The landscape of the business environment in India is evolving rapidly. India has grown from a nation looking outward, to a nation being looked at by businesses and investors abroad as a place with opportunity, growth and diversity.

An evolving economy evolves its laws and regulations to suit changing business dynamics and create frameworks to protect interests of investors and stakeholders. The Capital Markets in India have also witnessed significant interest from investors in India and abroad. It is expected that the markets, both primary as well as secondary, shall be receptive to growing businesses in India and provide means of channelizing investments into companies in India. This evolution of the financial system and financial markets brings about a need to remain financially intelligent and aware.

Over the past 35 years, we have seen several businesses grow through phases of ebbs and flows. It has been our motto and endeavour to provide advice which is financially prudent as well as relevant. Our company is supported by a team of enthusiastic and motivated people from different backgrounds with varied educational accomplishments and expertise. The talent pool of our company comprises of Chartered Accountants, Company Secretaries, MBAs, Lawyers as well as Ex-Bankers who have held senior positions at various banks and financial institutions. This mix of people infuses elements of creativity and professionalism in our workplace, which adds tremendous value to the services that we offer. With these years of experience and the support of an able team, we have been able to deliver financially intelligent solutions to suit the requirements of our clients.

With this, it gives me pleasure to present to you the 1st edition of ‘FINTELLIGENCE’, a bi-monthly publication through which we shall provide our thoughts and insights on Capital Markets, Corporate Finance and other such avenues in the world of finance.

Nilesh Vaishnav
Chairman
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The transition from a privately held company to public ownership is an invitation to public to partake in the aspirations and vision of the Promoters. Taking a company public is an event that may be a culmination of a management’s long term objectives to move into the next phase of the growth and development of a business, and for others it may also be an event to unlock value for its existing investors and invite new investors to be part of its growth and value creation process.

For many growing companies, “going public” is more than just selling shares. It’s a signal to the world that the business has made it. That it has what it takes to go public and be public. An IPO can not only provide a company with access to capital to fuel growth and liquidity for founders and investors, but it provides the public market’s unofficial stamp of approval. The act of going public can also serve as a marketing event for a company, to drum up interest in the business and its products or services of the company as well as add to the prestige of the company.

While going public serves as an exciting prospect to channel necessary long term funds, create and enhance its brand, unlock value for current investors and create value for new investors, it does not come without its challenges of being public. A public limited company in India has to gear up its Corporate Governance and abide by laws and regulations that could add to its compliance time and costs, disclose information that could be sensitive to its business operations and competitors, adhere to complex accounting standards, meet expectations of all stakeholders and also limit management’s autonomy compared to when the company was privately held.

Are you prepared to Go Public?

Going public and being public is not for every company. There are a plethora of factors to consider before summoning the Merchant Bankers. These factors include meeting certain financial qualifications set by the various regulators and stock exchanges, the appropriateness of an IPO strategy for your business and business goals, and the market’s receptivity to IPOs in general and for the industry in which the company operates. Hence the decision to go public not only considers whether a company is ready for an IPO, an important factor is – Is the market ready for the company or not. We shall discuss some of these factors below.

Eligibility Criteria for a Main Board IPO

To consider whether the company can be taken public with a larger participation from retail investors and HNIs, certain basic financial requirements are to be met which are set by the Capital Markets Regulator, Securities and Exchange Board of India (SEBI).

- 3 years’ track record of: Minimum Net Worth of INR 1 crore, Net Tangible Assets of INR 3 crores, of which not more than 50% are held in monetary assets;
- Minimum average pre-tax operating profits of INR 15 crores during the 3 most profitable years out of the immediately preceding 5years;
- In case the company has changed its name in last 1 year, 50% of revenues to be from the activity indicated by the company’s changed name, AND
- Aggregate of proposed issue and previous issues in same year does not exceed 5 times its pre-issue net-worth of the company as per the audited financial statements of the preceding year.
If the above conditions are not satisfied, a company can make an IPO only through Book Building Process and allocation of at least 75% of the net offer to public is to be made to Qualified Institutional Buyers (QIBs).

Apart from SEBI, the stock exchanges viz. BSE Limited (BSE) and National Stock Exchange Limited (NSE) also prescribes eligibility criteria to be met before a company approaches them to list its shares on the exchange.

**Listing Criteria**

<table>
<thead>
<tr>
<th>BSE Limited</th>
<th>NSE Limited</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Minimum post-issue paid-up capital of INR 10 crores;</td>
<td>• Minimum post-issue paid-up capital of INR 10 crores;</td>
</tr>
<tr>
<td>• Minimum issue size of INR 10 crores;</td>
<td>• Minimum market capitalization of the Company shall be INR 25 crores.</td>
</tr>
<tr>
<td>• Minimum market capitalization of the Company shall be INR 25 crores.</td>
<td></td>
</tr>
</tbody>
</table>

**Getting prepared to go public**

On arriving at the strategic decision and reasons to go public the next step is to gear up and get ready! Getting ready to go public is a time consuming process, which not only requires time commitment on part of the promoters and key managerial persons of the company, but also commitment to the costs to go public.

**Planning**

The most important step towards a successfully executed IPO process is to have a plan that works for the company. Every company and every management works in a different way and it is imperative to understand the company and its management in the planning phase of the IPO.

In the planning phase the company must evaluate the need to go public and have a business plan in place that justifies the need for equity fund raising. For example, if the company is planning a new project, it must have an idea on the probable cost of project and equity funds required for the project. The plan should also factor in elements such as the growth potential of the company, financial track record, indicative valuation – intrinsic as well as relative and the expected time when the funds are to be raised to get an indication on the timing of the IPO. As per SEBI guidelines, the offer to be made to public in an IPO cannot be less than 25% of the post issue share capital.

