue of sweat equity shares to promoters requires special resolution.

Q39. Due to growing numbers of startups in India, one of the leading listed startup has apprehension that the experienced employees may leave the company to get higher pay package. The CEO desires to issue Sweat Equity Shares to the employees to retain them. You being a Company Secretary advise the management about pricing of the shares under the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021. [June 2022 (4 Marks)]

Ans.: Pricing of sweat equity shares [Regulation 33]: 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 (ICDR) Regulations, 2018.

Pricing of Frequently Traded Shares [Regulation 164]: Price of shares in *preferential issue* is determined as follows:

- (1) **If the equity shares have been listed on a recognized stock exchange for a period of 90 trading days or more:** The price of the equity shares to be allotted pursuant to the preferential issue shall be **not less than higher of the following:**
 - (a) **90 trading days** volume weighted average price of the related equity shares quoted on the recognized stock exchange preceding the relevant date; or
 - (b) **10 trading days** volume weighted average prices of the related equity shares quoted on a recognized stock exchange preceding the relevant date.
- (2) **If the equity shares of the issuer have been listed on a recognized stock exchange for a period of less than 90 trading days:** The price of the equity shares to be allotted pursuant to the preferential issue shall be **not less than 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.
 - (b) The average of the volume weighted average prices of the related equity shares quoted on the recognized stock exchange during the period the equity shares have been listed preceding the relevant date.
 - (c) The average of the 10 trading days volume weighted average prices of the related equity shares quoted on a recognized stock exchange during the 2 weeks preceding the relevant date.

- (3) Where the price of the equity shares is determined in Clause (2), such price shall be recomputed by the issuer on completion of 90 trading days from the date of listing as specified above in Clause (1).

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.

- (4) **A preferential issue of specified securities to qualified institutional buyers, not exceeding five in number:** It 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 recognized 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.

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.

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: 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 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.
- (5) **Frequently traded shares:** It means the shares of the issuer, in which the traded turnover on any recognized 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.
- If 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.

Pricing of Infrequently Traded Shares [Regulation 165]: Where the shares of an issuer are not frequently traded, the price determined by the issuer shall take into account the valuation parameters including book value, comparable

trading multiples, and such other parameters as are customary for valuation of shares of such companies.

The issuer shall submit a certificate stating that the issuer is in compliance of this regulation, obtained from an independent registered valuer to the stock exchange where the equity shares of the issuer are listed.

Q40. Portable Marketing Ltd., a listed company on stock exchange, having paid-up capital ₹ 500 Crore consisting of 50 Crore equity share of ₹ 10 each. The Board of directors of company has recommended issuing of sweat equity shares to its promoters/directors and employees as a part of their recognition for valuable contribution to the growth of company. The board meeting was held on 1st March, 2020 and extraordinary general meeting was held on 27th March, 2020 for approving the issue of sweat equity shares. The details of closing market price available on stock exchange are given below:

90 trading days volume weighted average price of the related equity shares quoted on the recognized stock exchange	Preceding 31st January, 2020	₹ 540
	Preceding 26th February, 2020	₹ 550
10 trading days volume weighted average price of the related equity shares quoted on a recognized stock exchange	Preceding 31st January, 2020	₹ 580
	Preceding 26th February, 2020	₹ 575
Closing price of equity share of the company	On 27th March, 2020	₹ 578

Referring to the provisions of Companies Act, 2013 and SEBI Regulations, answer the following:

- What are the conditions to be fulfilled for issue of sweat equity shares?
- Can sweat equity shares be issued to promoters? If yes, what are the conditions to be fulfilled?
- What is the relevant date in above case?
- What should be the minimum price at which sweat equity shares should be issued? [June 2021 (8 Marks)]

Or

A listed NBFC has been granted licence to run as small finance bank by the Reserve Bank of India under recently announced policy to improve the financial inclusion of the country. During the last three years, the attrition rate for top level management employees was not too high As, RBI has granted licences to many small banks, therefore, the promoters of the Bank feels that attrition rate will be high in coming period. The

Board of directors wishes to allot Sweat Equity shares to employees. You, being compliance officer of the Bank, advise the Board about pricing of the Sweat Equity shares. [June 2019 (4 Marks)]

Ans.:

- (i) Conditions for issue of sweat equity shares [Section 54]:** A company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:
- The issue has been authorized by a **special resolution** passed by the company in the general meeting.
 - Such special resolution should clearly specify:
 - ◆ Number of shares
 - ◆ Current market price
 - ◆ Consideration and
 - ◆ Classes of directors or employees to whom such equity shares are to be issued.
 - At least 1 year should have elapsed from the date on which the company was entitled to commence business. [Deleted by the Companies (Amendment) Act, 2017]
 - A company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the **SEBI (Issue of Sweat Equity) Regulations, 2002**.
 - A company whose shares are not so listed should comply with the **Companies (Share Capital & Debentures) Rules, 2014**.
- (ii) Issue of Sweat Equity Shares to Promoters:** 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. The promoters or promoter group shall not participate in such resolution.
- (iii) Relevant date:** 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 (ICDR) Regulations, 2018. As per Regulation 161 of the SEBI (ICDR) Regulations, 2018, "Relevant date" for this purpose means the date 30 days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue.
- (iv) Minimum price for issue of sweat equity shares:** As per facts given in case, the meeting of the General Body of the shareholders is held on 27th March 2020; hence relevant date is 26th February, 2020.
- As per Regulation 164 of the SEBI (ICDR) Regulation, 2018, the price of equity shares which have been listed on a recognized stock exchange for

a period of 90 trading days or more, the price of the equity shares to be allotted pursuant to the preferential issue shall be **not less than higher** of the following:

- (i) 90 trading days volume weighted average price of the related equity shares quoted on the recognized stock exchange preceding the relevant date: ₹ 550
- (ii) 10 trading days volume weighted average prices of the related equity shares quoted on a recognized stock exchange preceding the relevant date: ₹ 575

Thus, minimum price at which sweat equity shares should be issued is ₹ 575.

Q41. Z Ltd. has issued Sweat Equity Shares for a non-cash consideration. What are the possible accounting treatments in the books of Z Ltd.?
[June 2019 (4 Marks)]

Or

"The accounting treatment of an issue of sweat equity shares is different than the public offer of shares." Elucidate briefly. Is there any requirement of Auditor's certificate after issue of sweat equity shares? When such shares are treated as part of managerial remuneration?

[Dec. 2021 (7 Marks)]

Or

Under what circumstances the amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purpose of Section 197 of the Companies Act, 2013?

Ans.: Accounting Treatment [Regulation 35]: 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 non-cash consideration takes form of a depreciable or amortizable asset:** It shall be **credited to the balance sheet** of the company in accordance with the relevant accounting standards.
- (b) **Where clause (a) is not applicable:** It shall be **expensed** as provided in the relevant accounting standards.

In simple words, consideration against which sweat equity shares are issued is either treated as asset or will be debited to profit & loss account as expenses.

Placing of auditor's certificate before AGM [Regulation 36]: 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 [Regulation 37]: 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) Sweat equity shares are issued to any director or manager; **and**
- (ii) 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.

Q42. What are the conditions to be fulfilled for issue of sweat equity shares? Explain the lock-in-period with regard to sweat equity shares. Whether sweat equity shares may be issued to the non-whole time directors?
[June 2023 (5 Marks)]

Ans.: Conditions for issue of sweat equity shares: A company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

- (a) The issue has been authorized by a **special resolution** passed by the company in the general meeting.
- (b) Such special resolution should clearly specify:
 - ◆ Number of shares
 - ◆ Current market price
 - ◆ Consideration and
 - ◆ Classes of directors or employees to whom such equity shares are to be issued.
- (c) At least 1 year should have elapsed from the date on which the company was entitled to commence business. [Deleted by the Companies (Amendment) Act, 2017]
- (d) A company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the **SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021**.
- (e) A company whose shares are not so listed should comply with the **Companies (Share Capital & Debentures) Rules, 2014**.

Lock-in of sweat equity shares [Regulation 38]: The sweat equity shares shall be locked in for such period of time as specified in relation to a preferential issue under the SEBI (ICDR) Regulations, 2018, as amended from time to time.

The provisions of the SEBI (ICDR) 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.

The SEBI (ICDR) Regulations, 2018 specifies period of 3 years as lock-in for sweat equity shares.

Sweat equity shares may be issued to employees & promoter [Regulation 30]: A company whose equity shares are listed on a recognized stock exchange may issue sweat equity shares in accordance with Section 54 of the Companies Act, 2013 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.

Employee means –

- (i) A permanent employee of the company working in India or abroad.
- (ii) A Director of the company whether a whole time director or not.

Hence, Sweat Equity shares can be issued to a director of the company whether a whole time director or not.

Q43. The Board of directors of Vijay Ltd., a listed entity proposes to issue sweat equity shares to Ganesh, an employee belonging to the promoter's group. Ganesh also participated in the Shareholders' resolution for allotment of sweat equity shares. By referring the relevant SEBI Regulations, answer the followings

- (i) Can Ganesh participate in the resolution (Give reason)?
- (ii) Briefly explain the provisions for issuing of sweat equity shares under SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021.
- (iii) When these regulations are exempted from enforcement in special cases? [Dec. 2022 (5 Marks)]

Ans.: Considering the provisions of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021, answer to given case is as follows:

- (i) **Participation of Ganesh in resolution:** As per Regulation 32, the promoters or promoter group shall not participate in special resolution to be passed for issuing sweat equity shares and thus Ganesh cannot participate in resolution.
- (ii) **Provisions relating to issue of sweat equity shares:**

Employee [Regulation 29]: Employee means –

- ◆ A permanent employee of the company working in India or abroad.
- ◆ A Director of the company whether a whole time director or not.

Issue of sweat equity shares to employees [Regulation 30]: A company whose equity shares are listed on a recognized 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 [Regulation 31]:

- ◆ A company shall not issue sweat equity shares for more than **15% of the existing paid-up equity share capital** in a year. However, the issuance of sweat equity shares in the company shall not exceed **25% of the paid-up equity share capital** of the company at any time.
- ◆ A company listed on Innovators Growth Platform shall be permitted to issue not more than **15% of the paid-up equity share capital** in a financial year subject to overall limit not exceeding 50% of the paid-up equity share capital of the company, up to **10 years** from the date of its incorporation or registration.

Special Resolution [Regulation 32]:

- (a) For the purposes of passing a special resolution, 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**.
- (b) 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.
- (c) For passing such a resolution, voting through postal ballot or e-voting as specified under the Companies (Management & Administration) Rules, 2014 shall also be adopted.
- (d) The promoters or promoter group shall not participate in such resolution.
- (e) Each issue of sweat equity shares shall be voted by a **separate resolution**.
- (f) The resolution for issue of sweat equity shares shall be valid for a period of not more than **12 months** from the date of passing of the resolution.

(iii) Exemption from enforcement of the regulations in special cases:

- ◆ SEBI may *suo motu* or on an application made by a company, for reasons recorded in writing, grant relaxation from strict compliance with any of these regulations subject to such conditions as the SEBI deems fit to impose in the interests of investors in securities and the securities market.
- ◆ A company making an application, shall pay a non-refundable fee of ₹ 1 lakh by way of direct credit in the specified bank account of the SEBI through NEFT/RTGS/IMPS or any other mode allowed by the RBI.

Q44. Harish is an Independent director of a listed company. In the Board Meeting, an agenda for formulation of policy for Sweat Equity Shares has been discussed. Harish objected on a clause, which made him ineligible for availing Sweat Equity Shares.

Is Harish eligible for the sweat equity shares?

Will your answer be different, if it was for an Employee Stock Option Scheme? [Dec. 2023 (5 Marks)]

Ans.: Employee: As per Regulation 29 of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021, employee means –

- (i) A permanent employee of the company working in India or abroad.
- (ii) A Director of the company whether a whole time director or not.

As per Explanation to Rule 8(1) the Companies (Share Capital & Debentures) Rules, 2014, Employee means –

- (a) A permanent employee of the company who has been working in India or outside India.
- (b) A director of the company, whether a whole time director or not.
- (c) An employee or a director of a subsidiary, in India or outside India, or of a holding company of the company.

Sweat equity shares can be issued to director who may be whole time or part time i.e. executive or non-executive. His holding in equity shares of the company is irrelevant. Hence, Sweat equity shares can be issued to a director of the company.

In terms of the provisions of the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021 and the Companies Act, 2013, independent directors are not entitled to ESOS.

GENERAL OBLIGATIONS & MISCELLANEOUS TOPICS

Q45. Elucidate obligations of the Company under the SEBI (Share Based Employee Benefits & Sweat Equity) Regulations, 2021.

Ans.: Obligations of the Company [Regulation 41]: The Company shall ensure that –

- (1) The explanatory statement to the notice for general meeting shall contain disclosures as are specified under section 54(1)(b) and Regulation 5(1).
- (2) The Auditor's certificate as required under Regulation 10 shall be placed in the general meeting of shareholders.
- (3) The company shall within 7 days of the issue of sweat equity, issue or send statement to the exchange, disclosing:
 - (a) Number of sweat equity shares.
 - (b) Price at which the sweat equity shares are issued.

- (c) Total amount invested in sweat equity shares.
- (d) Details of the persons to whom sweat equity shares are issued.
- (e) The consequent changes in the capital structure and the shareholding pattern after and before the issues of sweat equity.

Q46. The listed entity shall frame policy for determination of materiality and criteria for determination of materiality of events/information. Enumerate in brief with reference to the SEBI (LODR) Regulations, 2015. [June 2022 (5 Marks)]

Ans.: The listed entity shall frame policy for determination of materiality and criteria for determination of materiality of events/information.

Policy for determination of materiality:

- ◆ Policy is based on criteria specified under Regulation (4)(i) of SEBI (LODR) Regulations, 2015.
- ◆ Policy is duly approved by its Board of Directors.
- ◆ Policy shall be disclosed on its website.

Criteria for determination of materiality of events/information:

- ◆ The omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly.
- ◆ The omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date.
- ◆ An event/information may be treated as being material if in the opinion of the Board of Directors of listed entity, the event/information is considered material.

Q47. What are the pre-issue formalities under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 for ESOS/ESOS/SARS/GEBS/RBS? [June 2024 (5 Marks)]

Ans.:

Pre-Issue Formalities:

Checklist – Prior In-principle under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 for ESOS/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 & 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 & Sweat Equity) Regulations, 2021.
7. List of Promoters as defined under the SEBI (Share Based Employee Benefits & 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.

13

CHAPTER

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

Q1. Enumerate the applicability for issuance and listing of securities under the IFSCA (Issuance & Listing of Securities) Regulations, 2021.

Ans.: Eligibility Criteria: IFSCA (Issuance & Listing of Securities) Regulations, 2021 makes following provisions in relation to "eligibility for issuance securities": As per Regulation 10, an issuer shall be eligible to make an initial public offer only if one of the following conditions is met:

- (a) The issuer has **operating revenue** of at least **US\$ 20 Million** in the preceding financial year.
- (b) The issuer has an average pre-tax profit, based on consolidated audited accounts, of at least **US\$ 1 Million** during the preceding three financial years.
- (c) Any other eligibility criteria that may be specified by IFSCA.

As per Regulation 11, the issuer shall have commenced business at least 3 years prior to the date of filing of prospectus.

Eligibility for listing securities: An issuer shall be eligible to list its securities under these regulations in IFSC if all following conditions are fulfilled:

- (a) The issuer is duly incorporated or established according to the relevant laws of its place of incorporation or establishment.
- (b) The issuer is operating in conformity with its constitution.
- (c) The listing of securities in IFSC is in accordance with the applicable laws of the jurisdiction of incorporation.

Ineligibility for listing securities: An issuer shall not be eligible to list securities under these regulations if the issuer or any of its promoters, promoter group, controlling shareholders or directors or selling shareholders is -

- (a) Debarred from accessing the capital market.
- (b) A wilful defaulter.
- (c) A fugitive economic offender.

Q2. What are the categories of debt securities which are eligible for listing on a recognized stock exchange in an IFSC?

Ans.: Eligible Debt Securities: Following categories of debt securities are eligible for listing on a recognized stock exchange:

- Debt securities issued by an issuer incorporated in IFSC.
- Debt securities issued by an issuer incorporated in India or a Foreign Jurisdiction in any currency other than INR.
- Debt securities issued by a supranational, multilateral or statutory organisation/ institution/agency.
- Debt securities 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.
- Debt securities irrevocably guaranteed by a Sovereign (India or a Foreign Jurisdiction).
- Masala bonds.
- Any other debt securities as may be permitted by IFSCA from time to time.

Q3. What are the eligibility criteria and minimum subscription requirement for an issuer to make initial public offer in terms of IFSCA (Issuance and Listing of Securities) Regulations, 2021? [June 2024 (5 Marks)]

Ans.: Eligibility Criteria: IFSCA (Issuance & Listing of Securities) Regulations, 2021 makes following provisions in relation to "eligibility for issuance securities":

As per Regulation 10, an issuer shall be eligible to make an initial public offer only if one of the following conditions is met:

- (a) The issuer has **operating revenue** of at least **US\$ 20 Million** in the preceding financial year.
- (b) The issuer has an average pre-tax profit, based on consolidated audited accounts, of at least **US\$ 1 Million** during the preceding three financial years.
- (c) Any other eligibility criteria that may be specified by IFSCA.

As per Regulation 11, the issuer shall have commenced business at least 3 years prior to the date of filing of prospectus.

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 issue size.

- (b) The minimum number of subscribers shall be 200 or as may be specified by the Authority.

Q4. An issuer may make follow-on public offer through the fast-track route under the IFSCA (Issuance & Listing of Securities) Regulations, 2021, if certain conditions are fulfilled. Explain.

Ans.: 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 for a period of at least 18 months.
- (ii) Issuer is in compliance with all the regulatory requirements specified by IFSCA and the recognized stock exchange in the preceding 3 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 3 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.

Q5. A start-up company working towards innovation and development of products has annual turnover during the year more than US\$ 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 & Listing of Securities) Regulations, 2021?

Ans.: Various provisions of the IFSCA (Issuance & Listing of Securities) Regulations, 2021 relating to listing of Startup & SME Companies are discussed below:

Eligibility criteria for startup: A startup company shall be eligible to list its specified securities on a recognized stock exchange, with or without making a public offer, if it meets the following criteria:

- (a) The offer document of the company should be filed within a period of ten years from the date of incorporation/registration.

- (b) The annual turnover of the company for any of the financial years since incorporation/registration should not have exceeded US\$ 20 Million.
- (c) The company is working towards innovation, development or improvement of products or processes or services, or it is a scalable business model with a high potential of employment generation or wealth creation.

Eligibility SME: A small and medium enterprise company shall be eligible to list its specified securities on a recognized stock exchange, with or without making a public offer, if the annual turnover of the company for any of the financial years since incorporation/ registration should not have exceeded US\$ 50 Million.

In-principle approval from recognized stock exchange: The Company shall file an application with the recognized stock exchange seeking in-principle approval.

Where the application is made to more than one recognized stock exchange, the issuer shall choose one of them as the designated stock exchange.

The stock exchange 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 shall submit a due diligence certificate along with the information document.
- (3) The issuer shall simultaneously file the information document with the recognized stock exchange.

Listing with public offer: The provisions relating to offer for sale, filing of offer document, offer timing, initial disclosures in the offer document, pricing, offer period, 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 initial public offer by a start-up or SME company.

Issue size: The issue shall be of size US\$ 2 Million or more but less than US\$ 15 Million, or any other amount as may be specified by IFSCA.

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:

- Employees
- Directors
- Shareholders (other than promoters and promoter group) of listed subsidiaries or listed promoter companies.

The reservations shall not exceed 20% 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.
- (b) The minimum number of subscribers shall be 50 or as may be satisfied by the Authority.

Q6. What is Special Purpose Acquisition Company (SPAC)? Briefly explain the Regulatory Framework for Listing of SPACs in IFSC.

Ans.: Special Purpose Acquisition Company [SPAC]: Means a company which does not have any operating business and has been formed with the primary objective to affect a business combination. 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 have 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.

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 exchanges in IFSC, only if:
 - The target business combination has not been identified prior to the IPO.
 - 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 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 US \$ 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% of the issue size or US \$ 10 Million, *whichever is lower*.

Underwriting for SPAC IPO:

- May be underwritten and in such case adequate disclosure regarding underwriting arrangements shall be disclosed in the offer document.
- 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.
- In case of liquidation, the underwriter shall waive their rights on the deferred commission deposited in the escrow account.

Application size and allotment requirements:

- Minimum application size: US \$ 100,000.
- 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.
- 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.
- 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:

- 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.
- The escrow funds shall be invested only in instruments disclosed in the offer document and shall include only short-term investment grade liquid instruments.
- 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:
 - Payment of taxes.
 - General working capital expenses, subject to prior approval by way of special resolution of the shareholders other than sponsors.

14

CHAPTER

RAISING OF FUNDS FROM DEBT & PROCEDURAL ASPECTS

UNIT I

INDIAN FUND BASED

Q1. Write a short note on: Trading of government securities

Or

Write a short note on: Negotiated Dealing System

Ans.: Negotiated Dealing System (NDS): Negotiated Dealing System 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.

Trading of Government Securities: Government securities are traded on Stock exchanges through Negotiated Dealing System using members of BSE/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, NSDL and CDSL maintain records of holding of securities in a dematerialized form. Records of holding of Government securities for wholesale dealers like Banks/Primary Dealers and other financial institutions are maintained by the RBI.

