4

GREEN SHOE OPTION

4.1 Introduction

One of the problems in an IPO has been the post-issue price decline as compared to the issue price. This often has left retail investors feeling high and dry. A solution to this problem is the introduction of the Green Shoe Option in the issue.

Green Shoe Option, as a concept, has been around for several years in international markets. Even in India it was popular amongst the Bonds issued by ICICI, IDBI, e.g., Flexibonds, Safetybonds, etc. However, it was introduced in the Indian equity markets only recently. To describe it in layman terms, a Green Shoe Option ("GSO") is an option to retain (up to a certain limit) excess subscription to an issue of shares and to stabilise the post-issue price of the shares. Retail investors are given protection by the GSO since many times the post-issue listing price is at a substantial discount to the offer price. The first company to use this innovative structure was the Green Shoe Company and hence, the unique name. The SEBI DIP Guidelines define it to mean an option of allocating shares in excess of the shares included in the public issue and to operate a post-listing price stabilisation mechanism. The Guidelines lay down an elaborate procedure and mechanism. Companies which have opted for this option, include, Maruti Suzuki, Tata Consultancy Services, etc. ICICI Bank was the first company to use the GSO under the book building route. DSP Merrill Lynch was appointed as the Stabilising Agent to maintain the post-issue price and for this the GSO was up to 15% of the issue size. Life Insurance Corporation which was one of the major shareholders entered into an agreement with the Stabilising Agent to lend a stake equal to 7.85%.

Although, it has been tried and tested in a few issues, the GSO has not enjoyed the level of success which it was expected to and that could be one of the reasons why one does not see many companies adopting the GSO.

4.2 GSO Process

4.2.1 The GSO is exercised when the issuer company proposes to allocate Equity Shares in excess of the Equity Shares included in the Issue, in order to operate a post listing price stabilising mechanism, in accordance with the SEBI Guidelines. The shareholders must at a general meeting authorise the Green Shoe Option. The procedure in brief is stated hereinafter.

4.2.2 The Book Running Lead Manager ("BRLM") normally act as the Stabilizing Agent ("SA") for the purposes of effectuating the Green Shoe Option, under the SEBI Guidelines. The Stabilising Agent and the Company determine the number of shares to be over allotted. It cannot exceed 15% of the total issue size.

4.2.3 The Promoter of the Company agrees to lend the loaned Shares to the Stabilising Agent for the purposes of effectuating the Green Shoe Option. Promoters who own more than 5% of the pre-issue capital are entitled to participate.

4.2.4 The Stabilising Agent is responsible for the price stabilisation of the shares once they are listed, if required. However, the stabilisation is not mandatory. The stabilisation cannot continue for a period exceeding 30 days from the date of the receipt of permission for trading of the Equity Shares from the Stock Exchanges. For the purposes of the Green Shoe Option, the Stabilising Agent shall borrow the Loaned Shares from the Green Shoe Lender. The Loaned Shares and/ or purchased from the market for stabilising purposes will be in dematerialised form only.

4.2.5 Some of the key features of the Stabilisation Agreement include:

(a) Stabilisation Period

The Stabilisation Period commences from the date of obtaining trading permission from the Stock Exchanges for the Equity Shares under the Issue, and ends 30 days thereafter, unless it is terminated earlier by the Stabilising Agent. The objective of the Green Shoe Option is stabilisation of the market price of Equity Shares after listing. If after listing of the Equity Shares, the market price falls below the Issue Price, then the Stabilising Agent, may start buying shares from the market to stabilise the price of the Shares.

(b) Exercise of Green Shoe Option

Once the Issue closes, the Company takes a decision relating to the exercise of the Green Shoe Option in consultation with the BRLM. If it is decided that the Green Shoe Option shall be exercised, the Company in consultation with the Stabilising Agent, shall make overallotment of shares.