**Team IPO**

The right team gets the right results! A Company should set up internal and external teams of persons who are experts in the matters to be considered and activities to be carried out. Internal teams can be brought together from the existing talent pool of an organization or new team members shall have to be taken on board for the IPO and operations going forward. Internal talent pool shall include persons who have a deeper understanding of finance, secretarial aspects, operations, investor relations etc.

A Company naturally cannot do all the activities on its own. There are many external consultants and agencies which need to be brought on board either voluntarily or as required by laws and regulations. These external shall include merchant bankers, advisors, auditors, registrar of companies, legal advisors, corporate bankers, Registrar, Syndicate and Sub Syndicate Members, Advertising Agencies and certain other agencies during the issue process.

**Corporate Governance**

Increasingly regulators, investors and market participants have been giving greater importance to corporate governance, and rightfully so. In a public company the promoters of the company share ownership with public investors which creates a need to separate management and ownership in the interest of all shareholders and stakeholders. While preparing to go public, a company needs to align its governance standards to have a greater degree of transparency in its operating framework and disclosures. Corporate governance establishes a system where directors are entrusted with duties and
responsibilities in relation to the direction of the company's affairs. Corporate governance requirements in India include several aspects such as appointment of Independent Directors, creation of Audit Committees, having greater transparency in related party transactions, etc. While preparing to go public, a company is required to incorporate all the requirements of Corporate Governance in India.

Timelines
With the multitude of works that goes into getting ready for an IPO, there is little chance of getting there without a firm timeline in place. Experience of team members, advice from the merchant banker(s) and advisor(s) to the company and legal counsel serve as valuable inputs to plan the process of an IPO and draw up concrete timelines to get ready to hit the market. Estimates of time should be made for planning, developing the issue and issue structure, due diligence, preparation of the prospectus, approval process, finalizing the offer document, marketing and post issue requirements. Timelines should be rational and realistic keeping in mind the readiness of the company, team strength and structure and macro-economic consideration.

Due Diligence and Preparing the Offer Document
A thorough due diligence of a company is absolutely essential in an IPO process. The SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009, as amended, prescribe due diligence requirements in an IPO process and require the Lead Manager (Merchant Banker) to submit due diligence certificates at various stages of the transactions on aspects mentioned in the offer document. The objective of due diligence is to collect information about the issuer that helps the Lead Manager draft as well as assess disclosures that are made in the offer document. Broadly due diligence can be bucketed into three aspects – Business Due Diligence, Financial Due Diligence and Legal Due Diligence.

Business due diligence includes obtaining a keen understanding on the business of the company, its policies, processes, key customers and suppliers as well as material business arrangements and agreements. It also includes an evaluation of how the company was formed the various business its progresses through as well as material events that have taken place in the journey of the company so far. The diligence considers not only the company itself but also a diligence of group companies and promoters of the companies. Forward looking statements and financial projections for future years cannot be written in the offer document.

Financial due diligence includes an evaluation and understanding of the financial statements of the company, its accounting policies and practices, restated financial statements, build-up of shareholding, as well as factors such as its working capital cycle, borrowings from banks and financial institutions, an analysis of its tax filings, material agreements and documents that shall have a bearing on its financial statements and such other matters.

Legal due diligence includes an evaluation and understanding of the corporate and other legal compliances of the company from inception till date, whether the same have been done regularly and on time, understanding the various litigation filed against/by the company and its promoters, status and applicability of any statutory approvals and various other matters which the company is legally bound to follow and comply with.

The due diligence has a large bearing on the Risk Factors that are drafted in the document and disclosed to investors.

Marketing the Issue and Pricing
Marketing efforts usually begin after receiving SEBI's approval on the offer document. The offer document contains a large amount of information which may be suitable as the most appropriate marketing material for all types of investors. Marketing material should be created that suits the understanding and requirements of various types of investors. Road shows are organized to create an awareness of the IPO in the market and give an opportunity to market participants to interact with the company and its merchant bankers. Typically road show presentations cover details of the company, its management, vision, strategy, historical financials, end use of funds raised etc. As a marketing strategy reservation of the IPO are made for specific classes of investors such as Qualified Institutional Buyers (QIBs), High Net-worth Individuals (HNIs), Foreign Institutional Investors (FIIs), Employees and Retail Investors.

Pricing is an extremely important consideration which has a large bearing on the success of an IPO. The level of interest the market has towards a company's IPO is an important factor in its pricing. Pricing is driven by several factors such as
current economic environment, performance of the company compared to market peers, prices of comparable companies listed on stock exchanges, anticipated future performance of the company from the end use of funds raised, trust of promoters in the market etc. Keeping in touch with the market will create an understanding on optimum pricing of an issue.

Issue Closure and Listing
On successful completion of an IPO, a company has to complete the post issue formalities of allotment of shares to subscribers to the issue based on the price discovered in a 100% book building issue and certain other legal formalities. Once the post issue process is completed the lead managers coordinate with the relevant stock exchange(s) to get the shares listed on the stock exchanges. Under the current IPO framework in India, it takes 12 days for a company to be listed on the Stock Exchange(s) post completion of the issue.

Conclusion
Capital Markets play a vital role towards mobilizing funds for industries as well as create investment opportunities for investors and contribute to their wealth creation. An IPO requires careful and detailed planning and coordination between the Management, Merchant Banker(s) and other agencies and advisors. Meticulous adherence to laws and regulations, statutory compliances, adequate disclosures and strong corporate governance are paramount in the issue process.
Introduction

Working capital is a measure of company's efficiency and short term financial health. Working capital involves inventories, accounts receivable and payable, and cash. Decisions relating to working capital and short-term financing are referred to as working capital management. Managing Working Capital involves managing the relationship between a company's current assets and current liabilities. Hence working capital and its management is essential to ensure that the company is able to continue its operations with sufficient liquidity and optimum mix of receivables, inventory, cash & creditors.