Q2. Discuss briefly road map for listing of debt securities by newly incorporated entity.

Ans.: The major change brought out in the NCS Regulations is that even a newly incorporated entity, other than REIT/InvIT, is allowed to raised funds through the issuance of corporate bonds and tap the listed space of bond market provided it fulfills 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.
- ◆ Such issue may be subscribed by only Qualified Institutional Buyers.

Earlier, one had to be in existence for a period of at least 3 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.

Q3. Distinguish between: Market Linked Debentures (MLD) and Non-Convertible Debentures (NCD)

Ans.: Non-Convertible Debentures (NCD) is basically fixed-income security where the issuer assures to pay a fixed interest rate on the principal amount to the investor.

NCD 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 higher than NCDs when the market performs well but can be negative or zero when the market isn't performing well.

Q4. Write a short note on: Types of Debentures

Or

Distinguish between: Naked Debentures & Secured Debentures

[Dec. 2009 (3 Marks)]

Or

Distinguish between: Perpetual Debentures & Bearer Debentures

[Dec. 2009 (3 Marks)]

Or

Explain the term 'Naked Debentures'.

[June 2012 (2 Marks)]

Ans.: Various types of debentures are as follows:

- (1) **Naked or Unsecured Debentures:** Debentures of this kind do not carry any charge on the assets of the company. The holders of such debentures do not therefore have the right to attach particular property by way of security as to repayment of principal or interest and thus called as naked or unsecured debentures.
- (2) **Secured Debentures:** Debentures that are secured by a charge of the whole or part of the assets of the company are called mortgage debentures

or secured debentures. After creating charge on debentures, a charge is required to be registered with ROC within 30 days of creation.

- (3) **Redeemable Debentures:** Debentures that are redeemable on expiry of certain period are called redeemable debentures.
- (4) **Perpetual/irredeemable Debentures:** If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period, e.g. winding-up, they are called perpetual/irredeemable debentures.
- (5) **Bearer Debentures:** Such debentures are payable to bearer and are transferable by mere delivery. The name of the debenture holder is not registered in the books of the company, but the holder is entitled to claim interest and principal as and when due. A *bona fide* transferee for value is not affected by the defect in the title of the transferor.
- (6) **Registered Debentures:** Such debentures are payable to the registered holders whose name appears on the debenture certificate and is registered on the companies register of debenture holders maintained as per Section 88 of the Companies Act, 2013.

Q5. Distinguish between: Perpetual Debentures & Bearer Debentures
[June 2011 (2 Marks)]

Ans.: **Perpetual Debentures:** If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period, e.g. winding-up, they are called perpetual debentures.

Bearer Debentures: Such debentures are payable to bearer and are transferable by mere delivery. The name of the debenture holder is not registered in the books of the company, but the holder is entitled to claim interest and principal as and when due. A *bona fide* transferee for value is not affected by the defect in the title of the transferor.

Q6. Write a short note on: Debt Securities [June 2011 (4 Marks)]

Ans.: Debt security represents borrowed funds that must be repaid. In other words, debt securities are interest-paying Bonds, Notes, Bills, or Money Market Instruments that are issued by governments or corporations.

Some debt securities pay a fixed rate of interest over a fixed time period in exchange for the use of the principal. In that case, that principal, or par value, is repaid at maturity.

Some are pass-through securities, with principal and interest repaid over the term of the loan. Still other issues are sold at discount, with interest included in the amount paid at maturity.

Example of debt securities includes:

- ◆ Debentures
- ◆ Bonds

- ◆ Notes
- ◆ Certificates of Deposit (CD)
- ◆ Commercial Paper (CP)
- ◆ Treasury bills
- ◆ Mortgage-backed bonds

Q7. Explain the financial instrument: Naked debenture**[June 2012 (2 Marks)]**

Ans.: Naked or Unsecured Debentures: Debentures of this kind do not carry any charge on the assets of the company. The holders of such debentures do not therefore have the right to attach particular property by way of security as to repayment of principal or interest and thus called as naked or unsecured debentures.

Q8. Distinguish between: Fully Convertible Debentures & Partly Convertible Debentures**[June 2015 (3 Marks)]**

Ans.: Following are the main points of distinctions between fully and partly convertible debentures:

Points	Partly Convertible Debentures	Fully Convertible Debentures
Meaning	When only part of debenture is converted into equity shares they are known as partly convertible debentures.	When full value of debenture is converted into equity shares they are known as fully convertible debentures.
Suitability	Better suited for companies with established track record.	Better suited for companies without established track record
Capital base	Relatively lower equity capital on conversion of debentures.	Higher equity capital on conversion of debentures.
Flexibility in financing	Favourable debt equity ratio.	Highly favourable debt equity ratio.
Classification for debt-equity ratio	Convertible portion classified as 'equity' and non-convertible portion as 'debt'.	Classified as equity for debt-equity computation.
Popularity	Not so popular with investors.	Highly popular with investors.
Servicing of equity	Relatively lesser burden of equity servicing.	Higher burden of servicing of equity.

Q9. A public company may issue secured irredeemable debentures. Comment.**[Dec. 2018 (5 Marks)]**

Ans.: Perpetual/Irredeemable Debentures: If the debentures are issued subject to redemption on the happening of specified events which may not happen for an indefinite period, e.g. winding-up, they are called perpetual/irredeemable debentures.

As per Rule 18(1)(a) of the Companies (Share Capital & Debentures) Rules, 2014, an issue of secured debentures may be made, provided the date of its redemption shall not exceed 10 years from the date of issue.

However, following classes of companies may issue secured debentures for a period exceeding 10 years but not exceeding 30 years:

- (i) Companies engaged in setting up of infrastructure projects.
- (ii) Infrastructure Finance Companies.
- (iii) Infrastructure Debt Fund Non-Banking Financial companies.
- (iv) Companies permitted by a Ministry or Department of the Central Government or by RBI or by the NHB or by any other statutory authority to issue debentures for a period exceeding 10 years.

Thus, after the commencement of the Companies Act, 2013, no company either public or private can issue perpetual or irredeemable debentures.

Q10. Write short notes on: Optionally Fully Convertible Debenture**[Dec. 2019 (3 Marks)]**

Ans.: The Optionally Fully Convertible Debenture is a kind of debenture which can be converted into shares at the expiry of a certain period at a predetermined price, if the debt holder (investor) wishes to do so. The "securities" as defined under section 2(81) of the Companies Act, 2013 means securities as defined in section 2(f) of the Securities Contracts (Regulation) Act, 1956, and includes hybrids.

Hence, after analysing the above definitions of "OFCD", "hybrid" and "securities" it could be rightly concluded that an OFCD being a hybrid security falls under the definition of "securities" as defined under section 2(h) of Securities Contract (Regulation) Act, 1956 and under section 2(81) of the Companies Act, 2013 as it inherits the characteristics of debentures initially and also that of the shares at a later stage if the option to convert the securities into shares being exercised by the security holder.

BONDS**Q11. What are the various risks associated with Bond Investment? Explain.**

Ans.: 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:

- (a) **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.
- (b) **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.

- (c) **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.
- (d) **Reinvestment Risk:** When interest rates are declining, investors may have to reinvest their coupon income and their principal at maturity at lower prevailing rates.
- (e) **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.

Q12. What do you understand by "Online Bond Platform Provider"?

Ans.: SEBI on November 14, 2022, notified the circular, Registration and regulatory framework for Online Bond Platform Providers (OBPP) for regulating online bond trading platforms.

Online Bond Platform Provider (OBPP): Online Bond Platform Provider means any person operating or providing an online bond platform and "online bond platform" means any electronic system, other than a recognized 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.

Framework for Online Bond Platform Provider: A framework has been prescribed for entities operating/desirous of operating as OBPPs under Regulation 51A of the SEBI (Issue & Listing of Non-Convertible Securities) Regulations, 2021 [NCS Regulations]:

- Such entity shall be a company incorporated in India and register itself as a stock broker in the debt segment of the Stock Exchange.
- An entity acting as an OBPP on or prior to this provision coming into force, shall cease to offer products or services or securities on its OBP other than the following:
 - Listed debt securities.
 - Debt securities proposed to be listed through a public offering. Such OBPP shall divest itself of offerings of other products or services or securities.

Q13. What are the requirements while making application by any entity desirous of operating an Online Bond Platform as per SEBI Circular notified for registration and regulatory framework for Online Bond Platform Providers?

Ans.: 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, 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 3 years in the securities market.
- ◆ The entity has obtained 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 entity undertakes to take steps for redress of grievances of the investors within 30 days from the date of the receipt of the complaint, and disclose the number, nature and other particulars of the complaints received, if any, in such form as specified by the Stock Exchange.
- ◆ 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 in relation to their operations.

Q14. Write a short note on: Benefits of EBP Mechanism

Ans.: Benefits of EBP Mechanism: Electronic Book Provider 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 OIBs (*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.

Q15. Write short note on: Request for Quote (RFQ) Platform

Ans.: Request for Quote (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.

Q16. In February 2020, pursuant to approvals from SEBI, both NSE and BSE launched Request for Quote (RFQ) Platform. In this connection, you are required to explain the following:

(i) Basic features of the RFQ Platform

(ii) Securities eligible for being traded on the RFQ Platform

(iii) Mandatory trades on RFQ Platform

(iv) Permitting Stock Brokers on RFQ Platform

Ans.: 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.

(i) Basic features of the RFQ platform:

- RFQ Platform is a system or interface for inviting and giving quotes on an electronic platform.
- A participant who seeks quotes is termed as an Initiator and a participant who acts/responds to the quote requests of the Initiator is termed as a Responder.
- A participant may request other participants for a quote for eligible securities.
- The Initiator has the option to place quotes by disclosing its name or anonymously.
- 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).
- 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.
- 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.

(ii) Securities eligible for being traded on the RFQ platform

- ◆ Non-convertible securities
- ◆ Securitized Debt Instruments
- ◆ Municipal Debt Securities
- ◆ Commercial Paper

- ◆ Certificate of Deposit
- ◆ Government Securities
- ◆ State development Loans
- ◆ Treasury Bills
- ◆ Any other instrument, as may be specified by Stock Exchanges in consultation with SEBI.

(iii) Mandatory trades on RFO platform: In February 2020, the RFO platform was introduced as a 'participant-based' model wherein all regulated entities, listed body corporates, institutional investors and all India financial institutions were eligible to register, access and transact. To enhance liquidity on the RFO 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 RFO platform of stock exchanges. IRDAI has also prescribed similar stipulations for Insurers.

(iv) Permitting Stock Brokers on RFO platform: SEBI has allowed stock brokers registered under the debt segment of the Stock Exchange to place/seek bids on the RFO platform on behalf of clients, in addition to the existing option of placing bids in a proprietary capacity.

The RFO 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.

Q17. Write short note on: Characteristics of Bond

[Dec. 2021 (3 Marks)]

Ans.: Characteristics of Bond are given below:

- ◆ Bond has fixed face value, which is the amount to be returned to the investor upon maturity.
- ◆ Fixed maturity date, which can range from a few days to 20-30 years or even more.
- ◆ All bonds repay the principal amount after the maturity date.
- ◆ Provides regular payment of interest, semi-annually or annually.
- ◆ Interest is calculated as a certain percentage of the face value known as a 'coupon payment'.
- ◆ Generally considered as less risky investment as compared to equity.
- ◆ It helps to diversify and grow investor's money.

Q18. Discuss the measures taken by Government and Regulators to develop a vibrant Corporate Bond Market in India. [Dec. 2019 (5 Marks)]

Ans.: A vibrant capital 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 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 alongside 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.

Some important measures include:

- ◆ Framework for allowing banks to provide Partial Credit Enhancement for enhancing creditworthiness of corporate bonds.
- ◆ 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 Exchanges to enhance liquidity and price discovery in corporate bonds.
- ◆ Time taken for listing of public issue of bonds reduced from 12 days to 6 days.
- ◆ Doing away with the requirement of 1% security deposit for public issue of debt securities.

Q19. Discuss the obligations and duties of the Electronic Book Provider in relation to issuance of debt securities. [June 2022 (3 Marks)]

Ans.: Recognized stock exchange and depository are identified to act as Electronic Book Provider (EBP).

In order to streamline the procedures for issuance of debt securities on private placement basis and enhance transparency to discover prices, SEBI has laid down a framework for issuance of debt securities on private placement basis through an electronic book mechanism. The obligations and duties of the EBP:

- ◆ EBP shall ensure that all details regarding issuance are updated on website of the EBP.
- ◆ 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 website.

- ◆ Where an issuer has disclosed estimated cut-off yield/range to the EBP, the EBP shall ensure its electronic audit trail and secrecy.
- ◆ All 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.
- ◆ EBP shall ensure that bidding is done.
- ◆ The EBP shall be responsible for accurate, timely and secured bidding process of the electronic bid by the bidders.
- ◆ The EBP shall be responsible for addressing investor grievances arising from bidding process.
- ◆ EBP shall ensure that the pay-in of funds towards allotment of securities, placed through EBP platform, is done through clearing corporation mechanism.

GREEN DEBT SECURITIES

Q20. Write a short note on: Dos and don'ts on Greenwashing

Ans.: 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 occurrence:

- (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.

Q21. On 30th May, 2017 SEBI came out with a circular stating the disclosure requirements for issuance and listing of Green Debt Securities in India. Explain the Initial Disclosure Requirements in this context.

[Dec. 2020 (5 Marks)]

Ans.: An issuer desirous of issuing green debt securities shall make the following additional disclosures in the offer document for public issues/private placements:

1. A statement on environmental sustainability objectives of the issue of green debt securities.
2. Brief details of decision-making process followed/proposed for determining the eligibility of projects and assets, 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 projects and assets fit within the eligible green projects categories as defined under Regulation 2(1)(g) of NCS Regulations.
 - (b) The criteria making the projects and assets eligible for using the green debt securities proceeds.
 - (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 through issuance of transition bonds.
3. Details of the system/procedures to be employed for tracking the deployment of the proceeds of the issue.
4. Details of the projects and asset or areas where the issuer, proposes to utilize the proceeds of the issue of green debt securities, including towards refinancing of existing green project and assets, if any.
5. Details of an indicative estimate of distribution of proceeds raised through issuance of green debt security between financing and refinancing of project and asset; if applicable.
6. Details of the intended types of temporary placement of the unallocated and unutilized net proceeds from the issue of green debt securities.

7. Details related to the perceived social and environmental risks and proposed mitigation plan associated with the projects proposed to be financed/refinanced through the proceeds from the issue of green debt securities.
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 2 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 noncompliance/partial compliance and the steps initiated to achieve full compliance.

Q22. What do you understand by Green Debt Securities? Explain.

[June 2021 (5 Marks)]

Or

What are the different categories of projects which can be executed with the funds raised through issue of Green Debt Securities?

[Dec. 2022 (5 Marks)]

Ans.: Green Debt Security: As per Regulation 2(1)(g) of the SEBI (Issue & Listing of Non-Convertible Securities) Regulations, 2021, Green Debt Security means a debt security issued for raising funds subject to the conditions as may be specified by the SEBI from time to time, to be utilized for projects/assets falling under any of the following categories:

- (1) Renewable and sustainable energy including wind, bio-energy, other sources of energy which use clean technology.
- (2) Clean transportation including mass/public transportation.
- (3) 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.
- (4) Energy efficiency including efficient and green buildings.
- (5) Sustainable waste management including recycling, waste to energy, efficient disposal of wastage.
- (6) Sustainable land use including sustainable forestry and agriculture, afforestation.
- (7) Biodiversity conservation.

- (8) 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 & Climate Change.
- (9) 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.
- (10) **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.
- (11) **Yellow bonds** which comprise of funds raised for solar energy generation and the upstream industries and downstream industries associated with it.
- (12) **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.
- (13) Any other category, as may be specified by the SEBI from time to time.

Issuance of green debt securities [Regulation 26]: An issuer desirous of issuing and listing of green debt securities shall comply with the conditions as may be specified by the SEBI.

Q23. Explain the obligations of issuer of Green Debt Securities.

[June 2023 (3 Marks)]

Ans.: Obligations of issuer of Green Debt Securities: An issuer of Green Debt Securities shall:

- (1) Maintain a decision-making process which it uses to determine the continuing eligibility of the projects and assets. This includes, without limitation a statement on the environmental objectives of the Green Debt Securities and a process to determine whether the projects and assets meet the eligibility requirements.
- (2) Ensure that all projects and assets funded by the proceeds of Green Debt Securities, meet the documented objectives of Green Debt Securities.
- (3) Utilize the proceeds only for the stated purpose, as disclosed in the offer document.

An issuer of Green Debt Securities or any agent appointed by the issuer, if follows any globally accepted standard(s) for the issuance of Green Debt Securities including measurement of the environmental impact, identification of the projects and assets, utilization of proceeds, etc., shall disclose the same in the offer document/disclosure document and in continuous disclosures.

MUNICIPAL BONDS

Q24. What do you understand by Municipal Debt Securities? How Municipal Bonds are becoming a good alternative source of finance to fund projects undertaken by Municipal Corporations.

Ans.: Municipal Debt Securities: 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 as source of finance: 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, twelve issues of Municipal Bonds have been made by ten Municipal Corporations in the country, raising almost ₹ 2,000 Crore.

The funds raised have been used for various developmental projects like liquid waste management projects, water supply projects, tertiary sewage treatment plants, residential projects etc.

Unless otherwise provided in ILDMS Regulations, an issuer making an offer of municipal debt securities shall satisfy the conditions of the Regulations as on the date of filing of the draft offer document or preliminary placement memorandum with SEBI and also as on the date of filing the offer document or placement memorandum with SEBI or upon registering the offer document or placement memorandum with the Registrar of Companies, as the case may be.

ILDMS Regulations, *inter alia*, deals with:

- ◆ 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 & 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.

Q25. Write a short note on: Information Database for Municipal Bond.

Ans.: 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.
- ◆ 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.

SEBI (ISSUE & LISTING OF NON-CONVERTIBLE SECURITIES) REGULATIONS, 2021 [NCS REGULATIONS]

Q26. Discuss briefly the rules and regulations relating to redemption and roll-over of debt securities. [Dec. 2012 (5 Marks)]

Ans.: Roll-over of debt securities: Regulation 39 of the SEBI (Issue & Listing of Non-Convertible Securities) Regulations, 2021, makes following provisions in relation to roll-over of debt securities:

- (1) The issuer shall redeem the debt securities in terms of the offer document.
- (2) Where the issuer intends to roll-over debt securities of a particular International Securities Identification Number, it shall do so only upon giving 15 days notice for the proposed roll over.
- (3) The roll-over shall be approved by a majority of holders holding not less than 3/4th in value through postal ballot or e-voting of such debt securities in a duly convened meeting as per the offer document.
- (4) The notice shall contain disclosures with regard to rationale for roll-over and at least one credit rating, which shall be obtained from a credit rating agency within 6 months prior to the due date of redemption.
- (5) The issuer shall, prior to sending the notice to holders of debt securities, file a copy of the notice and proposed resolution with the stock exchange where such debt securities are listed, for dissemination of the same to public on its website.
- (6) The existing trust deed may be continued if it provides for such continuation or the same may be amended or fresh trust deed may be executed at the time of such roll over.

- (7) The issuer shall on completion of the roll over, intimate the stock exchange about the roll-over of the debt securities.
- (8) The issuer shall create and maintain adequate security in respect of such debt securities to be rolled over.
- (9) The issuer shall redeem the debt securities of all such holders, who have not given their positive consent for the roll-over.

Q27. "The Company Secretary shall ensure that the regulatory provisions contained in the NCS Regulations are complied with by the Issuer Company". State the obligations of issuer in relation to private placements of listed non-convertible securities.

Ans.: 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 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 ₹ 25 lakh per issuer.
- ◆ Pay regulatory fees to SEBI through the stock exchange.
- ◆ Make all payments on working days.
- ◆ Follow the actual day count convention for calculation of interest/dividend payments.
- ◆ Create "Debenture Redemption Reserve" [DRR] or "Capital Redemption Reserve" [CRR] in accordance with the relevant provisions of the Companies Act, 2013.
- ◆ Create and maintain security, in case of secured non-convertible securities.
- ◆ 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 ₹ 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.

Q28. Your promoters want to issue Non-Convertible Redeemable Preference Shares (NCRPS) and wish to list the same on a Recognized Stock Exchange. With respect to the proposed issue explain the call option and put option available to them of the right to recall or redeem prior to maturity pursuant to the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021. [Dec. 2023 (5 Marks)]

Ans.: Right to recall or redeem prior to maturity [Regulation 15 of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations 2021]

- (a) **Call Option:** An issuer making issuance of non-convertible securities shall have the right to recall such securities prior to the maturity date from all the investors or only from retail investors, which is known as call option.
- (b) **Put Option:** An issuer making issuance of non-convertible securities shall have a right to provide right of redemption of debt securities prior to the maturity date to all the investors or only to retail investors, which is known as put option.

Manner of exercising option: Such right to recall non-convertible securities or redeem debt securities prior to the maturity date shall be exercised in accordance with the terms of issue and detailed disclosure in this regard shall be made in offer document including date from which such right is exercisable, period of exercise (which shall not be less than 3 working days) and redemption amount (including the premium or discount at which such redemption shall take place).

For which type of securities such option can be exercised: The issuer or investor may exercise such right with respect to all the non-convertible securities issued or held by them respectively or with respect to a part of the non-convertible securities so issued or held.

Partial exercise of right: In case of partial exercise of such right in accordance with the terms of the issue by the issuer, it shall be done on proportionate basis only.

When such right can be exercised: No such right shall be exercisable before the expiry of 1 year from the date of issue of such non-convertible securities.

Notice to holders of non-convertible securities: The issuer shall send a notice regarding recall or redemption of non-convertible securities, prior to maturity, to all the eligible holders of such securities and the debenture trustee(s), at least 21 days before the date from which such right is exercisable and the notice to the eligible holders shall be sent in the following manner:

- (i) Soft copy of such notice shall be sent to the eligible holders who have registered their email address either with the listed entity or with any depository.
- (ii) Hard copy of the notice shall be sent to the eligible holders who have not registered their email address either with the listed entity or with any depository.

Copy of notice to stock exchange: The issuer shall simultaneously provide a copy of such notice to the stock exchange where the non-convertible securities of the issuer are listed, for dissemination on its website.

Interest on delay: Issuer shall pay interest at the rate of 15% p.a. for the period of delay, if any.

Compliances to be made: After the completion of the exercise of such right, the issuer shall –

- (a) Submit a report to the stock exchange(s) where the non-convertible securities are listed for public dissemination regarding the details of non-convertible securities redeemed during the exercise period and details of redemption thereof.
- (b) Inform the debenture trustee regarding the debt securities redeemed during the exercise period and details of redemption thereof.
- (c) Inform the depositories for extinguishing the non-convertible securities that have been redeemed.

Explanation: "Retail Investor" shall mean the holder of non-convertible securities having the aggregate face value not more than ₹ 2 lakh.

DEPOSITS

Q29. Directors of IRB Infra Limited wants to use the balance in Deposit Repayment Reserve Account for writing off discount on issue of debentures and for payment of dividend to equity shareholders. Examine the validity of the proposal given by the directors of the company in the light of the Companies Act, 2013.

Ans.: As per Section 74(5) of the Companies Act, 2013, the Deposit Repayment Reserve Account shall not be used by the company for any purpose other than repayment of deposits.

Thus, IRB Infra Limited cannot use the balance in Deposit Repayment Reserve Account for writing off discount on issue of debentures or for payment of dividend to equity shareholders.

Q30. Relaxo Limited received non-interest bearing security deposit from Mr. Suraj Kamat, employee of the company of ₹ 1,50,000. Salary of Mr. Suraj Kamat is ₹ 10,000 p.m. whether security deposit received by the Relaxo Limited be treated as 'Deposit' as per Companies (Acceptance of Deposits) Rules, 2014?

Ans.: Deposit does not include any amount received from an employee of the company not exceeding his annual salary under a contract of employment with the company in the nature of non-interest bearing security deposit. [Rule 2(1)(c)(x)]

Annual Salary of Mr. Suraj Kamat = ₹ 10,000 × 12 = ₹ 1,20,000.

Since, the non-interest bearing security deposit received from Mr. Suraj Kamat exceeds his annual salary, it amounts to 'Deposit'.

Q31. Trident Limited has accepted ₹ 5 lakh as advance towards the supply of goods to certain parties. As per the agreement, the company supplied goods after 8 months from the date of deposit. Internal auditors qualified their report on the ground that the company has violated provisions of the Companies Act, 2013 and the Rules made thereunder. Whether the qualification made by internal auditor in his report is justified?

Ans.: Deposit does not include any amount received in the course of, or for the purposes of, the business of the company as an advance for the supply of goods provided that such advance is appropriated against supply of goods within a period of 365 days from the date of acceptance of such advance. [Rule 2(1)(c)(xii)] Trident Limited had supplied goods within 8 months from the acceptance of advance and hence it cannot be treated as 'Deposit'. The Company has not defaulted in provisions relating to acceptance of deposit and hence remark passed by internal auditor is not correct.

Q32. Paid-up share capital, free reserve and securities premium balance of XYZ Ltd. is ₹ 65 Crore, ₹ 40 Crore and ₹ 25 Crore respectively. Directors of the company are planning to receive short term deposit which will be repayable after 4 months. Examining the provisions of the Companies Act, 2013 and the Rules made thereunder, advice whether XYZ Ltd. can accept deposits which are repayable before 6 months from the date of acceptance. If yes, calculate the maximum amount of deposit that company can accept.

Ans.: No company shall accept deposit which is repayable within a period of less than 6 months from the date of acceptance. [Rule 3(1)]

However, a company may, for the purpose of meeting any of its short-term requirements of funds, accept deposits for repayment earlier than 6 months from the date of deposit. Such deposits shall not exceed 10% of the aggregate of paid-up share capital, free reserve and securities premium account of the company.

Thus, XYZ Ltd. can accept deposit for 4 months up to ₹ 13 Crore. [₹ 65 Crore + ₹ 40 Crore + ₹ 25 Crore × 10%]

Q33. As per audited balance sheet of Don Ltd. as at 31st March, 2023, the details of share capital and reserves and surplus are as under.

	₹ in Crore
Equity Share Capital	60.00
<i>Reserves & Surplus:</i>	
Profit & Loss A/c	6.50
General Reserves	13.00
Securities Premium	20.00
As at 31st March, 2023 Deposits from members are ₹ 8 Crore.	
Compute the limits up to which Don Ltd. can accept further deposits from members.	
Can Don Ltd. accept deposit from public?	
If it is private company, how much further deposit can be accepted from the members?	

Ans.: Net worth of Don Ltd. = ₹ 60 Crore + ₹ 6.5 Crore + ₹ 13 Crore + ₹ 20 Crore = ₹ 99.5 Crore

Since, net worth of Don Ltd. is not more than ₹ 100 Crore, it is not Eligible Company and hence it can accept deposit from members only and not from public.

The company can accept deposit from its members up to 35% of the aggregate of the paid-up share capital, free reserves and securities premium account. [Rule 3(3)]

Maximum deposits that can be accepted = ₹ 99.5 Crore × 35% = ₹ 34.825 Crore.

Further deposits that can be accepted = ₹ 34.825 Crore – ₹ 8 Crore = ₹ 26.825 Crore.

Q34. As per the audited balance sheet of Dowell Ltd. as at 31st March, 2024, the details of share capital and reserves and surplus are as under.

	₹ in Crore
Equity Share Capital	300.00
<i>Reserves & Surplus:</i>	
Profit & Loss A/c	62.75
General Reserves	12.00
Securities Premium	25.00
Break-up of unsecured loans as at 31st March, 2024 in given below:	
Deposits from public	13.00
Deposits from shareholders	3.62
Compute the limits up to which Dowell Ltd. can accept further deposits from public & shareholders.	

Ans.: Dowell Ltd. is Eligible Company as its net worth is more than ₹ 100 Crore. [Rule 2(1)(e)] Thus, the company can accept deposit as per the limits specified in Rule 3(4).

Following are the limits for acceptance of deposits for Eligible Company:

- (1) Deposit from members:** Deposits up to 10% of the aggregate of the paid-up share capital, free reserves and securities premium account of the company.
- (2) Deposits from public:** Deposits up to 25% of aggregate of the paid-up share capital, free reserves and securities premium account of the company.

Particulars	₹ in Crore
Equity Share Capital	300.00
Profit & Loss Account	62.75
General Reserves	12.00
Securities premium	25.00
	399.75

Calculation of acceptance of deposit from members and from public: ₹ in Crore

Particulars	From Members	From Public
Limit up to which Dowell Ltd. can accept deposits		
[10% from shareholders & 25% from public of ₹ 399.75 Crore]	39.975	99.9375
(-) Existing deposits as at 31st March, 2024	(3.62)	(13.00)
Further deposits that can be accepted.	36.355	86.9375

Total amount of further deposits that can be accepted by the company = 36.355 Crore + 86.9375 Crore = 123.2925 Crore.

Q35. Jewel Ltd. needs funds for running its business operations. Mr. Sona one of the shareholders of Jewel Limited is ready to provide Loan to Jewel Ltd. The Board is skeptical on availing loan from a shareholder. One of the Directors of the Company is of the view that such loan will be treated as a deposit.

What is considered as deposit pursuant to the provisions of the Companies Act, 2013 and Rules made thereunder. Can the company accept deposit from its member?

Do you agree with the view of the Director? [Dec. 2023 (3 Marks)]

Ans.: Acceptance of deposit from members: As per Section 73(2) of the Companies Act, 2013, a company may accept deposits from its members on such terms and conditions, including the provision of security, if any, or for repayment of such deposits with interest, as may be agreed upon between the company and its members.

Acceptance of deposit is subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the RBI.

Private Company & Public Company [which is not Eligible Company] can accept deposit from members only and not from public.

Public Company which comes under definition of 'Eligible Company' can accept deposit from members as well from public. [Section 73(2) read with Section 76]

As per Rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014, "Deposit" includes any receipt of money by way of deposit or loan or in any other form, by a company. However, as per said definition of 'deposit' certain amount received by the company cannot be treated as deposit, known as 'exempted deposit'.

If a company receive loan from form shareholder then it amounts to 'deposit' within the meaning of Rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014.

In view of above, Jewel Ltd. can accept loan from Mr. Sonu, a shareholder subject to compliance of all provisions that are applicable to relating to acceptance of deposit.

NBFC

Q36. Discuss the Corporate Governance norms for NBFCs pertaining to following aspects:

(i) Constitution of Committees of the Board

(ii) Fit and Proper Criteria

(iii) Rotation of partners of the Statutory Auditors Audit Firm

Ans.: Corporate Governance norms for NBFCs are as follows:

Constitution of Committees of the Board:

(a) **Audit Committee:**

- All applicable NBFCs shall constitute an Audit Committee, consisting of not less than 3 members of its Board of Directors.
- Committee constituted by NBFC as required under section 177 of the Companies Act, 2013 shall be the Audit Committee.
- Audit Committee shall have the same powers, functions and duties as laid down in Section 177 of the Companies Act, 2013.
- 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 Nomination Committee to ensure 'fit and proper' status of proposed/existing directors. The Committee 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.

Fit and Proper Criteria: 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 RBI 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 RBI 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.

Rotation of partners of the Statutory Auditors Audit Firm: All Applicable NBFCs shall rotate the partners 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.

Q37. What do you mean by Non-Banking Financial Company? Enumerate the powers of Reserve Bank of India vested in the RBI Act for regulating and supervising the Non-Banking Financial companies.

[Dec. 2018 (4 Marks)]

Ans.:

(1) **Meaning of NBFC:** Non-banking financial company means –

- (a) A financial institution which is a company.
- (b) 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.
- (c) Such other non-banking institution or class of such institutions, as the RBI may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

- (2) **Registration with RBI:** In terms of Section 45-IA, all Non-Banking Financial Companies have to be mandatorily registered with the RBI.
- (3) **Regulatory Framework:** The Reserve Bank of India (RBI) is entrusted with the responsibility of regulating and supervising the Non-Banking Financial Companies by virtue of powers vested in **Chapter III-B** of the Reserve Bank of India Act, 1934.
- (4) **Objectives:** The regulatory and supervisory objective is:
- ◆ To ensure healthy growth of the financial companies;
 - ◆ To ensure that these companies function as a part of the financial system within the policy framework, in such a manner that their existence and functioning do not lead to systemic aberrations.
- (5) **Surveillance & Supervision by RBI:** The quality of surveillance and supervision exercised by the RBI over the NBFCs is sustained by keeping pace with the developments that take place in non-banking sector of the financial system.
- (6) **Powers of RBI:** The Reserve Bank has been given the powers under the RBI Act, 1934 to register, lay down policy, issue directions, inspect, regulate, supervise and exercise surveillance over NBFCs.
- (7) **Penal action by RBI:**
- ◆ The RBI can penalize NBFCs for violating the provisions of the RBI Act, 1934 or the directions or orders issued by RBI under the Act.
 - ◆ Following penal action can be taken by the RBI:
 - Cancellation of the Certificate of Registration issued to the NBFC.
 - Prohibiting the NBFC from accepting deposits and alienating their assets.
 - Filing a winding-up petition.

Q38. State the requirements for registration of Non-Banking Finance Company with Reserve Bank of India under the Reserve Bank of India Act, 1934. [Dec. 2019 (4 Marks)]

Ans.:

- (a) **Registration of NBFC:** In terms of Section 45-IA, all Non-Banking Financial Companies have to be mandatorily registered with the RBI.
- (b) **Requirement of registration:** No NBFC shall commence or carry on the business of a non-banking financial institution without –
- (i) Obtaining a certificate of registration.
 - (ii) Having the **net owned fund** of ₹ 25 lakh or such other amount, **not exceeding ₹ 100 Crore**, as the RBI may specify.

The RBI may notify different amounts of net owned fund for different categories of non-banking financial companies.

Every NBFC shall make an application for registration to the RBI in prescribed form.

- (c) **Conditions for registration of NBFC:** The RBI, for the purpose of considering the application for registration, may require to be satisfied by an inspection of the books of NBFC or otherwise that the following conditions are fulfilled:
- ◆ **Ability of the NBFC to pay depositors:** The NBFC is or shall be in a position to pay its present or future depositors in full as and when their claims accrue.
 - ◆ **Affairs of the NBFC:** Affairs of the NBFC are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors.
 - ◆ **Character of the management:** General character of the management or the proposed management of the NBFC shall not be prejudicial to the public interest or the interests of its depositors.
 - ◆ **Capital structure:** The NBFC has adequate capital structure and earning prospects.
 - ◆ **Public interest:** Public interest shall be served by the grant of certificate of registration to the NBFC to commence or to carry on the business of India.
 - ◆ **Monetary stability & economic growth:** The grant of certificate of registration shall not be prejudicial to the operation and consolidation of the financial sector consistent with monetary stability, and economic growth considering such other relevant factors which the RBI may specify.
 - ◆ **Other conditions:** Any other condition, fulfilment of which in the opinion of the RBI, shall be necessary to ensure that the commencement of or carrying on of the business in India by NBFC shall not be prejudicial to the public interest or in the interests of the depositors.
- (d) **Certificate of registration:** The RBI may, after being satisfied that the specified conditions are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

Q39. Distinguish between: Banks and Non-Banking Financial Companies

Or

NBFCs lend and make investments and hence their activities are akin to that of banks; however, there are a few differences between them. Explain. [Dec. 2022 (4 Marks)]

Ans.: Following are the main points of distinction between Banks and Non-Banking Financial Companies:

Points	Banks	Non-Banking Financial Companies
Meaning	Bank is a RBI authorized financial institution that aims at providing banking services to the general public.	NBFC is a company engaged in the business of loans and advances, acquisition of shares, stocks, bonds, debentures and securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business and chit business.
Demand deposits	Banks can accept terms deposits as well as demand deposits.	NBFCs can accept only term deposit but not demand deposits.
Payment & settlement system	Banks form part of the payment and settlement system.	NBFCs do not form part of the payment and settlement system.
Cheque	Banks can issue cheques drawn on itself.	NBFCs cannot issue cheques drawn on itself.
Credit creation	Banks are termed as creators of credit through money multiplier activity.	NBFCs cannot be termed as creators of credit.
Transaction services	Banks provides a variety of transaction services.	NBFCs do not facilitate transaction services.
Reserve ratios	Banks are required to maintain reserve ratios with RBI.	NBFCs are not required to maintain reserve ratios with RBI.
Deposit insurance	Banks can avail the facility of taking insurance on amount deposited by public.	NBFCs cannot take insurance on amount deposited by public.

Q40. Rakesh is interested to form a Non-Banking Financial Company (NBFC) for carrying business of providing micro finance in the rural areas in the name of 'SABKO Loan Company Ltd.'. Advise him about the various categories of NBFCs and let him know as to which category of NBFC will suit him for applying the license. [Dec. 2018 (5 Marks)]

Ans.: Before applying for NBFC License, the type and category of NBFC license must first be determined. Following are the categories of NBFC Companies:

- (1) **Asset Finance Company (AFC):** An Asset Finance Company is a company which is a financial institution carrying on as its principal business the financing of physical assets such as automobiles, tractors, lathe machines,

generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines.

- (2) **Investment Company:** An Investment Company is any company which is a financial institution carrying on as its principal business the acquisition of securities (shares/bonds/other financial securities).
- (3) **Loan Company:** Loan Company is any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.
- (4) **Infrastructure Finance Company:** Infrastructure Finance Company is a non banking finance company that deploys at least 75% of its total assets in infrastructure loans, has a minimum Net Owned Funds of ₹ 300 Crore, maintains a minimum credit rating of "A" or equivalent with a Capital to Risk Asset Ratio of 15%.
- (5) **Systemically Important Core Investment Company:** Systemically Important Core Investment Company is an NBFC with an asset size of over ₹ 100 Crore, accepts public funds, and is involved in the business or acquisition of shares and securities subject to the fulfillment certain conditions.
- (6) **Infrastructure Debt Fund:** Infrastructure Debt Fund is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. Infrastructure Debt Funds raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies can sponsor such companies.
- (7) **NBFC — Micro Finance Institution:** Micro Finance Institution is a non-deposit taking NBFC that is engaged in micro finance activities.
- (8) **NBFC Factor:** NBFC Factor is a non deposit taking NBFC engaged in the principal business of factoring.

Looking into the features of various NBFCs, Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI) will suit Mr. Rakesh as he is incorporating NBC for carrying business of providing micro finance in the rural areas.

Q41. Bhaskar is presently running a business of finance. He has planned to promote an Infrastructure Finance Company along with his friends. He seeks your advice to know whether it is a Non-Banking Finance Company requiring Reserve Bank of India's registration and criteria to be satisfied by such Company. Also clarify on how Net owned Fund is calculated. [Dec. 2019 (5 Marks)]

Or

Define the term 'Net Owned Fund'.

[Dec. 2020 (4 Marks)]

Ans.: Infrastructure Finance Company: IFC is a non-banking finance company means non-deposit taking NBFC that fulfills the following criteria:

- Which deploys at least 75% of its total assets in infrastructure loans
- Minimum Net Owned Funds of ₹ 300 Crore
- Minimum credit rating of 'A' or equivalent
- CRAR of 15% (with a minimum Tier-I capital of 10%). [CRAR means capital to risk weighted assets ratio]

Net Owned Fund [Explanation to Section 45-IA of RBI Act, 1934]: Net Owned Fund means:

- The aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the company after deducting:
 - Accumulated balance of loss
 - Deferred revenue expenditure
 - Other intangible assets
- Further reduced by the amounts representing:
 - Investments of such company in shares of:
 - Its subsidiaries
 - Companies in the same group
 - All other non-banking financial companies.
 - Book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with:
 - Subsidiaries of such company
 - Companies in the same group, to the extent such book value exceeds 10% of (a) above.

Registration with RBI: In terms of Section 45-IA, all Non-Banking Financial Companies have to be mandatorily registered with the RBI.

Q42. State with reasons whether the following Companies require registration as NBFC with Reserve Bank of India, if not who is regulating authority for these Companies:

(i) Infrastructure Debt Fund Company

(ii) Asset Finance Company

(iii) Merchant Banking Companies [June 2021 (3 Marks)]

Ans.:

- Infrastructure Debt Fund Company:** It is a company registered as NBFC to facilitate the flow of long-term debt into infrastructure projects. Infrastructure Debt Funds raise resources through issue of Rupee or

Dollar denominated bonds of minimum 5 year maturity.

Such Company requires registration as NBFC with RBI.

- Asset Finance Company:** An Asset Finance Company is a company which is a financial institution carrying on as its principal business of the financing of physical assets such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines.

Such Company requires registration as NBFC with RBI.

- Merchant Banking Companies:** Regulated by Securities & Exchange Board of India. Law which regulates the activities of the Merchant Bank in India are SEBI Act, 1992 and the SEBI (Merchant Bankers) Regulations 1992.

Such Company is not required to be registered as NBFC with RBI.

Q43. What are the various classes of Non-banking Financial Companies on the basis of their activities? [Dec. 2021 (4 Marks)]

Ans.: Classes of NBFCs on the basis of their activities are given below:

Classes of NBFCs	Activity
Asset Finance Company	Financing of physical assets including automobiles, tractors and generators.
Loan Company	Provision of loan finance.
Investment & Credit Company	Investment and provision of finance.
Investment Company	Acquisition of securities for purpose of selling.
Infrastructure Finance Company	Provision of infrastructure loans.
Systemically Important Core Investment Company	Makes investments and loans to group companies.
Infrastructure Debt Fund Company	Facilitation of flow of long-term debt into infrastructure projects.
Micro Finance Company	Credit to economically disadvantaged groups.
Factor Company	Acquisition of receivables or extending loans against the security interest of the receivables at a discount.
Operative Financial Holding Company	Facilitation of promoters/promoter groups in setting up new banks.
Mortgage Guarantee Company	Mortgage guarantee business.
Account Aggregator Company (NBFC-AA)	Collecting and providing information about a customer's financial assets in a consolidated, organized and retrievable manner to the customer or others as specified by the customer.
Peer to Peer Lending Company	Providing an online platform to bring lenders and borrowers together to help mobilize funds.

BANK FINANCE – FUND BASED FACILITIES & NON FUND BASED FACILITIES**Q44. Explain briefly two finance facility available in Indian currency for the exporters**

Ans.: A finance facility for the exporters, available in Indian currency in the following two forms:

- (1) 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.
- (2) 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).

Q45. State the securities that are considered as approved securities for obtaining "Loan against Securities". Also State the features of Loan against Securities.