Basis of working capital management

Working capital management primarily involves operating decisions for a Company and the decisions for its management are not taken in the same manner as capital formation or investment decision. Working capital decisions are based on Cash Flows and Profitability.

- Cash Flow: Cash flow should be adequate to meet a company's liquidity needs. In business cash is generated from the realization of debtors and net cash is retained in the business after meeting expenses of purchase of raw materials, creation of inventory and making payments to creditors. This is known as the cash conversion cycle - The net number of days from the outflow of cash for raw material to inflow of cash from the customer. This tool for decision making takes into consideration a holistic view of business operations and corresponds to the time that cash is blocked in business operations. The faster the conversion cycle the lower net time, which eventually retains liquidity in business operations.

- Profitability: Management decisions on quantum of credit and inventory depend on the difference between the income earned due to higher inventory and debtor levels or lower creditor levels and the costs (incurred/capital costs) associated with it. An optimum balance of working capital levels shall be based on such profitability concerns prevalent in the industry in which the company operates.

Trade-off between Liquidity, Risk and Return

In managing working capital there is sometime a dilemma to achieve desired trade-off between liquidity and profitability. It is commonly understood that higher risk will result in higher return. Thus, companies with high liquidity may have low risk and hence low profitability. Conversely, companies that have low liquidity may, have high risk and hence high profitability. However, a trade-off between returns and liquidity is essential to manage risks associated with the business, be it risk of actual loss in business or opportunity loss of business.
Working Capital Risks and their Mitigating Factors

It is important to understand the working capital requirements in a broader segment of industry prior to ascertaining risk associated with each component; table below highlights the same:

<table>
<thead>
<tr>
<th></th>
<th>Capital Goods</th>
<th>Manufacturing**</th>
<th>Retail</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventories</td>
<td>High Volume of WIP and Finished Goods</td>
<td>High Volume of WIP and Finished Goods</td>
<td>Usually low volume</td>
<td>None or very low levels of inventory</td>
</tr>
<tr>
<td>Trade Receivables</td>
<td>High levels of trade receivables</td>
<td>High levels of trade receivables</td>
<td>Low levels as goods are bought in cash</td>
<td>Moderate levels</td>
</tr>
<tr>
<td>Trade Payables</td>
<td>Low to medium level of trade payables</td>
<td>Low to medium level of trade payables</td>
<td>High levels of trade payables due to large purchase of inventories</td>
<td>Low levels of payables</td>
</tr>
</tbody>
</table>

** Manufacturing concerns have peak level requirements and should align the level of working capital accordingly.

The above mentioned industries carry varied degree of risks; both systematic and unsystematic. Machinery and Capital Goods industries are exposed to systematic risk because of their nature especially during economic slowdown and change in government policies. They have higher inventory holding periods as compared to other industries and require higher working capital, on the other hand manufacturing, retail and service industries have moderate to low requirement working capital. We shall focus on Unsystematic risk attributed to internal factors governing the organization.
Inventory

In inventory management, the major risk for businesses is the availability of raw material at the right price on a consistent basis to enable it to carry on its business operations. Raw material in chemical industry, petroleum, cotton, metals, fertilizer, gold & jewelry are highly price sensitive resulting in increased volatility. It either tempts to increase inventory when prices are low and vice-versa in times of escalated prices. For many other industries the availability of raw material is to be planned well in advance to ensure business operations are not stalled. Some of the mitigating factors of these risks could be:

- Appropriate price and quantity hedging
- Building inventory based on assessed requirements
- Use of Letter of Credit and Buyer Credit to reduce costs wherever appropriate
- Well planned manufacturing operations
- Avoiding speculative transactions
- Implementing JIT or EOQ system for inventory management
- Having the right supply chain in place and monitoring the same
- Use of Bill discounting or LC Discounting from Banks/Financial Institutions
- Use of Factoring services
- Incentivizing customer through discounts for faster realization
- MIS which provides timely information on receivables ageing
- Well placed system for credit quality checks of receivables
- Incentivizing customer through discounts for faster realization
- Use of Factoring services
- Use of Bill discounting or LC Discounting from Banks/Financial Institutions

Receivables

Receivables management could have risks of poor quality of receivables leading to non-realization of receivables or untimely realization of receivables. Systems are very essential to ensure the credit quality of receivables and timely realization of receivables. Higher receivable periods often lead to stress in the liquidity position of a company. Some of the mitigating factors of these risks could be:

- Well placed system for credit quality checks of receivables
- MIS which provides timely information on receivables ageing
- Incentivizing customer through discounts for faster realization
- Use of Factoring services
- Use of Bill discounting or LC Discounting from Banks/Financial Institutions
Payables
The primary risk associated with trade payables is untimely payment of creditors and other current liabilities which could result into higher pay-outs in terms of interest and late payment charges. Such costs add on to the need for working capital and have an impact on profitability as well. Untimely payment of trade payables has a larger impact on the creditworthiness of the company and drive away suppliers from doing business with the company. Some of the mitigating factors of these risks could be:

- **Management Information Systems**
  Today’s world of business and finance is complex. Transactions are numerous and resources to monitor them are limited. Technology and Management skills have played a significant role in bridging this gap. A small investment in the right electronic and manual methods of monitoring and controlling operations can lead to significant improvements in managing working capital, reducing costs and improving efficiency. An inefficient MIS leads to mutilated output and disarrayed data analysis resulting in erroneous conclusions. Management Information Systems may include aspects including but not limited to production planning, inventory budgeting and inventory management, sales and distribution management, receivables management, purchases and payables, cash management etc. Management information, to be relevant, has to be timely and accurate.