Ans.: 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.

- ◆ Non-Convertible Debentures
- ◆ Mutual Fund Units
- ◆ NABARD Bonds
- ◆ Dematerialized Shares
- ◆ National Saving Certificates/Kissan Vikas Patra (Accepted only in Demat form)
- ◆ 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.

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.

Q46. Write a short note on: Bills Finance [Dec. 2012 (3 Marks)]

Or

Distinguish between the following: Bills Finance & Project Finance

Ans.: Bills Finance and Project Finance are two different methods of financing.

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.

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 doc-

uments 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.

Project Finance: It is the long-term financing of infrastructure and industrial projects based upon the projected cash flows of the project. Usually, a project financing structure involves a number of equity investors, known as 'sponsors', a 'syndicate' of banks or other lending institutions that provide loans to the operation. They are most commonly loans which are secured by the project assets and paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors.

The financing is typically secured by all of the project assets, including the revenue-producing contracts. Project lenders are given a lien on all of these assets and are able to assume control of a project if the project company has difficulties complying with the loan terms.

Generally, a special purpose entity is created for each project, thereby shielding other assets owned by a project sponsor from the detrimental effects of a project failure.

As a special purpose entity, the project company has no assets other than the project. Capital contribution commitments by the owners of the project company are sometimes necessary to ensure that the project is financially sound or to assure the lenders of the sponsors' commitment. Project finance is often more complicated than alternative financing methods. Traditionally, project financing has been most commonly used in the infrastructure industry.

Q47. State the guidelines issued by RBI (Reserve Bank of India) for large borrowers under the cash credit facility. [Dec. 2020 (5 Marks)]

Ans.: In respect of borrowers having aggregate fund based working capital limit of ₹ 1,500 Million and above from the banking system, a minimum level of 'loan component' of 40% shall be effective from April 1, 2019. Accordingly, for such borrowers, the outstanding 'loan component' (Working Capital Loan) must be equal to at least 40% of the sanctioned fund based working capital limit, including ad hoc limits and TODs. Hence, for such borrowers, drawings up to 40 percent of the total fund based working capital limits shall only be allowed from the 'loan component'. Drawings in excess of the minimum 'loan component' threshold may be allowed in the form of cash credit facility. The bifurcation of the working capital limit into loan and cash credit components shall be effected after excluding the import credit limits and bills limit for inland sales from the working capital limit.

Q48. Differentiate between: Hire Purchase & Hypothecation [Dec. 2020 (5 Marks)]

Ans.: **Hire Purchase:** HP transactions are very similar to leasing transactions. Like Leasing Finance, in Hire Purchase, 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.

Under Hire Purchase the financing entity may get the benefit of depreciation as well as ownership of the asset financed. Also, 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

Hypothecation: Before SARFAESI Act, 2002, it was not define legally in India. It is a charge on any movable asset 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.

Q49. Write a note on: Rupee Deemed Export Credit

[Dec. 2020 (3 Marks)]

Ans.: **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.

Q50. Distinguish between: Overdraft & Cash Credit Account

[June 2021 (5 Marks)]

Ans.: **Overdraft:** 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 over 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: A cash credit facility is a short-term finance to a borrower company, having 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 borrowers normally either against pledge (Key Cash Credit) or hypothecation of stocks of raw materials, semi-finished goods and finished goods and Book Debts (Receivables). This type of limit is offered mainly to traders who find it difficult to maintain stock register and submitting periodic stock statements. 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 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 (pledge) 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, National Saving Certificates or Gold Jewels.

Q51. Distinguish between: Buyer's Credit & Supplier's Credit

[June 2021 (5 Marks)]

Or

In reference to the Import Finance, explain the difference between the term "Buyer's Credit" and "Supplier's Credit". [June 2023 (5 Marks)]

Ans.:

Buyers Credit	Suppliers credit
Buyer's credit refers to loans for payment of Imports into India arranged by the importer from overseas bank or financial institution.	Supplier's credit relates to the credit for imports into India extended by the overseas supplier.
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 permissible under the extant Foreign Trade Policy of the DGFT.
For the overseas exporter, it is converted into a Cash transaction.	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.

Q52. Explain the different purposes for which bank guarantees are issued. [June 2023 (3 Marks)]

Ans.: Some of the purposes for which Bank Guarantees are issued are:

- 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).
- Due performance of a specific contract undertaken by a customer in favour of Government bodies/Others. For example supply of materials, Construction of Roads, Buildings Dams, Civil Work, etc.
- Due performance of an equipment/project after completion for a specific period due to possible defects appearing after delivery during warranty period of the equipment's.
- 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.

Q53. Explain Fund Based and Non-Fund Based Credit Facilities.

[Dec. 2023 (2 Marks)]

Ans.: Fund Based & Non-Fund Based 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 hereunder.

Fund Based Credit Facilities	Non-Fund Based Credit Facilities
Overdraft	Letter of Credit
Cash Credit	Stand by Letter of Credit
Bills Finance	Bank Guarantee
Hire Purchase Finance	Suppliers Credit
Export Credit	

Q54. Anil is a retired from the Central Government Job in 2023. He is planning to invest ₹ 10 lakh in Fixed deposit and ₹ 25 lakh in mutual funds schemes. As these are the retirement fund, he is very cautious about the safety of investment. Is there any scheme of the Govt. for protection cover against losses in case of failure of bank/Asset Management Company?

[Dec. 2023 (3 Marks)]

Ans.: Deposit Insurance: Like any other insurance policy, it is a protection cover against losses accruing to bank deposits if a bank fails financially and has no money to pay its depositors and has to go in for liquidation.

In India, the Deposit Insurance and Credit Guarantee Corporation (DICGC), a subsidiary of the RBI was set up under an Act of the Parliament for the purpose of insurance of deposits and guaranteeing of credit facilities. The DICGC insures all deposits such as savings, fixed, current, recurring deposits except certain specified types of deposits.

Each depositor in a bank is insured up to a maximum of ₹ 5,00,000 for both principal and interest amount held by him in the same right and same capacity as on the date of liquidation/cancellation of bank's licence or the date on which the scheme of amalgamation/merger/reconstruction comes into force.

Thus, if Arun invest ₹ 10 lakh in fixed deposit he will get deposit insurance protection for ₹ 5,00,000 (for both principal and interest) only.

Investments that Arun plans to make in Mutual Funds are subject to market risk.

DISCOUNTING, FORFAITING, FACTORING & WORKING CAPITAL FINANCE

Q55. Write a note on: Types of factoring. [June 2000 (5 Marks)]

Or

Write a note on: Recourse Factoring. [June 2003 (5 Marks)]

Ans.: Various types of factoring are as follows:

- (1) Non-Recourse/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.
- (2) 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.

(3) 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.

(4) Advance Factoring: Under advance factoring arrangement the factor provides an advance against the uncollected and non-due receivables to the firm.

(5) 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.

(6) 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.

Q56. Write a short note on: Bills re-discounting. [June 2004 (2 Marks)], [Dec. 2012 (3 Marks)]

Ans.: Generally bill of exchange and other negotiable instruments are discounted with bank. But due to such discounting bank may face a problem of liquidity hence banks or financial institutions discounts the bill discounted in other banks or financial institution or with central bank which is called as rediscounting of bill.

Banks can rediscount the bills with the RBI and other approved institutions like LIC, GIC, UTI, ICICI, IFCI, DFHI etc.

As per RBI's guidelines regarding bill discounting by the commercial banks should not rediscount the bill discounted by NBFC as the RBI has provided enough rediscounting facilities to the banks, they can get the bill rediscounted from other banks.

Establishment of **Discount & Finance House of India (DFHI)** is a landmark step in this direction.

DFHI aims to impart liquidity to commercial bills, which have already been discounted by commercial banks or FI. For this purpose, it announces its bid and rediscount rates on a fortnightly basis.

Q57. Discuss the steps involved in the process of factoring. [Dec. 2013 (5 Marks)]

Or

Write a short note on: Mechanics of factoring. [June 2005 (5 Marks)], [June 2007 (5 Marks)]

Ans.: The steps involved in factoring operations are:

1. Customer (buyer) places the order to the client (seller).

- Client (seller) fixes the limit.
- Client delivers the goods and instructs the customer to make payment to the factor.
- Factor sends the invoice copy to the client.
- Factor makes the prepayment of invoice to the client.
- Factor follows up with the customer.
- Customer makes the payment to the factor.
- Factor after deducting its fees and other charges pays the balance amount to the client.

Q58. Distinguish between: Bill Discounting & Factoring.**[June 2019 (5 Marks)]**

Ans.: Following are the main points of difference between factoring & bill discounting:

Points	Factoring	Bill Discounting
Meaning	Factoring is an arrangement to have debts collected by a third party entity for a fee. It is outsourcing of receivables to the factoring company.	Generally bill of exchange and other negotiable instruments are discounted with bank. But due to such discounting bank may face a problem of liquidity hence banks or financial institutions discount the bill discounted in other banks or financial institution or with central bank which is called as rediscounting of bill.
Collection	Under factoring agreement, the factor undertakes the responsibility of collecting client's bills.	Under a bill discounting arrangement, the drawer undertakes the responsibility of collecting the bills and remitting the proceeds to the financing agency.
Types	Factoring can be either with recourse or without recourse.	Bill discounting is always with recourse.
Services	Apart from collecting clients bill a factor may offer other services like financing and managing the receivable of a client.	The finance house discounting bills and does not offer any non-financial services.

Q59. Factoring is a financial option for the management of receivables. In the light of this statement, explain the meaning and advantage of factoring.

[June 2015 (3 Marks)]

Ans.: Factoring is an arrangement to have debts collected by a third party entity for a fee.

Advantages of Factoring: Factoring is becoming popular all over the world on account of various services offered by the institutions engaged in it. Factors render services ranging from bill discounting facilities offered by the commercial

banks to total takeover of administration of credit sales including maintenance of sales ledger, collection of accounts receivables, credit control, protection from bad debts, provision of finance and rendering of advisory services to their clients. Thus, factoring is a tool of receivables management employed to release the funds tied up in credit extended to customers and to solve problems relating to collection, delays and defaults of the receivables.

A firm that enters into factoring agreement is benefited in a number of ways, some of the important benefits are outlined below:

The factor provides specialised services with regard to sales ledger administration and credit control and relieves the client from botheration of debt collection. He can concentrate on the other major areas of his business and improve his efficiency.

- ◆ The advance payments made by the factor to the client in respect of the bills purchased increase his liquid resources. He is able to meet his liabilities as and when they arise thus improving his credit standing position before suppliers, lenders and bankers. The factor's assumption of credit risk relieves him from the tension of bad debt losses. The client can take steps to reduce his reserve for bad debts.
- ◆ It provides flexibility to the company to decide about extending better terms to their customers.
- ◆ The company itself is in a better position to meet its commitments more promptly due to improved cash flows.
- ◆ Enables the company to meet seasonal demands for cash whenever required.
- ◆ Better purchase planning is possible. Availability of cash helps the company to avail cash discounts on its purchases.
- ◆ As it is an off balance sheet finance, thus it does not affect the financial structure. This would help in boosting the efficiency ratios such as return on asset etc.
- ◆ Saves the management time and effort in collecting the receivables and in sales ledger management.
- ◆ Where credit information is also provided by the factor, it helps the company to avoid bad debts.
- ◆ It ensures better management of receivables as factor firm is specialised agency for the same.

Q60. Distinguish between: Forfaiting & Export Factoring**[Dec. 2015 (5 Marks)], [Dec. 2017 (4 Marks)]**

Ans.: Following are the main points of difference between forfaiting & export factoring:

Points	Forfaiting	Export Factoring
Meaning	Forfaiting is a means of financing used by exporters that enables them to receive cash immediately by selling their medium-term receivables at a discount, and eliminate risk by making the sale without recourse, meaning the exporter has no liability regarding possible default by the importer on paying the receivables.	Export factoring is an arrangement to have export debts collected by a third party entity for a fee.
Types	Forfaiting is always without recourse.	Export factoring can be either with recourse or without recourse.
Services	Forfaiting is pure financing agreement.	Export factoring is finance agreement and may also involve other service to client in form of administration and collection and so on.
Finance	A forfaiter discount the entire value of bill.	In export factoring the factor finances between 75%-85% and retains a factor reserve which is paid after maturity.

UNIT II

INDIAN NON FUND BASED

Q61. Distinguish between: Letter of Credit & Bank Guarantee [June 2019 (5 Marks)]

Ans.: Letter of Credit: 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.

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 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. While letters of credit are used mostly in international trade agreements, bank guarantees are often used in real estate contracts and infrastructure projects.

Both bank guarantees and letters of credit work to reduce financial risk.

**Q62. Y Ltd, an Indian Company opened irrevocable letter of credit for 6 Million Swedish Kroner in favour of Z Ltd. for import of two pulsed rectifiers. Z Ltd. the Swedish Company shipped only one pulsed rectifier but invoiced for two pulsed rectifiers. Bill of Lading also stated that the packing contains two pulsed rectifiers. Based on the documents the Indian Bank remitted the amount to the Banker of Z Ltd. and debited the account of Y Ltd. Y Ltd. wants to hold the Indian Banker responsible for wrong payment against the short shipment. Will Y Ltd. succeed? Give your assessment with reasons.
[June 2019 (5 Marks)]**

Ans.: Indian Company will not succeed, since the foreign letter of credit (LC) is subject to Uniform Customs & Practices for Documentary Credit (UCPDC 600) as per the guidelines of International Chamber of Commerce (ICC). According to which LC is not payment against goods but only payment against documents.

As far as the Bank is concerned, the documents as called for in the LC have been presented by the seller and there is no interline discrepancy among the documents. Because of this he will not be held liable for short shipment of the goods, physically.

**Q63. Explain the conditions under which a bank can grant non-funded facilities to customers. (not availing facility from any bank in India)
[Dec. 2019 (3 Marks)]**

Ans.: 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.

**Q64. Explain briefly the documents handled under Letter of Credit.
[Dec. 2020 (3 Marks)]**

Ans.: Documents handed under letter of credit –

- (i) Bill of exchange
- (ii) Commercial invoice
- (iii) Transport document
- (iv) Bill of lading
- (v) Insurance Policy/Certificate
- (vi) Certificate of origin

Q65. Distinguish between: Letter of Credit and Bank Guarantee Limit.
[June 2021 (5 Marks)]

Ans.: 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 fulfilment 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.

Bank Guarantee Limit: Appraisal of proposals for Bank guarantees is done with same diligence as in the case of fund-based limits. Whenever an application for the issue of bank guarantee is received, Bank examine & satisfy the following aspects:

- The need of the bank guarantee & whether it is related to the applicant's normal trade/business.
- Whether the requirement is one time or on the regular basis.
- The nature of bank guarantee i.e., financial or performance.
- Applicant's financial strength/capacity to meet the liability/obligation under the bank guarantee in case of invocation.
- 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.
- Present outstanding on account of bank guarantees already issued.
- Margin
- Collateral security offered.

Q66. Whether 'Letter of Credit' (LC) and 'Letter of Guarantee' (LG) are one and same. Do you agree? If not, list out the points of differences between them.
[Dec. 2021 (5 Marks)]

Ans.: 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 doesn't go as planned. Therefore, the Letter of Credit (LC) and Letter of Guarantee (LG) are not one and same. There are some differences between the LC and LG which are as under:

Letter of Credit (LC): A letter of credit is a document from a bank that guarantees payment. A Letter of Credit is issued by a bank at the request of its customer (importer/buyer) in favour of the beneficiary (exporter/seller). 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, 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 to the beneficiary.
- ◆ The letter of credit ensures the payment will be made as long as the services are performed.
- ◆ 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.
- ◆ Letters of credit are used mostly in international trade agreements, whereas bank guarantees are often used in real estate contracts and infrastructure projects.

Letter of Guarantee (LG) [Bank Guarantees]: 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 fulfil his commitment to the beneficiary.

- ◆ 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 fulfil 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.

Q67. Distinguish between: Red Clause Letter of Credit and Green Clause Letter of Credit.
[June 2022 (5 Marks)]

Ans.: 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 the red clause letter of credit, as it provides the advance of not only the purchase of raw materials, processing and packaging of goods, but it also takes into account pre-shipment warehousing at the port of origin and insurance expenses.

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.

Q68. Distinguish between: Financial Bank Guarantee & Performance Bank Guarantee.
[June 2022 (5 Marks)]

Ans.: Financial Bank Guarantee: A financial guarantee assures repayment of money. 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 caution deposit/earnest money, the banker issues a guarantee in favour of the government department.

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 Bank Guarantee: A performance guarantee provides an assurance of compensation in the event of inadequate or delayed performance on a contract. Performance Guarantees are issued by banks on behalf of their clients. In performance guarantee, the bank issues on behalf of his client to assure the third party to complete some work on time or as per the terms of the contract between the parties. If the work is not completed as per the terms of the 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 the contract, the bank assumes monetary liability up to the amount specified in the Guarantee

Q69. Explain the difference between Fund based and Non-Fund based credit facilities.
[Dec. 2022 (5 Marks)]

Ans.: Difference between Fund Based & Non-Fund Based credit facilities: In Fund based credit 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-fund based facility, initially there is no cash outflow, later on there may or may not be cash outflow. The examples of non-fund 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.

UNIT III

PRACTICAL PROBLEMS

Problem No. 1]

Blue Line Shoe Company is contemplating a debenture issue on the following terms:

Face value	: ₹ 1,000
Terms to maturity	: 7 years
<i>Coupon rate of interest</i>	
Year 1 – 2	: 10% p.a.
Year 3 – 4	: 12% p.a.
Year 5 – 7	: 15% p.a.

The current market rate of interest on similar debentures is 15% p.a. The company proposes to price the issue so as to yield a (compounded) return of 16% p.a. to the investors. The debentures would be redeemed at a premium of 12% at the end of 7 years. Compute the maturity price of the debentures.
[June 2018 (4 Marks)]

Ans.:

Year	Cash flow	PV Factor 16%	PV
1 to 2 Interest	100	1.6053	160.53
3 to 4 Interest	120	1.193	143.16
5 to 7 Interest	150	1.2403	186.05
7 Redemption	1,120	0.3538	396.26
Value of debenture			886

Problem No. 2]

Aruna Steel Ltd. issued Bonds with the following terms:

Issue price of the Bond: ₹ 1000

Coupon rate: 3%

Maturity: 5 years

Convertible into equity shares @ ₹ 500 per share

Ivan had purchased 20 bonds. At the time of maturity, the market price of the equity shares was ₹ 400.

What are the options available to Ivan on the maturity date and which option he should prefer? [June 2021 (5 Marks)]

Ans.: Option I: To take the cash on redemption of debentures on maturity date and to purchase equity shares at market price at the time of maturity:

Maturity price = 20 bonds × 1,000 = 20,000

No. of equity shares that can be purchased from the market = 20,000 ÷ 400 = 50 equity shares

Option II: To convert the bonds into equity share:

No. of shares after conversion = 1,000/500 × 20 = 40 equity shares

Option I is better as investor is getting more equity shares.

Problem No. 3]

Suppose B. Co. Ltd. issues bonds with following terms:

Issue price of Bond ₹ 2000

Coupon rate 2% with maturity period of 2 years

Convertible into equity shares @ ₹ 100 per share

Y has subscribed for 5 bonds and made an investment of ₹ 10,000. On maturity date, investor will have an option to either claim full redemption amount or convert the Bonds into equity @ ₹ 100 per share. The quoted share price on maturity date is ₹ 150. If he goes for conversion how many shares Y will get? Will it be fair enough if he opts for redemption value? Calculate which option is best suitable to Y? [Dec. 2021 (5 Marks)]

Ans.: Option I: If Mr. Y opts for redemption:

As Mr. Y invested ₹ 10,000 the same amount he will get on redemption.

Option II: If Mr. Y opts for conversion of bonds in equity shares:

$$\text{No. of shares} = \frac{\text{₹ } 10,000}{100} = 100 \text{ shares}$$

Market value of converted shares = 100 shares × ₹ 150 = ₹ 15,000

Conclusion: Option II will be better for Mr. Y.

Note: In both options the investor will get interest and hence it will not be considered to decide whether bonds should be redeemed or converted into shares.

Problem No. 4]

You are required to compute Maximum Permissible Bank Borrowings (MPBB) under three methods of Tandon Committee Norms pertaining to M Ltd. from following data and how you will present it to the Board:

Existing Current Assets	Amount in ₹	Amount in ₹
Raw Materials	8,00,000	
Work in progress	80,000	
Finished Goods	3,60,000	
Receivables	2,00,000	
Other current assets	40,000	14,80,000
Existing Current Liabilities		
Creditors for purchase	4,00,000	
Other current liabilities	2,00,000	
Bank borrowings	8,00,000	14,00,000
Core current assets are ₹ 3,80,000		[June 2019 (5 Marks)]

Ans.: Maximum permissible bank borrowing as per 1st, 2nd & 3rd method of Tandon Committee Norms:

Method 1: = 75% of (Current Assets – Current Liabilities)
 = 75% × (14,80,000 – 6,00,000)
 = 6,60,000

Method 2: = 75% of Current Assets – Current Liabilities
 = (75% × 14,80,000) – 6,00,000
 = 5,10,000

Method 2: = 75% of (Current Assets – Core Current Assets) – Current Liabilities
 = 75% × (14,80,000 – 3,80,000) – 6,00,000
 = 2,25,000

Review:

Particulars	Method 1	Method 2	Method 3
Maximum Bank Borrowings	6,60,000	5,10,000	2,25,000
Actual Bank Borrowings	8,00,000	8,00,000	8,00,000
Excess Bank Borrowings	1,40,000	2,90,000	5,75,000

Under all the 3 methods, the excess bank borrowings can be converted in to long term debt.

Problem No. 5]

On the basis of following information, calculate the limit for Letter of Credit (L.C) for the financial year 2019-2020 of M/s Madhukar Enterprises:

- | | |
|---|----------------|
| (i) Estimated Raw Material purchase for the FY 2019-2020 | ₹ 172.64 Crore |
| (ii) Estimated purchase under Letter of Credit for FY 2019-2020 (L.C) | ₹ 69.41 Crore |
| (iii) Lead time i.e. time from order placement to shipment | 10 Days |
| (iv) Transit Time | 20 Days |
| (v) Credit (Usance) Period available | 3 Months |

[Dec. 2019 (5 Marks)]

Ans.:

Sr. No.	Particulars	
A	Annual Consumption of Raw Material (RM) to be purchased under Letter of Credit (L.C)	₹ 69.41 Crore
B	Average monthly purchase of Raw Material [69.41/12]	₹ 5.78 Crore
C	Lead time i.e. time from order placement to shipment	10 days
D	Transit Time	20 days
E	Credit (Usance) Period available	3 months
F	Total Period [C + D + E]	4 months
G	Requirement of LC [B × F] [5.78 × 4] i.e. LC limit recommended	23.14 Crore

Problem No. 6]

Following data relates to M/s ABC Pvt. Ltd.:

	Amount (₹ in lakh)		Amount (₹ in lakh)
Creditor for purchases	200	Raw Material	380
Other Current Liabilities	100	Work in process	40

Finished Goods	180
Receivables	110
Other current Assets	30

Calculate the Maximum Permissible Bank Finance (MPBF) as per the Tandon Committee Recommendations using the norm of a current ratio of 1.33. [Dec. 2019 (5 Marks)]

Ans.: Total Current Assets = 380 + 40 + 180 + 110 + 30 = 740

Total Current Liabilities = 200 + 100 = 300

To maintain the minimum current ratio of 1.33, Second method of lending as suggested by Tandon Committee would be used wherein maximum financing by bank can be up to 75% of current assets.

Maximum permissible bank borrowing as per 2nd method of Tandon Committee Norms:

$$\begin{aligned} \text{Method 2:} &= 75\% \text{ of Current Assets} - \text{Current Liabilities} \\ &= (75\% \times 740) - 300 \\ &= 255 \end{aligned}$$

With this additional borrowing the Current Liabilities shall become ₹ 555 lakh (300 + 255) and the new Current Ratio shall become 1.33 (740/555).

Problem No. 7]

Balance Sheet of X company as at 31st March, 2018 and its statement of changes in financial position for the year ending on 31st March, 2019 are presented below:

Balance Sheet as at 31st March, 2018

Liabilities	₹	Assets	₹
Common Stock	6,000	Land	9,800
Reserve	6,560	Equipment	12,200
Preferential Stock	2,500	Accumulated Depreciation	(2,000)
Long term Bonds	7,000	Inventory	2,370
Amount Payable	2,140	Amount Receivable	1,300
		Cash	530
	24,200		24,200

Statement of changes in Financial Presentation for the year ended on 31st March, 2019.

Sources	₹	Uses	₹
Net Income	1,200	Paid Cash Dividend	360

Sources	₹	Uses	₹
Depreciation	600	Repaid Preferential Stock	2,500
Loss on sale of land	(80)	Retired Bond Payable	1,400
Issued Stock	4,000	Purchased Equipment	3,000
Sold land	1,880	Increase in Working Capital	340
	7,600		7,600

Calculate the working capital as on 31st March, 2019.
[Dec. 2020 (5 Marks)]

Ans.: Total Current Assets = 2,370 + 1,300 + 530 = 4,200

Total Current Liabilities = 2,140

Working capital as on 31st March, 2018:

Current Assets – Current Liabilities = 4,200 – 2,140 = 2,060

Working capital as on 31st March, 2019:

Working Capital as on 31st March, 2018 + Increase in Working Capital

2,060 + 340 = 2,400

Problem No. 8]

Following data pertains to XYZ Ltd.:

	₹
Projected Sales	20,00,000
Creditors	3,00,000
Bank Borrowings	3,30,000
Current Assets	7,40,000

Assess the Working Capital requirement of XYZ Ltd. using the method given by Nayak Committee. [June 2021 (3 Marks)]

Ans.: Net Working Capital = Current Assets - Current Liabilities i.e. Bank Borrowings & Creditors

Net Working Capital = 7,40,000 – 6,30,000 = 1,10,000

Minimum Working Capital required = 20,00,000 × 25% = 5,00,000.

Margin/Minimum Borrower's contribution (5% of projected sales) = 20,00,000 × 5% = 1,00,000

Margin or Net Working Capital whichever is higher to be deducted from 25% of Sales.

5,00,000 – 1,10,000 = 3,90,000

So, maximum permissible finance as per Nayak Committee's recommendation in the case under consideration shall be 3,90,000.

Problem No. 9]

On the basis of following information, calculate the operating cycle of Raksha Goods Limited:

Particulars	As at April 1, 2019	As at March 31, 2020
Inventory (₹)	4,00,000	3,80,000
Accounts receivable (₹)	18,00,000	22,50,000

The sales and cost of goods sold for the year ended March 31, 2020 are ₹2,65,00,000 and ₹1,55,00,000 respectively. [Dec. 2021 (5 Marks)]

Ans.: Inventory Conversion Period:

$$\frac{\text{Average Inventory}}{\text{Cost of goods sold}} \times 365 = \frac{3,90,000}{1,55,00,000} \times 365 = 9.18 \text{ say 9 days}$$

Accounts receivable Period:

$$\frac{\text{Average Accounts receivable}}{\text{Sales}} \times 365 = \frac{20,25,000}{2,65,00,000} \times 365 = 27.89 \text{ say 28 days}$$

Operating Cycle = 9 days + 28 days = 37 days

Problem No. 10]

Alphameter Technologies Limited has outstanding guarantees of ₹ 92 Crore as on March 31, 2019. During the year, Company had given new guarantees of ₹ 8 Crore to the Telecom Department for new telephone lines. The income tax assessment proceedings for the Assessment Year (AY) 2014-2015 have concluded and the Department has released bank guarantees of ₹ 21 Crore which the company had provided earlier. The Department has demanded an additional guarantee of ₹ 2 Crore towards the interest for the AY 2015-2016, for which the Company had provided guarantee of ₹ 14 Crore in previous years. Compute the bank guarantee limits as on March 31, 2020. [Dec. 2021 (5 Marks)]

Ans.: Computation of Bank guarantee limits as on March 31, 2020

	Particulars	Amount
A	Outstanding Bank Guarantee as on 31st March 2019	₹ 92 Crore
B	Bank guarantees including additional guarantee issued during the period (₹ 8 Crore + ₹ 2 Crore)	₹ 10 Crore
C	Bank guarantees released during the year	₹ 21 Crore
D	Bank Guarantee Limits as on 31st March 2020 [A + B – C]	₹ 81 Crore

Notes:

- ◆ ₹ 92 Crore have been considered as the opening bank guarantees outstanding as on April 1, 2019.

- ◆ Additions during the year include ₹ 8 Crore and ₹ 2 Crore bank Guarantee provided towards the interest with the income-tax department.
- ◆ ₹ 14 Crore have not been considered separately, as it was provided during the earlier years and is included in the opening guarantees as on April 01, 2019

Problem No. 11]

Somaskanda Printers Limited approached Support Bank, for working capital facilities. The projected annual turnover of the Company is ₹ 1,85,00,000. Explain the assessment of working capital requirement as per Nayak Committee and compute the working capital finance which can be extended by the Bank. [Dec. 2021 (5 Marks)]

Ans.: As per Nayak Committee, bank credit for working capital purposes for borrowers requiring fund-based limits up to ₹ 5 Crore for Small Scale Industries borrowers and ₹ 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.

Computation of Working Capital:

Projected Sales turnover = ₹ 1,85,00,000

Working Capital Limit = ₹ 1,85,00,000 × 25% = ₹ 46,25,000

Permissible Bank Finance = ₹ 46,25,000 - ₹ 9,25,000 = ₹ 37,00,000

Minimum money from borrower = ₹ 1,85,00,000 × 5% = ₹ 9,25,000

Problem No. 12]

Gulab 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 following information, calculate limit for LC for the Financial Year 2021-2022:

- (i) Estimated Raw Material purchase for FY 2021-2022 ₹ 240 Crore
- (ii) Estimated purchase under Letter of Credit (LC) for FY 2021-2022 (90%) ₹ 216 Crore
- (iii) Of which import of Raw Material under Letter of Credit (30%) ₹ 64.80 Crore

(iv) Lead Time	- Domestic	1 Month
	- Import	2 Month
(v) Transit Time	- Domestic	1 Month
	- Import	2 Month
(vi) Credit (Usance) Period available	- Domestic	1 Month
	- Import	4 Month

[June 2022 (5 Marks)]

Ans.: Calculation of Inland & Foreign Letter of Credit Limit of Gulab Ltd. for the Financial Year 2021-2022:

Estimated Raw Material purchase for FY 2021-2022	₹ 240 Crore
Estimated purchase under Letter of Credit (LC) for FY 2021-2022 (90%)	₹ 216 Crore

	Particulars	Inland LC	Foreign LC
A	Annual Raw Material Procurement through ILC/FLC	₹ 151.20 Crore	₹ 64.80 Crore
B	Monthly Consumption	₹ 12.60 Crore	₹ 5.40 Crore
C	Lead Time (Time from order placement to shipment)	1 Month	2 Month
D	Transit Time	1 Month	2 Month
E	Credit (Usance) Period available	1 Month	4 Month
F	Total Period	3 Month	8 Month
G	LC limit Required for FY 2021-2022 [B × F]	₹ 37.80 Crore	₹ 43.20 Crore

Problem No. 13]

Moon Ltd. makes an application for Bank Guarantee Limit for the Financial Year 2021-2022 with following data to PQR Bank Ltd.:

- (i) Outstanding Bank Guarantee as per last Audited Balance Sheet : ₹ 95 lakh
- (ii) Bank Guarantee required for the Financial Year 2021-2022 : ₹ 115 lakh
- (iii) Estimated maturity or Cancellation during the period : ₹ 65 lakh

Compute the Bank Guarantee limit of Moon Ltd. for the Financial Year 2021-2022. [June 2022 (3 Marks)]

Ans.: Computation of Bank Guarantee limit of Moon Ltd for Financial Year 2021-22

Particulars	₹
Outstanding Bank Guarantee as per last Audited Balance Sheet	95 lakh
(+) Bank Guarantee required during the period	115 lakh
(-) Estimated maturity or cancellation during the period	65 lakh
Requirement of Bank Guarantee	145 lakh

Problem No. 14]

Following is the extract from the Balance Sheet of M/s YBL. Ltd. As on 31st March, 2022:

Current Liabilities	Amount (₹ in lakh)	Current Assets	Amount (₹ in lakh)
(1) Bank Borrowings	820	(1) Inventories	650
(2) Trade Payables	200	(2) Financial Assets	
(3) Other current Liabilities	180	(i) Investments	250
		(ii) Trade Receivables	75
		(iii) Cash & Cash Equivalents	125
		(iv) Bank Balance other than (iii) above	150
		(v) Other Financial Assets	350

YBL Limited had bank borrowings of ₹ 820 Lakh which includes bills discounted with the bank. It wishes to avail loan for its working capital and approaches your bank for financing. Which maintaining the minimum current ratio of 1.33. Calculate the Maximum Permissible Bank Finance (MPBF) as per methodology suggested by Tandon Committee. Should the bank sanction the loan request or not?

[Dec. 2022 (5 Marks)]

Ans.: Total Current Assets = 650 + 250 + 75 + 125 + 150 + 350 = 1,600

Total Current Liabilities = 200 + 180 = 380

To maintain the minimum current ratio of 1.33, Second method of lending as suggested by Tandon Committee would be used wherein maximum financing by bank can be up to 75% of current assets.

Maximum permissible bank borrowing as per 2nd method of Tandon Committee Norms:

Method 2:	=	75% of Current Assets – Current Liabilities
	=	(75% × 1,600) – 380
	=	820

Since YBL Ltd. has already availed Maximum Permissible Bank Finance and hence have reached the minimum current ratio of 1.33:1 via borrowings of ₹ 820 Lakh, the Bank Manager should not sanction the loan request of YBL Ltd.

Problem No. 15]

The projected Financial Information of M/s. Bansiwala is as given below:

Projected Annual Sales	₹ 6,50,000
Percentage of net profit on sales	25%
Average credit Period allowed to debtors	10 weeks
Average credit Period allowed by creditors	4 weeks
Average stock holding in terms of sales requirement	8 weeks

On the basis of above information, calculate the following:

(i) Current Ratio and

(ii) Working Capital

[Dec. 2022 (5 Marks)]

Ans.: Calculation of cost of sales:

Particulars	₹
Projected annual sales	6,50,000
(-) Net profit (25% on cost means 16.6667% on sales i.e. 1/6th)	(1,62,500)
Cost of sales	4,87,500

Statement showing working capital estimation:

Particulars	Norms	Calculations	₹
Current Assets:			
Stock	8 weeks	$\left(4,87,500 \times \frac{8}{52}\right)$	75,000
Debtors (on sales)	10 weeks	$\left(6,50,000 \times \frac{10}{52}\right)$	1,25,000
		(A)	2,00,000
Current Liabilities:			
Creditors	4 weeks	$\left(4,87,500 \times \frac{4}{52}\right)$	37,500
		(B)	37,500
Working Capital (A) – (B)			1,62,500

Problem No. 16]

ABC Limited is a trading company. Its annual turnover is ₹ 4,000 lakh out of which ₹ 2,800 lakh is on credit. Its average collection period is 90 days and presently its receivable collection cost is ₹ 35 lakh p.a.

The company needs immediate funds to finance its growth projects and it has an option to take short-term loans at interest rate of 18% p.a. Recently, one of the factoring company visited the Chief Executive of ABC Limited and offered him to provide the factoring services on recourse basis. As per terms of factoring arrangement, factoring company will provide for an advance payment of 80% (maintaining factor reserve of 20% to provide for disputes and deductions relating to the bills assigned) of the value of factored receivable and for guaranteed payment after 90 days from the date of purchasing the receivables. The advance will carry a rate of interest of 12% p.a. In addition to interest, factoring company will charge factoring commission @ 2.5% of the value of factored receivable. Both the interest and commission shall be collected by factoring company on upfront basis.

You are the Company secretary of ABC Limited and you have been requested to prepare a report containing the following aspects.

- What is the net annual cost of funding through factoring of receivables assuming 360 days in a year?
- Whether it is appropriate to choose the factoring of receivable in comparison to short term bank loan?
- Whether your advice would be changed if the clause of 'on recourse basis' is negotiated 'on non-recourse basis' keeping the other terms of agreement with factoring company as same. The experience indicates that bad debt losses on sales are 2% of sales.

[June 2023 (5 + 5 + 5 = 15 Marks)]

Ans.: Calculation of Average Receivables:

$$\text{Credit Sales} \times \frac{\text{Credit Period}}{360}$$

$$2,800 \times \frac{90}{360} = 700 \text{ lakh}$$

Computation of net amount paid to the firm:

Particulars		₹ in lakh
Average Receivables		700
(-) Reserve	(700 × 20%)	(140)
(-) Factor Commission	(700 × 2.5%)	(17.5)
		542.5

Particulars		₹ in lakh
(-) Interest on advance	$\left[542.5 \times 12\% \times \frac{90}{360} \right]$	(16.275)
Net amount paid to the firm		526.225

Computation of net cost of factoring (annual basis):

Particulars		₹ in lakh
Costs:		
Factoring commission	$\left[17.5 \times \frac{360}{90} \right]$	70
Interest charges	$\left[16.275 \times \frac{360}{90} \right]$	65.1
	(A)	135.1
Savings:		
Receivable collection cost		35
Net cost to firm (A) – (B)		100.1

$$\text{Effective cost of factoring} = \frac{154}{521.5} \times 100 = 29.53\%$$

Computation of net cost of bank proposal (annual basis):

Particulars		₹ in lakh
Interest charges	(700 × 80% × 18%)	100.8
Receivable collection cost		35
Net cost of bank proposal to the firm		135.8

Analysis: It is better to go with factoring proposal.

If factoring is non-recourse basis:

Net cost of factoring (annual basis) = 135.1

Net cost of bank proposal (annual basis) = 100.8

In this case it is better to go with bank proposal.

Problem No. 17]

A bond with a face value of 100 is paying an annual coupon of 12 per cent and trading in the markets for 109.50 per bond. What is the effective percentage yield of the bond? [June 2023 (5 Marks)]

Ans.:

$$\text{Effective Yield} = \frac{\text{Interest}}{\text{Market Price}} \times 100$$

$$= \frac{12}{109.50} \times 100$$

$$= 10.96\%$$

Problem No. 18]

From the latest CMA data of Vancouver Ltd., the projected figures are as under:

— Sales	:	₹ 10 Crore
— Total current assets	:	₹ 7 Crore
— Current liabilities	:	₹ 3 Crore

You are required to calculate the working capital requirement under turnover method and maximum permissible banking finance method (Method I). [Dec. 2023 (5 Marks)]

Ans.: Turnover Method (Nayak Committee): Under this method, bank credit for working capital purposes for 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.

Small Scale Industries Borrowers:

₹ 10 Crore × 25% = ₹ 2.5 Crore

1/5th to be provided by the borrower = ₹ 2.5 Crore × 1/5 = ₹ 0.5 Crore

4/5th to be extended by way of working capital finance = ₹ 2.5 Crore × 4/5 = ₹ 2 Crore

Other Borrowers:

₹ 10 Crore × 25% = ₹ 2.5 Crore (limited to ₹ 2 Crore)

1/5th to be provided by the borrower = ₹ 2 Crore × 1/5 = ₹ 0.4 Crore

4/5th to be extended by way of working capital finance = ₹ 2 Crore × 4/5 = ₹ 1.6 Crore

Maximum Permissible Banking Finance Method (Tandon Committee – 1st Method):

[75% of (Current Assets – Current Liabilities)]

75% of (₹ 7 Crore – ₹ 3 Crore) = ₹ 3 Crore

Problem No. 19]

XYZ Factoring Ltd. has agreed to finance receivable of IFK Ltd. on a term of advances 80% of the receivables with 10% p.a. interest and 2% commission as factoring. Based on the below information, find the net amount to be remitted by XYZ Factoring Ltd.

- Annual credit sales = ₹ 1 Crore
- Average collection period = 60 days
- Saving in administration cost = ₹ 1,00,000
- Bad debts = Nil.

Assume 365 days in a year for calculation purpose.

[Dec. 2023 (5 Marks)]

Ans.: Computation of Average Receivables:

$$\text{Credit Sales} \times \frac{\text{Credit Period}}{360} = 1,00,00,000 \times \frac{60}{365} = 16,43,836$$

Computation of net amount paid to the firm:

Particulars		₹
Average Receivables		16,43,836
(-) Reserve	(16,43,836 × 20%)	(3,28,767)
(-) Factor Commission	(16,43,836 × 2%)	(32,876)
		12,82,193
(-) Interest on advance	$\left[12,82,193 \times 10\% \times \frac{60}{365} \right]$	(21,077)
Net amount paid to the firm		12,61,116

Problem No. 20]

Calculate the amount of fund based and non-fund based credit facilities availed by Yamuna Ltd. from Bank from the following details:

Sr. No.	Credit Facilities provided by Bank	₹ in Lakh
1.	Standby Letter of Credit	2.50
2.	Clean Overdraft	9.80
3.	Bank Guarantee	12.50
4.	Car Loan	60.95
5.	Letter of Credit	22.50
6.	Key Cash Credit	35.50
7.	Post Shipment Packing Credit	80.40
8.	Suppliers Credit	30.50
	Total Credit Facilities	254.65

[Dec. 2023 (3 Marks)]

Ans.: Computation of fund based and non-fund based credit facilities availed by Yamuna Ltd. from Bank:

(a) Fund Based Credit Facilities (Immediate outflow of funds from the bank):

Particulars	₹ in lakh
Clean Overdraft	9.80
Key Cash Credit	35.50
Car Loan	60.95
Post Shipment Packing Credit (Export Credit)	80.40
	186.65

(b) Non-Fund Based Credit Facilities (No immediate outflow of funds from the bank):

Particulars	₹ in lakh
Standby Letter of Credit	2.50
Bank Guarantee	12.50
Letter of Credit	22.50
Suppliers Credit	30.50
	37.50

Problem No. 21]

Balance sheet of GKJ Ltd. for the year ended 31st March, 2024 is given below:

Liabilities	Amount (₹ lakh)	Assets	Amount (₹ lakh)
Equity Shares ₹ 10 each	200	Fixed Assets	500
Retained Earnings	200	Raw Materials	150
11% Debentures	300	W.L.P.	100
Public Deposits (Short-term)	100	Finished goods	50
Trade Creditors	80	Debtors	125
Bills Payable	100	Cash/Bank	55
	980		980

Calculate the amount of maximum permissible bank finance under three methods as per Tandon Committee lending norms. The total core current assets are assumed to be ₹30 lakh. [June 2024 (5 Marks)]

Ans.:

Current Assets = 480 Lakh

Current Liabilities = 180 Lakh

Public deposits are excluded from current liabilities as it does not belong to operating liabilities and assuming that having maturity period of more than one year.