- **Treasury Management**
  Changes in exchange rates affect prices to raw materials as well as realization of finished goods. Companies with imports and exports should constitute an appropriate hedging policy suited to their business operations and use financial products to manage risk of fluctuation in exchange rates, interest rates etc.

- **Financial Products and Facilities**
  In today’s evolved banking systems, various avenues are available for managing working capital in an effective and cost efficient manner. In assessing working capital peak level requirements are to be estimated and planned for, lack of which results in shortage of liquidity. At times it has been observed that the need for working capital has not been assessed
appropriately and funds necessary for working capital are utilized for capital formation which causes significant stress to business operations. Several financial products and facilities are available in the banking and financial system today to assist with the assessment and financing of working capital. These products may be fund based or non-fund based. The financial products and facilities include, Cash Credits, Working Capital Demand Loans, Commercial Paper, Factoring, Forfeiting, Foreign Currency Demand Loans, Letter of Credit, Buyers’ Credit, Bank Guarantees etc. In assessing the limits and facilities that may be sanctioned to companies, banks would consider several aspects such as past business operations, current business operations, future business operations and financial projections, several ratios that give indications of net working capital, levels of trade receivables and payables, debt equity ratio, creditworthiness of receivables, among other factors. The right representation goes a long way in securing the right financial facilities for current and future anticipated business operations.

Conclusion

Good management of working capital shall ensure that a business has the cash and resources available to have successful and healthy business operations and meet its current liabilities, without which a company shall always be under the risk of having a working capital deficit thereby hampering its business operations. In the short term this can damage the profitability of the business, and affect its operations. In the long term, poor working capital management can compromise a company’s eligibility for business loans and damage its ability to attract potential investors. In recent times, there have been greater bankruptcies on account of working capital deficits and unmanaged cash flows such that companies have not been able to repay their debt obligations. The right systems and policies in place to manage business operations as well as the right mix of financial products and facilities from banks and financial institutions to ensure cost effective liquidity shall enable companies to manage such risks of working capital deficits and maintain a healthy business cycle.
Introduction
For most business owners, the business represents a vast majority of the owner’s net worth. A business owner understands that the business that is created is run and managed by an able team of human capital that drives processes, delivers results, adds to the growth and success of an organisation ergo contributing to the growing net worth of the business and business owner. This pool of work force adds to the growth and success of an organisation when it feels connected to the organisational ethos and their career objectives are aligned with the growth objectives of business owners and senior management.

In today’s business environment, management philosophy has evolved to have a more inclusive approach by harnessing the skill sets of their key employees, including them in the major decision making process, making them responsible for delivering results in key areas of work and aligning compensation structures in line with overall management objectives. Over the years an understanding of ‘working with’ an organisation has evolved which demonstrates the need to align career objectives and aspirations with that of the management as no company can really grow unless the management and key employees have an aligned purpose towards the business.

One such tool available to business owners to make employees feel connected and aligned to the organisational objectives is the use of an Employee Stock Option Plan (ESOP). Under this scheme, an option is given to the employee to acquire shares of the company known as stock options and are granted by the employer based on certain key considerations which may include, among others, performance, time spent with the organisation, seniority etc. Companies offer shares as an employee benefit and as a deferred compensation.

The main purposes of an ESOP are motivating, rewarding, attracting talented employees and retaining human capital. In recent times, ESOP has become a popular tool to achieve these purposes. In countries across the world ESOPs are used as tools of motivating employees, creating post retirement structures and leveraging off the effects of available tax benefits specific to those countries.

History
Interestingly enough while ESOPs are used as a tool to motivate and retain key employees, the birth of ESOPs is said to have been from saving employees from losing their jobs. In 1956, Louis Kelso, a corporate and financial lawyer cum merchant banker, was charged with the responsibility of developing a succession plan for Peninsula Newspapers, Inc. The Co-Owners, both in their 80’s were reluctant to sell their company and wanted to explore ways in which the ownership could be transferred to its workers and employees. Kelso suggested that the employees, who lacked the capital to buy the shares from the Co-owners, borrow from the Stock Bonus Plan of the Company (an IRS qualified profit-sharing plan which allowed the loan to be paid off from pre-tax dollars) to purchase the shares. This was a successful plan which is now referred to the first ESOP in the world.

Many of the earlier ESOP structure in the United States of America were designed to prevent a buy-out by competitors and transfer ownership to employees in a structured manner. However, as time and laws have evolved the application of ESOPs have changed form and evolved based on the requirements of the transaction, legislation and need of the hour. Today ESOPs are being used popularly as a tool to motivate, retain and reward employees based on the performance of the business based on their performance in the business.
Merits and De-merits of ESOPs

ESOPs offer significant advantages to Companies as well as Employees. However, there have been instances where poorly structured ESOPs have resulted in ESOPs being unpopular in organisations or counter-productive from a Company point of view. Some key merits and de-merits of ESOPs for Companies and Employees are as under:

<table>
<thead>
<tr>
<th>Merits</th>
<th>De-Merits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Companies</strong></td>
<td><strong>Employees</strong></td>
</tr>
<tr>
<td>• Align employees’ interests with those of promoters and shareholders;</td>
<td>• Financial rewards, linked to individual and organisational performance or a long term savings and ownership structure;</td>
</tr>
<tr>
<td>• Recruit or retain key employees, increase loyalty and reduce staff turnover;</td>
<td>• An increased sense of ‘ownership’ and association with the enterprise;</td>
</tr>
<tr>
<td>• Compensate for lower salaries and relieve pressure on cash flow;</td>
<td>• Improved awareness about the ‘big picture’ decisions; directions and corporate plans of the enterprise;</td>
</tr>
<tr>
<td>• Lower the supervision required of employees;</td>
<td>• Better partnership and communication between management and their employees;</td>
</tr>
<tr>
<td>• Increase innovation and motivate employees to become more productive;</td>
<td>• ESOPs are often linked with employee engagement and involvement and this presents the opportunity to influence decisions about products and process.</td>
</tr>
<tr>
<td>• Increase shareholder value;</td>
<td>• Employees may have all their eggs in one basket. Essentially the employee is over exposed to the company’s shares, so if the company does not perform or worse goes into administration the employees investment is lost;</td>
</tr>
<tr>
<td>• Improve communication between employee and managers and increase cooperation;</td>
<td>• The share price can decrease and this can impact the value of the holding for an employee;</td>
</tr>
<tr>
<td>• Increase employee job satisfaction;</td>
<td>• Employees cannot predict or influence share prices despite improved performance and hence as a result the plan has no value for them.</td>
</tr>
</tbody>
</table>

Key Regulations in India to Structure an ESOP

Applicable to Listed Companies

SEBI (Employee Share Based Payments) Regulations, 2014

Listed Companies in India are required to structure their ESOP plans taking into consideration the SEBI (Employee Share Based Payments) Regulations, 2014. The guidelines govern the form and manner in which ESOPs in its various forms are to be offered to employees of listed companies. As per these guidelines, no ESOPs can be issued to employees unless they conform to these guidelines and are approved by the shareholders of the company through a special resolution in the general meeting. The guidelines lay down the various committees that are to be formed for operating the ESOP scheme such as the Compensation Committee etc. as well as several specific parameters that are essential to structuring an appropriate ESOP such as Pricing norms, Lock In Period, Transferability of ESOPs, process of Listing the Shares issued under an ESOP etc.
As part of the process of getting the shares of an ESOP listed on a recognised Stock Exchange in India, a SEBI registered Merchant Banker is required to certify the ESOP scheme and state that it is in conformity with the current ESOP guidelines of SEBI.

SEBI (Prohibition of Insider Trading) Regulations, 2015

While Structuring an ESOP scheme and operating it, specific attention must be taken to the SEBI (Prohibition of Insider Trading) Regulations, 2015 to ensure that the scheme is being operated under due compliance with laws and regulations and the scheme is not being used as a tool for Insider Trading.

Applicable to all Companies

Companies Act, 2013 and Companies Rules, 2014

The primary legislative document for corporate matters in India is the Companies Act 2013 read with the Companies Rules 2014 for all notified sections and rules under the new Act. For all sections and rules not yet notified the erstwhile Companies Act 1956 shall be applicable.

The Companies Act 2013 read with Companies Rules, 2014 prescribe several important provisions that are imperative to structuring an ESOP scheme, for example, Employees under a Scheme are defined and prescribed under Rule 12(1) read with sections 2(37) and 197(7) which specifically exclude Independent Directors, Promoters or Promoter Group, Directors who hold directly or indirectly more than 10% of outstanding equity shares of the Company. Several procedural aspects such as requirements of special resolutions, approval by the Board in certain matters, determination of exercise price as well as operation of an ESOP scheme through a Trust mechanism are prescribed in the Act read with the Rules. Hence, it is essential that while structuring an ESOP scheme due care be taken to follow the regulations and rules applicable to the form and manner of the ESOP scheme as well as its operation to avoid any legal complications in the future.

Stages of an ESOP Scheme

<table>
<thead>
<tr>
<th>Activities</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Structure</td>
<td>At the inception of the ESOP life cycle is the structuring of an ESOP scheme in consultation with the promoters, directors and management of the company. An ESOP is structured by analysing the past history of the company, its future plans, mix of staff, performance indicators and intention of the management to retain and reward certain key employees.</td>
</tr>
<tr>
<td>Grant Date</td>
<td>The Grant Date in an ESOP scheme is the date on which the option to purchase shares or participate in an ESOP scheme is granted to an eligible employee. Eligibility criteria are decided by management, directors or a committee appointed by the Board of Directors.</td>
</tr>
<tr>
<td>Vesting Conditions</td>
<td>Vesting conditions are parameters laid down by management, Board of Directors or a committee appointed by the Board of Directors to analyse and understand whether the employee has served the required tenure in the company or has met the stated performance parameters. Based on this assessment, the granted options vest to the employee and the employee is eligible to exercise such options.</td>
</tr>
<tr>
<td>Vesting Date</td>
<td>The vesting date is the date on which the options vest to an eligible employee. It is also the earliest date on which the employee can exercise the options vested under the plan/scheme.</td>
</tr>
<tr>
<td>Exercise Period</td>
<td>The exercise period is the time frame given to an eligible employee within which the options that have vested can be exercised. In certain cases, if an employee does not exercise the options that have vested within the exercise period, the vested options lapse. In other cases, the Board of Directors or a committee appointed by the Board of Directors can extend the exercise period giving some additional time to the eligible employee to exercise the options that have vested.</td>
</tr>
<tr>
<td>Exercise Date</td>
<td>The date on which an eligible employee exercises the options that have vested is the Exercise Date</td>
</tr>
<tr>
<td>Exercise Price</td>
<td>The options granted and vested to the employee usually state a price at which the options can be exercised. The price may be predetermined or may be a price to be arrived at the time of exercising the option. This price is known as the Exercise Price.</td>
</tr>
</tbody>
</table>
Tax Considerations

In the ESOP life cycle of India, from a Taxation perspective much has changed over the years. Until 1999 there were no specific provisions governing taxation of benefits accrued under an ESOP and a practice emerged where ESOPs were considered perquisites and taxed accordingly on the difference between the Fair Market Value (FMV) of the shares on the date of vesting and the exercise price.