Maximum permissible bank borrowing as per various method of lending under the Tandon Committee Norms:

$$\begin{aligned} \text{Method 1:} &= 75\% \text{ of (Current Assets - Current Liabilities)} \\ &= 75\% \times (480 - 180) \\ &= 225 \text{ Lakh} \end{aligned}$$

$$\begin{aligned} \text{Method 2:} &= 75\% \text{ of Current Assets - Current Liabilities} \\ &= (75\% \times 480) - 180] \\ &= 180 \text{ Lakh} \end{aligned}$$

$$\begin{aligned} \text{Method 3:} &= [75\% \text{ of (Current Assets - Core Current Assets)] - Current Liabilities} \\ &= [75\% \times (480 - 30)] - 180 \\ &= 157.5 \text{ Lakh} \end{aligned}$$

Current ratio under various methods:

$$\text{Method 1: Current Ratio} = \frac{960}{360 + 450} = \frac{960}{810} = 1.19$$

$$\text{Method 2: Current Ratio} = \frac{960}{360 + 360} = \frac{960}{720} = 1.33$$

$$\text{Method 3: Current Ratio} = \frac{960}{360 + 315} = \frac{960}{675} = 1.42$$

Problem No. 22]

From the following information of Ganpati Ltd., you are required to calculate:

(i) Net operating cycle period.

(ii) Number of operating cycles in a year.

Particulars	(₹)
Raw material inventory consumed during the year	6,00,000
Average stock of raw material	50,000
Average cost of production	5,00,000
Average work-in-progress inventory	30,000
Cost of goods sold during the year	8,00,000
Average finished goods stock held	40,000
Average collection period from debtors	45 days
Average credit period availed	30 days
No. of days in a year	360 days

[June 2024 (5 Marks)]

Ans.:

Raw Material Conversion Period:

$$\frac{\text{Average Raw Material Stock}}{\text{Raw Material Consumed during the year}} \times 360 \text{ days} = \frac{50,000}{6,00,000} \times 360 = 30 \text{ days}$$

WIP Conversion Period:

$$\frac{\text{Average Stock of WIP}}{\text{Annual Cost of Production}} \times 360 \text{ days} = \frac{30,000}{5,00,000} \times 360 = 21.6 \text{ days}$$

Finished Goods Conversion Period:

$$\frac{\text{Average Stock of Finished Goods}}{\text{Cost of Goods Sold during the year}} \times 360 \text{ days} = \frac{40,000}{8,00,000} \times 360 = 18 \text{ days}$$

Average Collection Period (Given) 45 days

Creditors Payment Period (Given) 30 days

Operating Cycle = (30 + 21.6 + 18 + 45 - 30) = 84.6 days say 85 days

Problem No. 23]

Galaxy 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 2024-2025:

(i)	Estimated Raw Material purchase for FY 2024-25	₹ 480 Crore
(ii)	Estimated purchase under Letter of Credit (LC) for FY 2024-25 (90%)	₹ 432 Crore
(iii)	Of which import of Raw Material under Letter of Credit (30%)	₹ 129.60 Crore
(iv)	Lead Time:	
	Domestic	1.5 months
	Import	2.5 months
(v)	Transit Time:	
	Domestic	1.5 months
	Import	2.5 months
(vi)	Credit (Usance) Period available:	
	Domestic	2 months
	Import	5 months

[June 2024 (5 Marks)]

Ans.:

Calculation of Inland & Foreign Letter of Credit Limit of Galaxy Ltd. for the Financial Year 2024-2025:

Estimated Raw Material purchase for FY 2024-2025 ₹ 480 Crore

Estimated purchase under Letter of Credit (LC) for FY 2024-2025 (90%) ₹ 432 Crore

	Particulars	Inland LC	Foreign LC
A	Annual Raw Material Procurement through ILC/FLC	₹ 302.40 Crore	₹ 129.60 Crore
B	Monthly Consumption	₹ 25.20 Crore	₹ 10.80 Crore
C	Lead Time (Time from order placement to shipment)	1.5 Month	2.5 Month
D	Transit Time	1.5 Month	2.5 Month
E	Credit (Usance) Period available	2 Month	5 Month
F	Total Period	5 Month	10 Month
G	LC limit Required for FY 2024-2025 [B × F]	₹ 126 Crore	₹ 108 Crore

TAXMANN

15

CHAPTER

FOREIGN FUNDING – INSTITUTIONS

INTERNATIONAL FINANCE CORPORATION (IFC)

Q1. What do you mean by the International Finance Corporation (IFC)? How IFC helps the countries to develop their private sectors?

Ans.: International Finance Corporation (IFC): The 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.
2. Promote shared prosperity in every country.

The 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. **Mission of IFC:** The mission of IFC is advance economic development by encouraging the growth of private enterprise in developing countries.

How IFC helps countries to develop their private sectors: 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.

Q2. Briefly discuss the funding instruments used by the International Finance Corporation (IFC)?

Ans.: Under funding program, IFC issues bonds in a variety of markets, formats, and currencies – including global benchmarks, 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:

- (a) **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.
- (b) **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.
- (c) **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.
- (d) **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.
- (e) **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.

(f) **Social Bonds:** IFC'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).

Q3. 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." Explain the functions of IFC. [Dec. 2021 (3 Marks)]

Ans.: International Finance Corporation (IFC): The 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.

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. However, the bulk of the funding, as well as leadership and management responsibility, lies with private sector owners and investors.

ASIAN DEVELOPMENT BANK (ADB)

Q4. Discuss briefly Loans and other Debt Instruments offered by the Asian Development Bank (ADB)?

Ans.: 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.

Q5. Asian Development Bank (ADB) may invest directly in an enterprise. Explain.

Ans.: 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.

Q6. Briefly discuss following aspects of Financing and Investment by Asian Development Banks:

- (i) Guarantees
- (ii) Loan Syndication
- (iii) Blended Finance

Ans.: **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.
- (v) Promoting high standards.

Q7. "Achieving a prosperous, inclusive, resilient and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty" – Justify the mission of Asia Development Bank in your own words.

[Dec. 2019 (3 Marks)]

Ans.: 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 is committed to achieving a prosperous, inclusive, resilient, 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.

Asian Development Bank in partnership with member governments, independent specialists and other financial institutions is focused on delivering projects in developing member countries that create economic and development impact.

As a multilateral development finance institution, Asian Development Bank provides:

- Loans
- Technical Assistance
- Grants

Asian Development Bank maximizes the development impact of its assistance by:

- ◆ Facilitating policy dialogues
- ◆ Providing advisory services
- ◆ Mobilizing financial resources through co-financing operations that top official, commercial, and export credit sources.

INTERNATIONAL MONETARY FUND (IMF)

Q8. Write a short note on: IMF Resources

Ans.: 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 16th 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.

Q9. Distinguish between: Asian Development Bank & International Monetary Fund [June 2019 (5 Marks)]

Ans.: **Asian Development Bank:** Asian Development Bank (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 67 members 48 of which are from the Asia and the Pacific region.

The ADB is committed to achieving a prosperous, inclusive, resilient, 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.

International Monetary Fund (IMF): 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.

Q10. International Monetary Fund (IMF) plays a vital role in the global economy. Explain its mission and activities. [June 2021 (5 Marks)]

Ans.: The International Monetary Fund (IMF) is an organization of 189 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. Created in 1945, the IMF is governed by and accountable to the 189 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.

The IMF assists countries hit by crises by providing them financial support to create breathing room as they implement adjustment policies to restore economic stability and growth. The IMF's fundamental mission is to ensure the stability of the international monetary system which 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.
- (iii) Giving practical help to members.

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.

WORLD BANK

Q11. What are the five constituent institutions under World Bank?

Ans.: 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. **International Bank for Reconstruction and Development (IBRD)** – It provides loans at market rates of interest to middle-income developing countries and creditworthy lower-income countries.
2. **International Development Association (IDA)** - It 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. **International Finance Corporation (IFC)** – It is operating in partnership with private investors, provides loans and loan guarantees and equity financing to business undertakings in developing countries.
4. **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. **International Centre for Settlement of Investment Disputes (ICSID)** – It is responsible for the settlement by conciliation or arbitration of investment disputes between foreign investors and their host developing countries.

Q12. Write a short note on: Priorities of World Bank Group

Ans.: Priorities of World Bank Group: Priorities of World Bank Group *inter alia* covers the following:

- A. **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.
- B. **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.
- C. **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 the 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.

EXTERNAL COMMERCIAL BORROWING (ECB)

Q1. Write a short note on: External Commercial Borrowings

[Dec. 2010 (4 Marks)]

Ans.: External Commercial Borrowings: External Commercial Borrowings (ECBs) are **commercial loans** raised by **eligible resident entities** from **recognized non-resident entities**.

ECB 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.

Advantages of external commercial borrowings: Following are the advantages of external commercial borrowings:

- ◆ ECBs provide opportunity to borrow large volume of funds.
- ◆ Funds are available for relatively long term for 3 to 10 years.
- ◆ Interest rate on ECB is lower compared to domestic funds which reduces the cost of the funds.
- ◆ ECBs in form of foreign currencies enable the corporate to make fast imports.
- ◆ Corporate can raise ECBs from internationally recognized sources such as banks, export credit agencies, international capital markets etc.

Types of external commercial borrowings: ECB Framework enables permitted resident entities to borrow from recognized non-resident entities in the following forms:

1. Loans including bank loans
2. Floating rate notes/bonds, fixed rate notes/bonds, debentures (other than fully and compulsorily convertible instruments)
3. Trade credits beyond 3 years
4. Financial Lease

5. Foreign Currency Convertible Bonds (FCCBs)
6. Foreign Currency Exchangeable Bonds (FCEBs)
7. Plain vanilla Rupee Denominated Bonds issued overseas

Q2. Discuss the framework for raising External Commercial Borrowings (ECBs) by Startups under the automatic route.

Ans.: 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:

- (1) **Eligibility:** An entity recognized as Startup by the Central Government as on date of raising ECB.
- (2) **Maturity:** Minimum average maturity period will be 3 years.
- (3) **Recognized 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.
- (4) **Forms:** The borrowing can be in form of loans or non-convertible, optionally convertible or partially convertible preference shares.
- (5) **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 mobilize INR through swaps/ outright sale undertaken through an AD Category-I bank in India.
- (6) **Amount:** The borrowing per Startup will be limited to US\$ 3 Million or equivalent per financial year either in INR or any convertible foreign currency or a combination of both.
- (7) **All-in-cost:** All-in-cost shall be mutually agreed between the borrower and the lender.
- (8) **End use:** For any expenditure in connection with the business of the borrower.
- (9) **Conversion into equity:** Conversion into equity is freely permitted subject to Regulations applicable for foreign investment in Startups.
- (10) **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.

- (11) **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.
- (12) **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.
- (13) **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.

Q3. Discuss in brief Standard Operating Procedure 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.

Ans.: Standard Operating Procedure (SOP) for Untraceable Entities: 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 returns 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/auditors/directors/promoters 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 authorized by the AD bank for the purpose.
- B. Entities have not submitted Statutory Auditor's Certificate for last two years or more.

Action: 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'.
- (d) No inward remittance or debt servicing will be permitted under auto route.

Q4. XYZ Ltd. has availed External Commercial Borrowings of US\$ 100 million. For the project in India it needs US\$ 80 Million. The Board of Directors of the company desires to use remaining US\$ 20 Million for investment in Stock Market in India. Decide.

Ans.: RBI has prescribed negative list for use of proceeds of ECB. Proceeds received out of ECB cannot be utilized for investment in Capital Market/Stock Market. Hence, XYZ Ltd. cannot invest US\$ 20 Million in Stock Market.

Q5. What is parking of External Commercial Borrowings (ECB) proceeds? [June 2011 (5 Marks)]

Or

The External Commercial Borrowings (ECB) proceeds can be parked abroad. Explain. [Dec. 2021 (3 Marks)]

Or

Explain in brief manner of parking of ECB proceeds abroad & domestically. [June 2022 (3 Marks)]

Ans.: 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 utilization, these funds can be invested in the following liquid assets -

- ◆ 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.
- ◆ Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above.
- ◆ Deposits with overseas 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. These term deposits should be kept in unencumbered position.

Q6. Describe the end use of external commercial borrowings under the approval route. [June 2014 (5 Marks)]

Ans.: The negative list, for which the ECB proceeds cannot be utilized, would include the following:

- (i) Real estate activities
- (ii) Investment in capital market
- (iii) Equity investment
- (iv) Working capital purposes
- (v) General corporate purposes
- (vi) Repayment of Rupee loans
- (vii) On-lending to entities for the above activities

Exception (ECB allowed to be used): Restrictions mentioned in clauses (d), (e), (f) & (g) are not applicable in following cases:

Category	Minimum Average Maturity Period
(a) ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans	5 years
(b) ECB raised for: <ul style="list-style-type: none"> - Working capital or general corporate purposes - On-lending by NBFCs for working capital purposes or general corporate purposes 	10 years
(c) ECB raised for: <ul style="list-style-type: none"> - Repayment of Rupee loans availed domestically for capital expenditure - On-lending by NBFCs for the same purpose 	7 years
(d) ECB raised for <ul style="list-style-type: none"> - Repayment of Rupee loans availed domestically for purposes other than capital expenditure - On-lending by NBFCs for the same purpose 	10 years

Q7. Whether conversion of 'External Commercial Borrowing' into equity is permissible? [June 2019 (4 Marks)]

Or

State the conditions pertaining to conversion of External Commercial Borrowings (ECBs) into Equity. [Dec. 2020 (5 Marks)]

Ans.: **Conversion of ECB into equity:** Conversion of ECB, including those which are matured but unpaid, into equity is permitted subject to the following conditions:

- (a) The activity of the borrowing company is covered under the automatic route for Foreign Direct Investment or Government approval is received, wherever applicable, for foreign equity participation as per extant Foreign Direct Investment policy.
- (b) 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.
- (c) Applicable pricing guidelines for shares are complied with.
- (d) In case of partial or full conversion of ECB into equity, the reporting to the RBI will be as under:
- For partial conversion, the converted portion is to be reported in Form FC-GPR prescribed for reporting of FDI flows, while monthly reporting to DSIM in Form ECB-2 Return will be with suitable remarks, viz. "ECB partially converted to equity".
 - For full conversion, the entire portion is to be reported in Form FC-GPR, while reporting to DSIM 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.
 - For conversion of ECB into equity in phases, reporting through Form FC-GPR and Form ECB-2 Return will also be in phases.
- (e) 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 RBI, including guidelines on restructuring are complied with.
- (f) 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.

Exchange rate for conversion of ECB dues into equity: 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.

Q8. Explain the procedure for raising external commercial borrowings under approval route of RBI by the borrower. [Dec. 2020 (4 Marks)]

Or

What is the procedure of raising external commercial borrowings? Explain. [Dec. 2021 (4 Marks)]

Ans.: Procedure for raising external commercial borrowings under Automatic Route and Approval Route is as follows:

For Automatic Route cases:

- ◆ All ECB can be raised under the automatic route if they conform to the parameters prescribed under this framework.
- ◆ 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.

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, macro-economic situation and merits of the specific proposals.
- ◆ ECB proposals received above certain threshold limit would be placed before the Empowered Committee set up by the RBI.
- ◆ The Empowered Committee will have external as well as internal members and the RBI will take a final decision in the cases taking into account recommendation of the Empowered Committee.

Q9. Outline the reporting requirements under External Commercial Borrowing (ECB) reporting framework. [Dec. 2021 (5 Marks)]

Ans.: Borrowings under ECB Framework are subject to following reporting requirements apart from any other specific reporting required under the framework:

- (a) **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.
- (b) **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.
- (c) **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.

(d) **Late Submission Fee 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.

Q10. Who are recognized lenders in External Commercial Borrowing Framework? [June 2022 (4 Marks)]

Ans.: Following are the Recognized Lenders under the ECB Framework:

- ◆ Lender should be resident of **Financial Action Task Force (FATF)** or **International Organization of Securities Commission's (IOSCO)** compliant country, including on transfer of ECB.
- ◆ Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognized lenders.
- ◆ Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad.
- ◆ Foreign branches/subsidiaries of Indian banks are permitted as recognized lenders only for Foreign Currency 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.

Q11. How hedging is regulated under External Commercial Borrowing framework? [June 2022 (4 Marks)]

Ans.: Hedging Provisions:

- ◆ The entities raising ECB are required to follow the guidelines for hedging issued, 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% of their ECB exposure in case the average maturity of the ECB is less than 5 years. The designated AD Category-1 bank shall verify that 70% hedging requirement is complied with during the currency of the ECB and report the position to RBI through Form ECB 2.

Operational aspects with respect to hedging: Following operational aspects with respect to hedging should be ensured:

- (a) **Coverage through financial hedge:** The ECB borrower will be required to cover the principal as well as the 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 the liability is created in the books of the borrower).

(b) **Tenor & Rollover:** A minimum tenor of one year for the 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 the ECB.

(c) **Natural Hedge:** Natural hedge, in lieu of financial hedge, will be considered only to the extent of offsetting projected cash flows/revenues in matching currency, net of all other projected outflows. For this purpose, an ECB may be considered naturally hedged if the offsetting 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 a natural hedge.

(d) **Eligibility of hedging by overseas investors:** Overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category-1 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.

DEPOSITORY RECEIPTS (DR)

Q12. What is "Offering Circular"? Explain the contents of offering circular for Euro Issue. [Dec. 2010 (10 Marks)]

Or

"Offering circular is a mirror through which the prospective investors can access vital information of the company in order to form their investment strategies." Explain the statement and list out the contents included in the offering circular. [June 2016 (5 Marks)]

Ans.: **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.

Contents of Offering Circular: 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 capitalization.
- ◆ 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.

Q13. Write notes on: Subscription Agreement [Dec. 2010 (4 Marks)]

Ans.: One of the important principle important document in the process of issue of Depository Receipts is "Subscription Agreement".

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) Authorize 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.
- (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 up to a certain prescribed number of additional GDRs solely to cover over-allotments, if any.

Q14. List the approvals required for resources mobilization by a company in the international capital market. [June 2011 (7 Marks)]

Or

What are the approvals required for issuance of Global Depository Receipts (GDRs)? [Dec. 2012 (5 Marks)]

Or

States the procedure laid out for issuance of ADRs/GDRs. [Dec. 2019 (5 Marks)]

Ans.: 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.

- (a) **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 authorized for seeking Government approval in connection with Euro issue and signing agreements with depository, organizing 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.

- (b) **Approval of Shareholders:** Proposal for making Euro issue, as proposed by Board of Directors requires 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.
- (c) **Approval of Ministry of Finance – In Principle and Final:** ADR/GDR has been brought under the automatic route and therefore the requirement of obtaining approval of Ministry of Finance, Department of Economic Affairs has been dispensed with.
- Further, private placement of ADR/GDR will also not require prior approval provided the issue is managed by investment banker.
- (d) **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.
- (e) **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.

Q15. Write notes on: Road show in Euro issues [Dec. 2011 (4 Marks)]
Or

Road shows are in fact, a conference by the issuer company with the potential/future/prospective investors. Elucidate.

[Dec. 2013 (5 Marks)]

Ans.: Road shows represent meetings of issuers, analysts and potential investors. Details about the company are presented in the road shows and such details usually include the following information about the company making the issue:

- History
- Organizational structure
- Principal objects
- Business lines
- Position of the company in Indian and international market
- 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 organized 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.

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.

Q16. Explain briefly: Two-way Fungibility Scheme.

[Dec. 2014 (3 Marks)]

Ans.: **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.

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.

Q17. Indian companies are allowed to raise Equity Capital in the International Market through the issue of ADR/GDR/FCCB/FCFB. Briefly, discuss the regulatory framework of ADR & GDR in India.

[June 2018 (5 Marks)]

Ans.: Issue of ADR/GDR/FCCB/FCFB is regulated by the following regulations in India:

- ◆ Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993
- ◆ Companies Act, 2013 and Rules thereunder.
- ◆ FEMA Act, 1999 and Rules & Regulations made thereunder
- ◆ Depository Receipts Scheme, 2014
- ◆ Notifications/Circulars issued by Ministry of Finance (MoF), GOI.
- ◆ Consolidated FDI Policy

- ◆ RBI Regulations/Circulars
- ◆ SEBI (LODR) Regulations, 2015

Q18. Discuss the different modes of Euro Issue detail.*[June 2019 (3 Marks)]*

Ans.: 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:

1. Depository Receipts

(a) American Depository Receipts

- Existing shares
- Fresh shares

(b) Global Depository Receipts

- From Euro market *[Apply from 26-07-2022]*
- From US market

2. Foreign Currency Convertible Bonds/Foreign Currency Exchangeable Bonds.

Q19. Speed Information Ltd. would like to issue US \$ 750 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 the Companies (Issue of Global Depository Receipts) Rules, 2014. *[June 2022 (5 Marks)]*

Ans.: Following provisions of the Companies (Issue of Global Depository Receipts) Rules, 2014 are required to be complied by the Speed Information Ltd. to issue Global Depository Receipts:

Eligibility to issue depository receipts [Rule 3]: 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]: Following conditions to be fulfilled by a company for issue of depository receipts:

- (a) The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorizing the company to do so.
- (b) 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.

- (c) 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.
- (d) 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.
- (e) The company shall appoint a merchant banker or a practicing chartered accountant or a practicing cost accountant or a practicing company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practicing chartered accountant or practicing cost accountant or practicing 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 authorized 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.

Q20. Explain the differences between abbreviations "ADR" and "GDR". *[June 2023 (5 Marks)]*

Ans.: Typically, companies in India issue securities in the form of depository receipts (DR) viz. American Depository Receipts (ADR), Global Depository Receipts (GDR) etc. Both ADRs and GDRs are equity based instruments. "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.

"Global Depository Receipt (GDR)" means a security issued by a bank or a depository outside India (other than the United States of America) against underlying rupee shares of a company incorporated in India (E.g. DRs issued on the Luxembourg Stock Exchange). The difference between American Depository Receipts (ADR) and Global Depository Receipts (GDR) is that ADRs are US \$ denominated and traded only in US while GDRs are traded in various places such as London Stock Exchange.

FCCB & FCEB

Q21. FCCB and ECB are different modes for raising foreign capital. *[Dec. 2011 (3 Marks)]*

Ans.: Following are the main points of difference between ECB and FCCB:

Points	ECB	FCCB
Meaning	ECB refer to commercial loans in the form of bank loans, securitized instruments, buyer's credit, supplier's credit availed of from non-resident lenders with a minimum average maturity of 3 years.	FCCB mean a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency.
Nature	ECB is borrowing and is thus purely debt finance.	FCCB is hybrid instrument. It is issued as bond but later it is converted in to equity.
Procedure	ECBs are to be availed as per the relevant guideline, notification and circulars issued by the RBI from time to time.	FCCBs are required to be issued in accordance with the scheme viz., Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.
Listing	Since ECB is borrowing/loan it cannot be listed at all in stock exchange.	FCCBs can be listed in stock exchange after their conversion into shares.

Q22. Distinguish between: FCCB & FCEB [Dec. 2015 (2 Marks)]

Ans.: FCCBs are issued by a company to non-residents giving them the option to convert them into shares of the same company at a predetermined price. On the other hand, FCCBs are issued by the investment or holding company of a group to non-residents which are exchangeable for the shares of the specified group company at a predetermined price.

The key difference, therefore, is while FCCB involves just one company, FCEB involves at least two companies – the bonds are usually of the parent company while the shares offered are of the operating company which must be a listed company.

Q23. "Both foreign currency exchangeable bonds (FCEBs) and foreign currency convertible bonds (FCCBs) are convertible into equity shares." Since both are convertible into equity shares, you are required to highlight the advantages of FCEBs over FCCBs. [Dec. 2014 (6 Marks)]

Ans.: Foreign Currency Exchangeable Bonds (FCEB) as defined includes the following:

- ◆ A bond expressed in foreign currency.
- ◆ The principal and the interest of which is payable in foreign currency.
- ◆ The issuer of the bond is an Indian company.
- ◆ The bonds are subscribed by a person resident outside India.
- ◆ The bonds are exchangeable into equity shares of another company which is also called the offered company.

Foreign Currency Convertible Bond (FCCB) means a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency.

The launch of the FCEB scheme affords a unique opportunity for Indian promoters to unlock value in group companies. FCEBs are another arrow in the quiver of Indian promoters to raise money overseas to fund their new projects and acquisitions, both Indian and global, by leveraging a part their shareholding in listed group entities.

FCEB involves three parties: The issuer company, Offered Company (OC) and an 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.

Thus, FCEBs are exchangeable into shares of offered company. They have an inherent advantage that it does not result in dilution of shareholding at the offered company level.

Q24. What do you mean by Foreign Currency Convertible Bonds (FCCBs)? State the benefits of FCCBs to investors and the issuer. [Dec. 2016 (5 Marks)]

Ans.: Foreign Currency Convertible Bond (FCCB) means a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency.

Peculiarities of FCCB:

- ◆ FCCB is hybrid instrument. It is issued as bond but later it is converted into shares.
- ◆ FCCB carry a fixed rate of interest until bond is converted into shares.
- ◆ FCCB can be secured as well as unsecured. Mostly the FCCB issued by the Indian Companies are unsecured.
- ◆ FCCBs are denominated foreign currency.
- ◆ Interest is payable in foreign currency.
- ◆ Redemption price is payable in foreign currency (if option of conversion is not exercised).

Benefits of FCCB to the issuer company:

- ◆ FCCB generally has low rate of interest as compared to pure debt instrument. Thus, it reduces the debt financing cost.
- ◆ FCCB does not require credit rating.
- ◆ FCCB saves risks of immediate equity dilution as in the case of public shares.
- ◆ FCCB can be raised within a month while pure debt takes a longer period to raise.

Benefits of FCCB to investors:

- ◆ FCCB has advantage of both equity and debt.
- ◆ FCCB 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 interest 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 interest rate.

Q25. What do you mean by Foreign Currency Exchangeable Bonds (FCEB)? Explain the pricing norms for issuing of FCEB under the Foreign Currency Exchangeable Bonds Scheme, 2008.

[Dec. 2020 (3 Marks)]

Ans.: Foreign Currency Exchangeable Bonds (FCEB) as defined includes the following:

- ◆ A bond expressed in foreign currency.
- ◆ The principal and the interest of which is payable in foreign currency.
- ◆ The issuer of the bond is an Indian company.
- ◆ The bonds are subscribed by a person resident outside India.
- ◆ The bonds are exchangeable into equity shares of another company which is also called the offered company.

Pricing of Foreign Currency Exchangeable Bonds (FCEBs): 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 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 6 months.
- (ii) the average of weekly high and low of the closing prices of the shares of the offered company quotes on a stock exchange during the 2 weeks preceding the relevant date.

PRE-ISSUE & POST-ISSUE FORMALITIES FOR GDRS/ADRS/FCCBS

Q26. Which documents are required for granting approval under the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015, for companies proposing to come out with issue of GDRs/ADRS/FCCBs?

Ans.: 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.

Q27. Which documents are required for listing approval for equity shares underlying GDRs/ADRS or equity shares allotted upon conversion of FCCBs issued by the Companies?

Ans.: **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 required to be 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 (LODR), 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 1/4/2017, 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.

motena8074@digidy.com 26-07-2024
09:44

TAXMANN

17

CHAPTER

ROLE OF INTERMEDIARIES IN FUND RAISING

INTERMEDIARY

Q1. Define the term 'Intermediary' as per the SEBI (Intermediaries) Regulations, 2008.

Ans.: Intermediary [Regulation 2(1)(g)]: Intermediary means a person mentioned in Section 11(2)(b) & (ba) and Section 12(1) & (1A) of the SEBI Act, 1992 and includes:

- (a) An Asset Management Company as per the SEBI (Mutual Funds) Regulations, 1996.
- (b) A Clearing Member of a clearing corporation or clearing house.
- (c) Foreign Portfolio Investors.
- (d) A Trading Member of a derivative segment or currency derivatives segment of a stock exchange.

Intermediary does not include:

- (i) Foreign Venture Capital Investor
- (ii) Mutual Fund
- (iii) Collective Investment Scheme
- (iv) Venture Capital Fund.

As per Section 11(2)(b) & (ba) and Section 12(1) & (1A) of the SEBI Act, 1992, following are intermediaries:

- Stock brokers & Sub-brokers
- Share Transfer Agents
- Bankers to an Issue
- Trustees of trust deeds
- Registrars to an Issue
- Merchant Bankers
- Underwriters
- Portfolio Managers

- Investment Advisers
- Depository
- Depository Participant
- Custodian of securities
- Foreign Institutional Investor
- Credit Rating Agency
- Other intermediaries associated with securities markets as SEBI may notify.

SEBI (INVESTMENT ADVISERS) REGULATIONS, 2013

Q2. Investment Adviser provides guidance about financial obligations and investment. Comment on this statement and state the role of investment advisers in capital market. [June 2015 (5 Marks)]

Ans.: Introduction: An investment adviser is an individual or a firm that is in the business of giving advice about securities to clients. For instance, individuals or firms that receive remuneration for giving advice on investing in stocks, bonds, mutual funds, or exchange traded funds are investment advisers. Some investment advisers manage portfolios of securities.

Registration: In terms of the SEBI (Investment Advisers) Regulations, 2013, a person cannot act as an investment adviser unless he has obtained a certificate of registration from the SEBI unless specifically exempted.

Investment Advice: 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 shall include financial planning.

However, investment advice given through newspaper, magazines, any electronic or broadcasting or telecommunications medium, which is widely available to the public shall not be considered as investment advice for the purpose of these regulations.

Investment Adviser: Investment adviser means any 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.

Net worth:

- **Non-Individuals:** Not less than ₹ 50 lakh.
- **Individuals:** Not less than ₹ 5 lakh.

Q3. What are the general obligations and responsibilities of investment adviser under the SEBI (Investment Advisers) Regulations, 2013?

Ans.: General obligations and responsibilities [Regulation 15]:

- (1) **Fiduciary Capacity:** An investment adviser shall act in a fiduciary capacity towards its clients and shall disclose all conflicts of interests as and when they arise.
- (2) **Remuneration:** 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.
- (3) **Arms-length relationship:** An investment adviser shall maintain an arms-length relationship between its activities as an investment adviser and other activities.
- (4) **Segregation of 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.
- (5) **Disclosure of conflict of interest:** 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.
- (6) **Secrecy of confidential information:** 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.
- (7) **Not to enter into transactions on its own account:** 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. However, during the period of such 15 days, if the investment adviser is of the opinion that the situation has changed, then it may enter into such a transaction on its own account after giving such revised assessment to the client at least 24 hours in advance of entering into such transaction.
- (8) **KYC procedure:** An investment advisor shall follow Know Your Client procedure as specified by the Board from time to time.
- (9) **Code of Conduct:** An investment adviser shall abide by Code of Conduct as specified in Third Schedule.
- (10) **Not to act on its own account:** 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.
- (11) **Change in control:** In case of change in control of the investment adviser, prior approval from the SEBI shall be taken.

(12) Information & Reports to SEBI: Investment advisers shall furnish to the SEBI information and reports as may be specified by the SEBI from time to time.

(13) Compliance with certification & qualification: It shall be the responsibility of the investment adviser to ensure compliance with the certification and qualification requirements at all times.

Q4. Whether 'Insurance agent' or 'Insurance broker' is exempted from obtaining registration under the SEBI (Investment Advisers) Regulations, 2013?

Ans.: 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 may be registered and regulated under the SEBI (Investment Advisers) Regulations, 2013 for such other financial products other than insurance products.

Q5. Whether a person acting in multiple capacities such as insurance agent, pension advisor, mutual fund distributor, etc. is exempted from obtaining registration under the SEBI (Investment Advisers) Regulations, 2013?

Ans.: A person acting in multiple capacities such as insurance agent, pension advisor, mutual fund distributor, etc. and expand his scope of activities to include investment advice on other financial products or engaged in the financial planning of the clients, then he may be registered and regulated under the SEBI (Investment Advisers) Regulations, 2013 for advising on such other financial products or financial planning of the clients.

Q6. Which entities are exempted from registration under the SEBI (Investment Advisers) Regulations, 2013? Briefly explain.

[June 2024 (5 Marks)]

Ans.: 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 obligations 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).

Q7. Dealing in unregulated products by SEBI registered Investment Advisers. Comment.

Ans.: 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.

Q8. What are the key parameters of the Investment Advice Service?

Ans.:

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

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.

B. Suitability: 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:
 - Meets the client's investment objectives.
 - Is such that the client is able to bear any related investment risks consistent with its investment objectives and risk tolerance.
 - 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.

Institutional/corporate clients are treated as sophisticated investors and may not require risk profiling. However, if advice relates to investment in derivatives, complex structured products, etc. risk profiling may be required.

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.

SEBI (MERCHANT BANKERS) REGULATIONS, 1992

Q9. Explain briefly the role of the following in capital market.

(i) Merchant Bankers

(ii) Bankers to an Issue

[Dec. 2012 (2 x 2 = 4 Marks)]

Ans.:

(i) **Merchant Bankers:** Merchant Banker means any person engaged in the business of issue management. Merchant Bankers are generally engaged in following activities:

- ◆ Making arrangements regarding selling buying or subscribing to securities.
- ◆ Acting as manager/consultant/advisor.
- ◆ Rendering corporate advisory services.

Merchant bankers are the key intermediary between the company and issue of capital.

(ii) **Bankers to an Issue:** The Bankers to an issue are engaged in activities such as acceptance of applications along with application money from investors in respect of issues of capital and refund of application money. Only 'Scheduled Bank' can act as 'Banker to an Issue'.

Bankers to the issue carry out all the activities of ensuring that the funds are collected and transferred to the Escrow Accounts.

Q10. "Merchant bankers are the key intermediary between the company and issue of capital." Comment. [June 2016 (5 Marks)]

Ans.: **Merchant Banker – Meaning:** Merchant Banker means any person engaged in the business of issue management.

Need of Merchant Banker: Making public issue of shares is a highly specialized job which involves tremendous and time bound work. Organizations undertaking this task are called as Merchant Bankers. Most of the leading banks and financial institutions have formed 'Merchant Banking Division' specializing in this work. They have to register with SEBI and hence called Registered Merchant Bankers.

SEBI has little control over the companies making public issue as they are not registered with SEBI and SEBI does not have many legal powers to control

them. Hence, SEBI casts all responsibility on Merchant Bankers in respect of public issue. Merchant Bankers are also known as Lead Managers.

Merchant bankers are the key intermediary between the company and issue of capital.

Who can be a merchant banker: Only body corporate is allowed to function as merchant bankers.

Activities of Merchant Bankers: SEBI has advised that merchant bankers shall undertake only those activities which relate to securities market. These activities are:

- ◆ Managing of public issue of securities.
- ◆ Underwriting connected with the aforesaid public issue management business.
- ◆ Managing/Advising on international offerings of debt/equity i.e. GDR, ADR, bonds and other instruments.
- ◆ Private placement of securities.
- ◆ Primary or satellite dealership of government securities.
- ◆ Corporate advisory services related to securities market including take-overs, acquisition and disinvestment.
- ◆ Stock broking.
- ◆ Advisory services for projects.
- ◆ Syndication of rupee term loans.
- ◆ International financial advisory services.

Regulatory Framework: Activities of 'Merchant Bankers' are regulated by the SEBI Act, 1992 and the SEBI (Merchant Bankers) Regulations, 1992.

Capital adequacy requirement: The Merchant Banker shall have a net worth of not less than ₹ 5 Crore.

Q11. A merchant banker or the investment banker plays a pivotal role in any public issue. Discuss.

Ans.: 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 an IPO, particularly 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 bank-

ers. 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.

Q12. Discuss briefly general obligations and responsibilities of the merchant banker under the SEBI (Merchant Bankers) Regulations, 1992.

Ans.: General obligations and responsibilities of the merchant banker: Following are the general obligations and responsibilities of the merchant banker as per Regulations 13 to 28B of the SEBI (Merchant Bankers) Regulations, 1992:

- ◆ 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.

SEBI (PORTFOLIO MANAGERS) REGULATIONS, 2020

Q13. Distinguish between: Merchant Banker & Portfolio Manager

[June 2010 (3 Marks)]

Ans.: Following are the main points of difference between merchant banker & portfolio manager:

Points	Merchant Banker	Portfolio Manager
Meaning	Merchant Banker means any person engaged in the business of issue management.	Portfolio manager means any person who pursuant to contract or arrangement with the client, advises or directs or undertakes on behalf of the client the management or administration of a portfolio of securities or the funds of the clients.
Regulation	Merchant Bankers are regulated by the SEBI (Merchant Bankers) Regulations, 1992.	Portfolio Managers are regulated by the SEBI (Portfolio Manager) Regulations, 2020.
Type of intermediary	Merchant Bankers mostly acts as primary capital market intermediary.	Portfolio Managers are secondary capital market intermediary.
Act on behalf of	Merchant Bankers acts on behalf of issuer company.	Portfolio Managers acts on behalf of their client i.e. investors.
Nature of work	Merchant Bankers most of the work is to comply with the SEBI Act, 1992 and Regulations made there under.	Portfolio Managers has to handle the portfolio of his client and try to increase market value by buying, holding and selling securities.
Capital adequacy	The capital adequacy requirement for Merchant Banker is a net worth of not less than ₹ 5 Crore.	The capital adequacy requirement for portfolio manager is a net worth of not less than ₹ 5 Crore.

Q14. Write a short note on: Portfolio Manager

[Dec. 2010 (3 Marks)] & [June 2018 (4 Marks)]

Or

Write short notes on: Role of Portfolio Manager [Dec. 2019 (3 Marks)]

Or

What do you mean by discretionary portfolio manager? How portfolio manager plays a pivotal role in deciding the best investment plan for an individual? [Dec. 2021 (5 Marks)]

Ans.: Meaning of Portfolio: The term portfolio means a basket or combination of securities. Thus, if a person invests in more than security, he is creating portfolio.

Meaning of Portfolio Manager: Portfolio manager means any person who pursuant to contract or arrangement with the client, advises or directs or undertakes on behalf of the client the management or administration of a portfolio of securities or the funds of the clients as the case may be.

There are two types of portfolio managers:

- (1) Discretionary Portfolio Manager:** Discretionary portfolio manager is one who exercises any degree of discretion as to the investment or management of the portfolio of the securities or the funds of the client.
- (2) Non-discretionary Portfolio Manager:** Non-discretionary portfolio manager manages the funds with the discretion of client.

Net worth requirement: The Portfolio Manager shall have a net worth of not less than ₹ 5 Crore.

Regulatory Framework: Activities of 'Portfolio Managers' are regulated by the SEBI Act, 1992 and the SEBI (Portfolio Managers) Regulations, 2020.

Role of Portfolio Manager:

- ◆ A portfolio manager plays important role in deciding the best investment plan for an individual as per his income, age and ability to undertake risks.
- ◆ A portfolio manager makes aware his client regarding various investment tools available in the market and benefits associated with each plan.
- ◆ After investment, portfolio manager also advise his client whether to hold the security or sell as per the movement in stock market.
- ◆ A portfolio manager is responsible for designing customized investment solutions for the clients according to their financial needs.

Q15. Discuss briefly Investment Rules for Portfolio Manager for investment of client's funds.

Ans.: 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.
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.
6. "Unlisted securities" for investment by Portfolio Managers shall include units of Alternative Investment Funds (AIFs), Real Estate Investment Trusts (REITs), Infrastructure Investment Trusts (InvITs), debt securities, shares, warrants, etc. which are not listed on any recognized stock exchanges in India.
However, funds of clients availing discretionary PMS cannot be invested in unlisted bonds, which are traded over the counter but settled and reported to the Stock Exchanges.
7. 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.
8. The portfolio manager is required to accept minimum ₹ 50 lakh or securities having a minimum worth of ₹ 50 lakh from the client.
9. Clients of Portfolio Managers on-boarded before January 21, 2020 shall, in case of any top-up, comply with the requirement of new minimum investment amount and top up their accounts to minimum ₹ 50 lakh.
10. 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.
11. 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.

Q16. Which types of reports are required to be provided by the Portfolio Manager as per the agreement with his clients?

Ans.: 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 3 months and such report shall contain the following details, namely:

- (a) 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.
- (b) Transactions undertaken during the period of report including date of transaction and details of purchases and sales.
- (c) Beneficial interest received during that period in the form of interest, dividend, bonus shares, rights shares, etc.
- (d) Expenses incurred in managing the portfolio of the client.
- (e) Details of risk foreseen by the portfolio manager and the risk relating to the securities recommended by the portfolio manager for investment or disinvestment.
- (f) 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.
- (g) Details of commission paid to distributors for the particular client.

Q17. Discuss briefly general obligations and responsibilities of the portfolio manager under the SEBI (Portfolio Managers) Regulations, 2020.

Ans.: General responsibilities of a portfolio manager:

- (1) Every portfolio manager shall abide by the Code of Conduct.
- (2) 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.
- (3) The portfolio manager shall act in a fiduciary capacity with regard to the client's funds.
- (4) The portfolio manager shall segregate each client's holding in securities in separate accounts.
- (5) The portfolio manager shall keep the funds of all clients in a separate account to be maintained by it in a Scheduled Commercial Bank.
- (6) 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.
- (7) The portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities.
- (8) The portfolio manager shall not borrow funds or securities on behalf of the client.
- (9) The portfolio manager shall not lend securities held on behalf of the clients to a third person except as provided under these regulations.

- (10) The portfolio manager shall ensure proper and timely handling of complaints from his clients and take appropriate action immediately.
- (11) 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 COMPANY SECRETARY

Q18. Write a short note on: Importance of Company Secretary to a company desirous of getting listed

Ans.: 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.

Under regulation 6 of the SEBI (LODR) 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.

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.

18

CHAPTER

PROJECT EVALUATION

Q1. What do you mean by Project Evaluation? What are factors which affect the cost of a Project?

Ans.: 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.

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. Various cost incurred in a construction project is placed below:

- Material cost
- Impact of labor wage on project cost
- Impact of method of construction on project cost
- Impact of variation orders on project cost
- Impact of delay on cost overrun in project cost
- Nature of construction site
- Nature of structure
- Project quality
- Regulator and insurance requirements
- Size of the project

Q2. Explain the project appraisal through Technical, Legal and Financial feasibility study.