When Fringe Benefits Tax (FBT) was introduced, in the period between 2007 to 2009 the employer was required to pay a FBT on the benefits provided to the employee from such ESOPs.

At present, ESOP benefits are taxed as perquisite as a part of an employee’s income from salary. The employer is required to deduct tax at source on the perquisite value.

For listed Companies, in order to determine the taxation of ESOPs the Fair Market Value shall be determined based on the price per share quoted on the stock exchange on which it is listed. However, for Unlisted Companies, in order to arrive at the FMV a valuation of shares needs to be done. This is governed under section 17(2)(vi) of the Income Tax Act, 1961 and clause (iii) of sub rule 8 of Rule 3 of the Income Tax Rules, 1962. The Rule states that the fair value will be that which is arrived at by a SEBI registered Merchant Banker in India on the date of exercising the option or at any date (not more than 180 days) earlier than the date of exercising of the option.

Conclusion

In terms of Industry participation, ESOPs have been most popular in the IT/ITeS companies in India with a primary focus on rationalising their salary spends with alternative equity based compensation as well as retaining key talent. That being said, several other companies in Financial Services, Healthcare as well as in Manufacturing are utilising this tool to retain key talent, align organisations objectives, create a sense of ownership for employees and in turn contribute to the wealth creation of employees.

ESOPs have proven to be a motivational tool to improve employee performance and meet organisational objectives. However, it is essential that ESOPs be structured in the right manner, keeping in mind the current and future plans of the Company as well as current regulations in India. Poorly structured ESOPs offering poor valuation gains to employees have often resulted in the ESOP scheme being unpopular in Companies and have reduced employee morale. There is no set basis on which an ESOP can be structured, due consideration has to be given to the objectives and vision of the management, culture of the organisation as well as performance criteria of the business.
Stock market plays a pivotal role in the growth of the industry and commerce of a country affecting, to a great extent, the economy of a country. The government, industry and even the central banks of countries keep a close watch on the happenings of the stock market.

Stock exchanges in India hold a place of prominence not only in Asia but also at the global stage. BSE Limited (BSE) is one of the oldest stock exchange across the world, while the National Stock Exchange Limited (NSE) which came into existence in 1992 is among the best in terms of sophistication and advancement of technology, also the third biggest stock exchange in Asia and among the five biggest stock exchanges in the world in terms of transaction volume. The stock markets in India really picked up after the opening up of the economy in the early nineties. There are over 9,000 companies listed on the stock exchanges across the country.

History of Indian stock market - Pre-independence scenario
The stock market in India dates back to the close of 18th century when the East India Company used to transact loan securities. After 1865, a number of financial failures and problems in speculative activity led brokers to form an association in 1875, known as “The Native Share and Stock Brokers’ Association” (also known as “The Bombay Stock Exchange”). Various stock exchanges were established during the period 1894 to 1947 including Ahmedabad (1894), Calcutta (1908), Madras (1920), Indore (1930), Punjab (1936), Uttar Pradesh and Nagpur (1940), Hyderabad (1944) and The Delhi Stock Exchange Association Limited (1947).

Post-independence scenario
The depression witnessed after the Independence led to the closure of several exchanges in the country. Most of the exchanges that survived were in dire conditions till 1957. The Exchanges that were recognised under the newly enacted Securities Contracts (Regulations) Act, 1956, were: Bombay, Calcutta, Madras, Ahmedabad, Delhi, Hyderabad, Bangalore and Indore Stock Exchange. Many more stock exchanges were established during 1980’s, namely: Cochin (1980), Uttar Pradesh (at Kanpur, 1982), Pune (1982), Ludhiana (1983), Guwahati (1984), Kanara (at Mangalore, 1985), Magadh (at Patna, 1986), Jaipur (1989), Bhubaneswar (1989), Saurashtra & Kutch (at Rajkot, 1989), Vadodara (at Baroda, 1990), Coimbatore, OTCEI (Over The Counter Exchange of India) and Meerut Stock Exchange.

SEBI – Regulatory authority
Securities and Exchange Board of India (SEBI) was set up on April 12, 1988 as a non-statutory body. Later it became a statutory body under the Securities and Exchange Board of India Act, 1992. The Act entrusted SEBI with comprehensive powers for overall development and regulation of the securities market and regulate and control the business on stock exchanges. Historically, Central Government /SEBI under section 4(1) of the Securities Contracts (Regulations) Act, 1956, had granted recognition to 25 stock exchanges.

The economic relevance and raison d’être of the institution of stock exchange lies in its effectiveness in performing successfully two basic functions:

- to facilitate resource raising from the community for financing corporate sector and government for various activities; and
- to provide an organised market place for the investors to freely buy and sell securities
Genesis/emergence of Regional Stock Exchanges (RSEs)

RSEs, have its genesis in a circular issued by Ministry of Finance, Government of India vide F. No. 14 (2)/SE/85 dated September 23, 1985 which stipulated that all, then existing listed companies were required to be listed on the stock exchange located in an area where the registered office or the main works/ fixed assets of the company were situated. Since there was little automation and modern advanced telecommunication systems were not very much prevalent, these stock exchanges catered to the needs of the industry for mobilization and regional allocation of capital and resources and also met the needs of regional investors in the remotest parts of the country. Over a period of time, stock exchanges came to be set up almost in every state. These stock exchanges set up regionally were known as the Regional Stock Exchanges (RSEs).