Ans.: 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 analyze various assumptions made in the project report with respect to the cost and profitability.
- ◆ 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:

- (a) **Management Appraisal:** Whether promoters can manage the Project successfully and infuse the required equity capital into the project.
- (b) **Technical Appraisal:** Whether the necessary resources are available for the manufacturing of products.
- (c) **Marketing Appraisal:** Whether products can be sold in the market and can surmount the competition.
- (d) **Financial Appraisal:** Whether a project can make profit to meet the financial obligations without any default.
- (e) **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.

Q3. Elaborate the concept of risk assessment and mitigation. Also, define the role of credit risk management in Project Finance?

Ans.: 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 predictable 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 x 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.

Majority 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.

Credit risk management: 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.

Q4. How to prepare a Detailed Project Report (DPR)?

Ans.: 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.

Things to consider while writing 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.

Q5. Distinguish between: Technical aspects of project appraisal & Financial aspects of project appraisal

Ans.: Following are the main points of difference between technical & financial aspects of project appraisal:

Points	Technical aspects of project appraisal	Financial aspects of project appraisal
Meaning	Technical feasibility implies to mean the adequacy of the proposed plant and equipment to produce the product within the prescribed norms.	The primary aim of financial analysis is to determine whether the project satisfies the investment criteria of generating acceptable level of profitability.
Measures	<p>While assessing the technical feasibility of the project, the following inputs covered in the project should be taken into consideration:</p> <ul style="list-style-type: none"> ◆ Availability of land and site. ◆ Availability of other inputs like water, power, transport, communication facilities. ◆ Availability of servicing facilities like machine shops, electric repair shop, etc. ◆ Coping-with anti-pollution law. ◆ Availability of work force as per required skill and arrangements proposed for training-in-plant and outside. ◆ Availability of required raw material as per quantity and quality. 	<p>Financial aspects of project is judged with reference to following:</p> <ul style="list-style-type: none"> ◆ NPV ◆ Benefit Cost Ratio (BCR)/ Profitability Index ◆ Internal Rate of Return (IRR) ◆ Sensitivity Analysis ◆ Scenario Analysis ◆ Risk Analysis

Q6. Social cost-benefit analysis is a systematic and cohesive method to survey all the impacts caused by a project. Comment.

Or

Write a short note on: Social cost-benefit analysis

[Dec. 2002 (4 Marks)], [June 2005 (5 Marks)]

Ans.: In Social Cost-Benefit Analysis, a project is analyzed from the point of view of the benefit it will generate for the society as a whole.

Social cost-benefit analysis is a systematic and cohesive method to survey all the impacts caused by a project. It comprises not just the financial effects but all the social effects, like pollution, safety, market, legal aspects, etc. The main aim of a social cost benefit analysis is to attach a price to as many effects as possible in order to uniformly weigh the abovementioned heterogeneous effects. As a result, these prices reflect the value a society attaches to the caused effects, enabling the decision maker to form a statement about the net social welfare effects of a project.

Major advantages of a social cost-benefit analysis are that it enables investors to systematically and cohesively compare different project alternatives. Hence, these alternatives will not just be compared intrinsically, but will also be set against the "null alter-native hypothesis". This hypothesis describes "the most likely" scenario development in case a project will not be executed. Put differently, investments on a smaller scale will be included in the null alternative hypothesis in order to make a realistic comparison in a situation without "huge" investments.

The social cost-benefit analysis calculates the direct (primary), indirect (secondary) and external effects:

- (a) Direct effects are the costs and benefits that can be directly linked to the owners/users of the project properties (e.g., the users and the owner of a building or highway).
- (b) Indirect effects are the costs and benefits that are passed on to the producers and consumers outside the market with which the project is involved (e.g., the owner of a bakery nearby the new building, or a business company located near the newly planned highway).
- (c) External effects are the costs and benefits that cannot be passed on to any existing markets because they relate to issues like the environment (noise, emission of CO₂, etc.), safety (traffic, external security) and nature (biodiversity, dehydration, etc.).

The results of a social cost-benefit analysis are:

1. **An integrated way of comparing the different effects:** All relevant costs and benefits of the different project implementations are identified and monetized as far as possible. Effects that cannot be monetized are described and quantified as much as possible.
2. **Attention for the distribution of costs and benefits:** The benefits of a project do not always get to the groups bearing the costs. A social cost-benefit analysis gives insight in who bears the costs and who derives the benefits.
3. **Comparison of the project alternatives:** A social cost-benefit analysis is a good method to show the differences between project alternatives and provides information to make a well informed decision.
4. **Presentation of the uncertainties and risks:** A social cost-benefit analysis has several methods to take economic risks and uncertainties into account. The policy decision should be based on calculated risk.

Q7. What are the steps taken by financial institutions while appraising the project?
[June 2003 (10 Marks)], [Dec. 2016 (4 Marks)]

Ans.: Project Report submitted by a corporate unit to a financial institution for grant of financial facilities is properly appraised by a team of expert drawn from different disciplines.

The project appraisal is done as a "business risk" and, therefore, efforts are made to corroborate the data submitted by a company with authentic sources. Each project is appraised on its own merits and flexibility is observed while applying the norms of ratio analysis, funds flow analysis, financial indicators, technical norms etc. The basic objective during appraisal remains the project and its future in the form of successful implementation and efficient operation so as to contribute to national economy. If a project remains successful, the money lend by financial institutions is returned safely. The growth of the project is the best security for the financial institutions than the physical and legal security. No doubt this security forms an important part in the entire transaction for lending and borrowing for the project.

Viewing from the above angle, project appraisal, in general, by the financial institutions seek to consider *inter alia* the following aspects:

- ◆ The project profile, its reliability and project report.
- ◆ The promoter's capacity and competence.
- ◆ **Viability Tests:**
 - Technical Aspects
 - Financial Aspects
 - Economic Aspects
 - Social Aspects
 - Environment, Energy Management and Economical Aspects
 - Organization and Management Aspects
 - Commercial Aspects
 - Marketing Aspects

Q8. Briefly discuss the financial aspects of project appraisal.

[Dec. 2003 (4 Marks)]

Ans.: Financial Appraisal of a project is most important for a banker. The primary aim of financial analysis is to determine whether the project satisfies the investment criteria of generating acceptable level of profitability. The project should be able to service the debt and ensure expected returns to the investor. The important aspects which are examined while conducting financial appraisal are investment outlay, means of financing, projected financial statements, viability and profitability, break-even point analysis, sensitivity analysis and risk analysis.

Cash flow statement is the basis for financial analysis. In the initial period there is a negative cash flow because of investment in capital assets, but after the project takes off, the cash flow becomes positive due to the increased income.

Investment is generally required in the initial years, which is a cash outflow for the project. In the operational phase, there is inflow from the business, which results in positive cash flow till the project is wound up. In the last year, the inflow is higher due to the residual value adding to the cash inflow.

The period from start of the project till its winding up is known as project life and will vary from project to project.

Measures of financial viability:

- (a) **NPV:** Financial viability is measured by net present value, benefit cost ratio, internal rate of return and debt service coverage ratios. A project is considered viable if the NPV is positive at a given discount rate. When two or more mutually exclusive projects are being appraised, the project with the highest NPV should be selected. Among the discounted techniques, NPV is considered the most important parameter for assessing viability.
- (b) **Benefit Cost Ratio (BCR)/Profitability Index:** BCR is the ratio of discounted value of benefit and discount value of cost. The project is viable when BCR is one or more than one and is unviable when it is less than one.
- (c) **Internal Rate of Return (IRR):** IRR represents the returns internally generated by the project. This is also the rate which makes the net present value equal to zero. The project is considered viable if the IRR is more than the acceptable rate for the entrepreneur which could be the opportunity cost for his funds.
- (d) **Sensitivity Analysis:** Projects are sensitive to fluctuation in values of critical variables like costs of inputs and prices of outputs. It is important to examine how sensitive is the project to fluctuations in the values of these variables because the basic assumptions taken for projections of balance sheet, cash flow statements for future years have an element of uncertainty. Different projects may, however, get affected differently from changes in the assumption of cost and return items. Sensitivity analysis helps us in finding out that how sensitive is the project to these fluctuations. Sensitivity analysis involves identification of crucial variable relating to costs and returns, specification of alternative values of the crucial variables and re-computation of the NPV and IRR by using the alternative values. A project, which is highly sensitive to even small fluctuations in cost and price, is a risky project for financing.
- (e) **Scenario Analysis:** Sensitivity analysis takes care of only one or two variable which is at times inadequate. This limitation is partially overcome by what is known as scenario analysis, where scenario of certain prices, cost and other variables are created and the financial parameters are computed.

- (f) **Risk Analysis:** Under risk analysis probabilistic analysis is done by identification of key risk variables, finding out values of each risk variable, assigning probabilities for each value to each of the risk variables, using these values for risk analysis and finding out the probability of negative outcome of the project *i.e.* what is the probability that the NPV of the project will be negative. The risk analysis adds valuable information to the project analysis and it is an important tool in this respect but to take up investment or not depends on the risk taking capacity of the entrepreneur which will vary from person to person. Therefore, it is judgmental in nature.

Q9. Write a short note on: Technical aspects of project appraisal

[June 2004 (5 Marks)], [June 2010 (5 Marks)]

Ans.: While making project appraisal, the technical feasibility of the project also needs to be taken into consideration. In the simplest sense, technical feasibility implies to mean the adequacy of the proposed plant and equipment to produce the product within the prescribed norms. As regards know-how, it denotes the availability or otherwise of a fund of knowledge to run the proposed plants and machinery.

It should be ensured whether that know-how is available with the entrepreneur or is to be procured from elsewhere. In the latter case, arrangement made to procure it should be clearly checked up. If project requires any collaboration, then, the terms and conditions of the collaboration should also be spelt out comprehensively and carefully.

In case of foreign technical collaboration, one needs to be aware of the legal provisions in force from time to time specifying the list of products for which only such collaboration is allowed under specific terms and conditions. The entrepreneur, therefore, contemplating for foreign collaboration should check these legal provisions with reference to their projects.

While assessing the technical feasibility of the project, the following inputs covered in the project should also be taken into consideration:

- ◆ Availability of land and site.
- ◆ Availability of other inputs like water, power, transport, communication facilities.
- ◆ Availability of servicing facilities like machine shops, electric repair shop, etc.
- ◆ Coping-with anti-pollution law.
- ◆ Availability of work force as per required skill and arrangements proposed for training-in-plant and outside.
- ◆ Availability of required raw material as per quantity and quality.

Q10. Project planning aims at choosing the minimum quantum of investment which may yield the highest return or maximized investment for obtaining the highest growth of the project. Comment.

[June 2007 (5 Marks)]

Ans.: Project planning aims at choosing the minimum quantum of investment which may yield the highest return or maximized investment for obtaining the highest growth of the project.

Project planning defines the project activities and end products that will be performed and describes how the activities will be accomplished. The purpose of project planning is to define each major task, estimate the time and resources required, and provide a framework for management review and control.

The project planning activities and goals include defining:

1. The specific work to be performed and goals that define and bind the project.
2. Estimates to be documented for planning, tracking, and controlling the project.
3. Commitments that are planned, documented, and agreed to by affected groups.
4. Project alternatives, assumptions, and constraints.

The planning process includes steps to estimate the size of the project, estimate the technical scope of the effort, estimate the resources required to complete the project, produce a schedule, identify and assess risks, and negotiate commitments.

Repetition of these steps is necessary to establish the project plan. Typically, several iterations of the planning process are performed before a plan is actually completed.

Q11. Write a short note on: Economic Rate of Return (ERR)

[June 2007 (5 Marks)]

Ans.: In Social cost benefit analysis the financial viability of the project is examined at the revised rate and assessed the same with reference to economic justification of the project. The appropriate measure for this aspect is the economic rate of return for the project which will equate the present value of capital expenditure to net cash flows over the life of the project. The rate of return should be acceptable which accommodates the rate of inflation per annum.

Thus, economic Rate of Return is a rate of discount which equates the real economic cost of project outlay to its economic benefits during the life of the project.

PRACTICAL PROBLEMS

Problem No. 1]

Rex of Mumbai intends to set-up a plant involving a cost outlay of ₹ 20 lakh. After vigorous persuasion, the bankers agree to finance the project and allow a moratorium period of 3 years, i.e., repayment will start from the end of third year with the condition that the loan as such will be squared up by Rex in three equal yearly instalments along with interest @ 6% per annum. You are required to find out the amount of the yearly instalment and also the amount to be paid on account of interest.

Ans.: Calculation of yearly Instalment & Interest:

Year	Instalment	Principal	Interest @ 6%	Balance
0	-	-	-	20,00,000
1	-	-	1,20,000	21,20,000
2	-	-	1,27,200	22,47,200
3	8,40,703	7,05,871	1,34,832	15,41,329
4	8,40,703	7,48,223	92,480	7,93,106
5	8,40,703	7,93,106	47,597	-

$$\text{Instalment} = \frac{\text{Loan Amount}}{\text{Annuity factor of 6\% for 3 years}} = \frac{22,47,200}{2.673} = 8,40,703$$

Problem No. 2]

Aalia Ltd. has two alternative projects under consideration. Project-A requires a capital outlay of ₹ 1,60,000 and Project-B needs ₹ 1,80,000. Both are estimated to provide a cash flow for 5 years; Project-A: ₹ 45,000 per year and Project-B: ₹ 58,000 per year.

The cost of capital is 10%. Show which project is preferable from the view point of net present value?

Ans.: Calculation of net present value:

Year	CFAT		PV Factor 10%	Present Value	
	Project-A	Project-B		Project-A	Project-B
1 to 5	45,000	58,000	3.791	1,70,595	2,19,878
(-) Initial investment				(1,60,000)	(1,80,000)
Net Present Value (NPV)				10,595	39,878

Analysis: Since, NPV of Project-B is higher, it should be selected.

Q10. Project planning aims at choosing the minimum quantum of investment which may yield the highest return or maximized investment for obtaining the highest growth of the project. Comment.

[June 2007 (5 Marks)]

Ans.: Project planning aims at choosing the minimum quantum of investment which may yield the highest return or maximized investment for obtaining the highest growth of the project.

Project planning defines the project activities and end products that will be performed and describes how the activities will be accomplished. The purpose of project planning is to define each major task, estimate the time and resources required, and provide a framework for management review and control.

The project planning activities and goals include defining:

1. The specific work to be performed and goals that define and bind the project.
2. Estimates to be documented for planning, tracking, and controlling the project.
3. Commitments that are planned, documented, and agreed to by affected groups.
4. Project alternatives, assumptions, and constraints.

The planning process includes steps to estimate the size of the project, estimate the technical scope of the effort, estimate the resources required to complete the project, produce a schedule, identify and assess risks, and negotiate commitments.

Repetition of these steps is necessary to establish the project plan. Typically, several iterations of the planning process are performed before a plan is actually completed.

Q11. Write a short note on: Economic Rate of Return (ERR)

[June 2007 (5 Marks)]

Ans.: In Social cost benefit analysis the financial viability of the project is examined at the revised rate and assessed the same with reference to economic justification of the project. The appropriate measure for this aspect is the economic rate of return for the project which will equate the present value of capital expenditure to net cash flows over the life of the project. The rate of return should be acceptable which accommodates the rate of inflation per annum.

Thus, economic Rate of Return is a rate of discount which equates the real economic cost of project outlay to its economic benefits during the life of the project.

PRACTICAL PROBLEMS

Problem No. 1]

Rex of Mumbai intends to set-up a plant involving a cost outlay of ₹ 20 lakh. After vigorous persuasion, the bankers agree to finance the project and allow a moratorium period of 3 years, i.e., repayment will start from the end of third year with the condition that the loan as such will be squared up by Rex in three equal yearly instalments along with interest @ 6% per annum. You are required to find out the amount of the yearly instalment and also the amount to be paid on account of interest.

Ans.: Calculation of yearly instalment & interest:

Year	Instalment	Principal	Interest @ 6%	Balance
0	–	–	–	20,00,000
1	–	–	1,20,000	21,20,000
2	–	–	1,27,200	22,47,200
3	8,40,703	7,05,871	1,34,832	15,41,329
4	8,40,703	7,48,223	92,480	7,93,106
5	8,40,703	7,93,106	47,597	–

$$\text{Instalment} = \frac{\text{Loan Amount}}{\text{Annuity factor of 6\% for 3 years}} = \frac{22,47,200}{2.673} = 8,40,703$$

Problem No. 2]

Aalia Ltd. has two alternative projects under consideration. Project-A requires a capital outlay of ₹ 1,60,000 and Project-B needs ₹ 1,80,000. Both are estimated to provide a cash flow for 5 years; Project-A: ₹ 45,000 per year and Project-B: ₹ 58,000 per year.

The cost of capital is 10%. Show which project is preferable from the view point of net present value?

Ans.: Calculation of net present value:

Year	CFAT		PV Factor 10%	Present Value	
	Project-A	Project-B		Project-A	Project-B
1 to 5	45,000	58,000	3.791	1,70,595	2,19,878
(-) Initial investment				(1,60,000)	(1,80,000)
Net Present Value (NPV)				10,595	39,878

Analysis: Since, NPV of Project-B is higher, it should be selected.

Problem No. 3]

An iron ore company is considering investing in a new processing facility. The company extracts ore from an open pit mine. During a year, 1,00,000 tons of ore is extracted. If the output from the extraction process is sold immediately upon removal of dirt, rocks and other impurities, a price of ₹ 1,000 per ton of ore can be obtained.

The company has estimated that its extraction costs amount to 70% of the net realizable value of the ore.

As an alternative to selling all the ore at ₹ 1,000 per ton, it is possible to process further 25% of the output. The additional cash cost of further processing would be ₹ 100 per ton. The processed ore would yield 80% final output and can be sold at ₹ 1,350 per ton.

For additional processing the company would have to install equipments costing ₹ 100 lakh. The equipment is expected to have a useful life of 5 years with no salvage value. The company follows the straight line method of depreciation.

Additional working capital requirement is estimated at ₹ 10 lakh. The company's cut-off rate for such investments is 15%. Assume corporate tax rate 30% (including surcharge and education cess).

Should the company install the equipment for further processing of the iron ore?

Ans.: Calculation of Initial Investment:

Equipment cost	1,00,00,000
Additional working capital requirement	10,00,000
Net initial investment	1,10,00,000

Processed final output = 1,00,000 tons × 25% × 80% = 20,000

Additional price per unit = 1,350 – 1,000 = 350

Calculation of cash inflow:

Incremental revenue (20,000 × 350)	70,00,000
(-) Cost of processing (25,000 × 100)	(25,00,000)
(-) Depreciation on equipment (1,00,00,000/5)	(20,00,000)
EBIT	25,00,000
(-) Tax @ 30%	(7,50,000)
PAT	17,50,000
(+) Depreciation	20,00,000
CFAT	37,50,000

Calculation of NPV:

Year	CFAT	PV Factor 15%	PV
1 to 5	37,50,000	3.352	1,25,70,000
5	*10,00,000	0.497	4,97,000
Total present value			1,30,67,000
(-) Initial investment			(1,10,00,000)
Net Present Value (NPV)			20,67,000

Analysts: Since, NPV is positive it is advised to invest in new processing facility.

Problem No. 4]

Madhuri Ltd. is evaluating a project for which the initial investment required is ₹ 50 lakh to be met by internally generated funds of ₹ 10 lakh, from a rights issue of ₹ 15 lakh and the rest from a term loan @ 12% per annum. Rights issue will involve flotation cost of 5% and the term loan processing will cost 1%. Corporate tax rate is 40%. The risk-free rate of interest is 6.5%, market return is 15% and the relevant asset beta for the investment is estimated to be 1.5. Net operating cash inflows after tax from the project are:

Year-1 : ₹ 15 lakh

Year-2 : ₹ 35 lakh

Year-3 : ₹ 15 lakh

Besides these cash inflows, residual value of ₹ 5 lakh (net of taxes) is also expected at the end of third year. Should the project be taken up?

Ans.: Calculation of cost of capital:

$$K_c = R_f + \beta (R_m - R_f) \\ = 6.5 + 1.5 (15 - 6.5) \\ = 19.25\%$$

Calculation of present value of cash inflow of project:

Year	CFAT	PV Factor 19.25%	PV
1	15,00,000	0.839	12,58,500
2	35,00,000	0.703	24,60,500
3	20,00,000	0.590	11,80,000
Total present value			48,99,000
(-) Initial investment			(50,00,000)
Net Present Value (NPV)			(1,01,000)

Initial investment required = 50,00,000

18.14

PART II : CORPORATE FINANCE

Internally generated funds = 10,00,000

Right issue = 15,00,000

12% Term loan = 25,00,000

The term loan processing cost is 1%. Hence, loan amount to be raised –

$$= \frac{25,00,000}{100 - 1} \times 100 = 25,25,253$$

Rights issue has flotation cost of 5%. Hence, amount to be raised by right issue –

$$= \frac{15,00,000}{100 - 5} \times 100 = 15,78,947$$

Calculation of adjusted NPV:

Base NPV	(1,01,000)
Flotation cost of right issue (15,78,947 – 15,00,000)	(78,947)
Processing cost of term loan (25,25,253 – 25,00,000)	(25,253)
Tax benefit on interest on term loan (25,25,253 × 12% × 40% × 2.402)	2,91,152
Adjusted NPV	85,952

Analysis: Since, adjusted NPV is positive, it is suggested to take the project.

morena8074@digdy.com 26-07-2024
19:45

TAXMANN