Abolition of the concept of regional listing

With the availability of nationwide access to a liquid market, the need for compulsory listing on the RSEs lost its relevance. Regional listing proved to be an unnecessary burden in terms of cost to companies which were listed on NSE and BSE. SEBI therefore issued the SEBI (Delisting of Securities) Guidelines, 2003 vide circular SMD/Policy/Cir-7/2003 dated February 17, 2003 which, inter-alia, did away with the requirement for existing companies to remain listed on any stock exchange merely because they were incorporated or did business from a region, provided such companies were also listed on either of the two national exchanges. Freedom was given to companies to list on a stock exchange of their choice. Companies, therefore, chose to remain listed on BSE and NSE and opted for delisting from the RSEs. This resulted in further loss of revenue by way of listing fees for the RSEs.

Consequent to issuance of the SEBI's circular referred to in the foregoing paragraph, the Government of India vide circular No.F.No.1/9/SE/2003 dated April 23, 2003 inter-alia, withdrew the requirement relating to compulsory listing by companies on RSE. The concept of RSEs was, thus, finally abolished.

Causes for the decline of RSEs

After the emergence of nationwide trading terminals, developments in technology and abolition of compulsory listing on regional stock exchanges, trading in equity and equity derivative segments was concentrated in two exchanges namely, Bombay Stock Exchange Ltd (BSE) and National Stock Exchange Ltd (NSE). The smaller/regional stock exchanges which did not have trading on their own platform became defunct due to lack of sustainable operations and the shareholders of companies listed on these stock exchanges did not have an exit option, as these companies were not listed on stock exchanges having nationwide trading terminal. The continued existence of defunct stock exchanges requires SEBI to carry out various regulatory, supervisory and administrative activities which is unproductive and regulatory burden on the resources of SEBI.

Post completion of the process of corporatization and demutualization a committee was formed to review the future role of the RSEs and their subsidiaries. Three factors have been primarily responsible for downfall of RSEs:

- the advent of automated trading and extension of nationwide reach of BSE and NSE which offered a large and liquid market to investors across the country;
- the introduction of uniform rolling settlement from June 2001 in place of account period settlement with varying settlement cycles; and
- the abolition of the concept of regional listing.

Present status of regional stock exchanges

Over the years several methods were adopted to revive RSEs, however none could provide the desired results. In terms of the exit circular, SEBI, vide its various exit orders, derecognized around sixteen stock exchanges during the period January 2013 to June 2015 including ISE and OTCEI formed with the object of providing national level liquidity.

Compulsory exit process has been initiated in the cases of Magadh Stock Exchange Ltd. and Vadodara Stock Exchange Ltd., Ahmedabad Stock Exchange Limited and Pune Stock Exchange Limited have applied for exit and the process of exit is underway. Calcutta Stock Exchange is still a recognized stock exchange as it continues to meet certain guidelines specified by SEBI in the exit orders and circulars.
Exit policy for de-recognized/ non-operational stock exchanges
SEBI vide circular dated December 29, 2008 formulated an exit policy for stock exchanges which permitted the exchanges to exit from functioning as a stock exchange while retaining their movable and immovable assets, subject to compliance with certain conditions.

The Exit Circular states, inter-alia, that the stock exchanges having annual trading turnover on its own platform of less than Rs. 1000 Crores can apply to SEBI for voluntary surrender of recognition and exit at any time before the expiry of two years from the date of issuance of the circular, i.e., latest by May 29, 2014, failing which SEBI may proceed with compulsory exit of such stock exchanges. Therefore, all the de-recognized/non-operational stock exchanges voluntarily or compulsorily have to exit from the business of a stock exchange.

The road forward for companies exclusively listed on such exchanges
Subsequent to issuance of the above circular, certain issues arose in this regard, primarily on exit option to shareholders of exclusively listed companies and utilization of assets by de-recognized stock exchanges. This exit policy was subsequently reviewed by the SEBI Board in its meeting held on April 02, 2012 and the revised policy for exit of derecognized/non-operational stock exchanges dealt with the interest of a) shareholders of exclusively listed companies: by providing an exit option, b) trading members: by providing trading opportunity through subsidiary route and c) shareholders of stock exchanges: by allowing them to deal with assets of stock exchanges after payment of all dues.

The same was implemented vide circular dated May 30, 2012 ("Exit Circular") as under:

- To facilitate the listing of these exclusively listed companies on recognized Stock Exchanges by allowing relaxation in their listing criteria in the interest of investors viz., by providing differential listing criteria i.e. Market Capitalization, Dividend paying track record, profitability, and paid-up capital.
- Exclusively listed companies on such bourses, which failed to obtain listing on any other stock exchange, will cease to be a listed company and will be moved to the dissemination board by the stock exchanges.

Dissemination board:
- To safeguard the interest of investors, a mechanism of dissemination board has been set up by stock exchanges having nationwide trading terminals;
- Under this mechanism, a buyer is given an opportunity to disseminate their offers using the services of brokers of the stock exchanges hosting such board.

Features of dissemination board:
- Exiting Stock Exchanges will be required to enter into an agreement with at least one of the stock exchanges with nationwide trading terminals providing the Dissemination Board;
- Exchanges having nationwide trading terminal will not have a listing agreement with these companies. However, information received from such companies will be disseminated;
- The buyers/sellers will be required to register with brokers of the exchanges where the dissemination board is set up;
- No contract note is required to be issued for such transactions;
- The matched trades will not be settled through the stock exchanges/ Clearing Corporation mechanism and hence, there will be no recourse to the Settlement/ Trade Guarantee Fund and Investor Protection Fund of the Exchange for the trades on Dissemination Board;
- The exiting Stock Exchange as well as exchange providing dissemination board will give wide publicity about the dissemination board in one leading national daily and one local daily. The stock exchanges hosting dissemination board shall issue uniform operational guidelines for the dissemination board.
Options given to companies exclusively listed on de-recognized / non-operational stock exchanges
SEBI vide circular dated May 22, 2014 advised the non-operational stock exchanges/exclusively listed companies of such stock exchanges to comply with the following:

**Listing:** Exclusively listed companies of non-operational stock exchanges may opt for listing in nation-wide exchanges.

**Voluntary Delisting:** Such exclusively listed companies may opt for voluntary delisting from such stock exchanges. In compliance with SEBI (Delisting of Equity Shares) Regulations, 2009, nation-wide stock exchanges are advised to provide a platform to facilitate reverse book building for voluntary delisting. To facilitate voluntary delisting, SEBI has waived off the requirements of Minimum Public Shareholding.

**Dissemination Board:** Non-operational stock exchanges to shift those companies that have not opted to list in nation-wide stock exchanges or voluntarily delist from the non-operational stock exchanges, to the Dissemination Boards of the nation-wide stock exchanges. Until listing, these companies shall continue to remain in the dissemination board.

Thereafter, SEBI received representations from the exclusively listed companies that although they are interested and eligible to migrate to the main board of nationwide Stock Exchanges, they are unable to list on nationwide stock exchanges due to shortage of time and hence sought time for listing. Considering the concerns expressed by exclusively listed companies and in the interest of investors in such companies, it was proposed to specify a time line of eighteen months, within which such companies shall obtain listing subject to compliance with the listing requirements of the nationwide stock exchange, subject to the several conditions, some of which were: listing to be permitted to only those securities that were already listed on the non-operational exchanges, there is no material change in their shareholding pattern, companies that have moved to the dissemination board shall be able to migrate to the main board subject to certain compliances and nationwide stock exchanges to provide a dedicated cell to process applications of such companies listing on the main board and those on the dissemination board.

SEBI has directed that all promoters and directors of such companies, who fail to provide the trading platform or exit to its shareholders, even after the extended time of eighteen months, shall have to undergo stricter scrutiny for their any future association with the securities market.
Conclusion

Several technological advances have made the functioning of Regional Stock Exchanges draconian leading to the regulators to believe that it is in the interest of investors to have access to main board stock exchange or get an exit option in the form of delisting from RSEs. While some consider the move by the regulator harsh from the point of view of the stock exchanges, increasingly it was becoming difficult for RSEs to remain financially viable and most of the RSEs were debared and did not have any trading activity since the past few years. Many experts believed that it was in a way inevitable as national exchanges such as BSE and NSE have expanded their reach across the country making the regional bourses irrelevant. While change is a constant phenomenon, the RSEs contributed tremendously to the creation of stock markets in India, proving a means to raise capital for companies and channelising savings of investors. Indian investor should give thanks to these RSEs who have contributed to nation building and respect the work carried out over the years.
About Vivro
Vivro is a Financial Services Group engaged in the business of providing Investment Banking, Corporate Finance, Corporate & Financial Advisory and Asset Resolution Services. Vivro Financial Services Private Limited is a Merchant Banker registered with the Securities Exchange Board of India (SEBI) and Vivro Capital Advisors Private Limited is a Company that provides Asset Resolution Services to Banks and Financial Institutions.

Our Team
Vivro is founded by experienced professionals who have been engaged in Capital Market and Corporate Finance services for the last three decades. Our company is supported by a team of more than 90 enthusiastic and motivated people from different backgrounds with varied educational accomplishments and expertise. The talent pool of our company comprises of Chartered Accountants, Company Secretaries, MBAs, Lawyers as well as Ex-Bankers who have held senior positions at various banks and financial institutions. This mix of people infuses elements of creativity and professionalism in our workplace, which adds tremendous value to the services that we offer. With a strong team in place, Vivro is able to deliver value added solutions, tailor-made to suit the requirements of our clients.

Our Value Proposition
Vivro has emerged as a knowledgeable and reliable partner for businesses both in India and Abroad. Vivro has catered to several companies over the years and it enjoys tremendous confidence from clients, investors, lenders, brokers and financial institutions. Our advisory services and our ability to access the right capital for the right investment opportunity have resulted in significant stakeholder value creation. Vivro has a disciplined and demonstrated process specifically tailored for each client and transaction to maximize value.

Capital Market Services
Our Capital Markets team assists private companies to raise capital from capital markets through Initial Public Offers of Equity & Debt, Placements, while they assist public limited companies in a host of capital market transactions ranging from Rights Issue, Qualified Institutional Placements, Institutional Placement Program, and various other Merchant Banking compliances relating to Takeover, Open Offers, Buybacks, Delisting, etc.

Corporate Finance
Vivro syndicates and structures debt finance through several instruments such as:
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- Factoring/Commercial Paper
- Inter Corporate Deposits, Structured Finance, Infrastructure Financing, etc.
Corporate Advisory
Our corporate advisory services:
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- ESOP Structuring and Valuation

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Our Business Consulting Services:
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- Corporate Governance and Reporting
- Corporate Organization
- Succession Planning
- Entry into India Services

Asset Resolution
Vivro is empaneled with over 30 banks and carries out effective strategies for recovery of NPA accounts, enforcement of assets under law, arranging for sale of assets or eventual settlement to affect Final Recovery of advances on behalf of these banks and financial institutions.
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