(c) Over Allotment and Stabilisation

The allotment of the Over Allotment Shares is pro rata to various categories. Money received from the bidders for the Over Allotment Shares are kept in the GSO Bank Account which is separate from the Issue Account and it is used solely for the purpose of buying shares from the market during the Stabilisation Period for the stabilisation of the post listing price. On allotment, the Stabilising Agent transfers the Over Allotment Shares from the GSO Demat Account to the depository accounts of the successful bidders. The Stabilisation Agent uses the funds lying to the credit of GSO Bank Account for the purchasing the Equity Shares. The timing of buying the Equity Shares, the quantity, the price, etc., at which the Equity Shares are to be bought from the market are all decided by the Stabilising Agent. The Equity Shares purchased from the market by the Stabilising Agent are credited to the GSO Demat Account and returned to the Green Shoe Lender within 2 days from the expiry of the Stabilisation Period. On the expiry of the Stabilisation Period, in the event the Equity Shares lying to the credit of the GSO Demat Account at the end of the Stabilisation Period but before the transfer to the Green Shoe Lender is less than the Over Allotment Shares, upon being notified by the Stabilising Agent, the company must within five days of the end of the Stabilisation Period allot, new Equity Shares equal to such shortfall to the credit of the GSO Demat Account. The newly issued Equity Shares are returned by the Stabilising Agent to the Green Shoe Lender in lieu of the Over Allotment Shares, within 2 days of them being credited into the GSO Demat Account. The GSO Demat Account is then closed. The Equity Shares returned to the Green Shoe Lender are subject to the remaining lock-in-period, if any.

(d) GSO Bank Account

The Stabilising Agent uses the GSO Bank Account to pay the Green Shoe Lender, a consideration equal to the number of Equity Shares allotted by the Company at the Issue Price. The amount left in this account, if any, after this remittance and deduction of expenses and net of taxes, if any, is transferred to the investor protection fund of the Stock Exchanges. Once the equity shares are returned to the Green Shoe Lender the GSO Bank Account is also closed by the Stabilising Agent.

4.2.5 Reporting

During the Stabilisation Period, the Stabilising Agent has to submit a report to the BSE and the NSE on a daily basis. The Stabilising Agent also has to submit a final report to SEBI in the prescribed format.

4.2.6 Rights and Obligations of the Stabilising Agent

The key responsibilities and obligations of the Stabilising Agent include to:

(a) Open a special bank account which shall be the GSO Bank Account and deposit the monies received for the Over Allotment Shares, in the GSO Bank Account.

(b) Open a demat special account which shall be the GSO Demat Account and credit the Equity Shares bought by it.

(c) Stabilise the market price if it falls below the Issue Price and determine of the price at which such Equity Shares are to be bought and the timing of such purchase.

(d) Request the Green Shoe Lender to lend the Loaned Shares and to transfer funds from the GSO Bank Account to Green Shoe Lender within 5 days of close of the Stabilisation Period.

(e) On expiry of the Stabilisation Period, to return the Equity Shares to the Green Shoe Lender either through market purchases as part of stabilising process or through issue of fresh Equity Shares by the company.

(f) To transfer the net gains arising on market purchases in the GSO Bank Account after meeting all expenses and taxes, to the investor protection funds of the Stock Exchanges.

4.2.7 Rights and Obligations of the Company

The key responsibilities and obligations of the Company include:

(a) If the Stabilising Agent buys the Equity Shares from the market, then it has to issue the Equity Shares to the GSO Demat Account to the extent of Over Allotment Shares, which have not been bought from the market.

(b) If Equity Shares are not bought from the market, then it has to issue Equity Shares to GSO Demat Account to the entire extent of Over Allotment Shares.

4.2.8 Rights and obligations of the Green Shoe Lender

The key responsibilities and obligations of the Lender include:

(a) The Green Shoe Lender delivers all necessary documents and give all necessary instructions to ensure that the rights, title and interest in the loaned shares pass over to the Stabilising Agent/ GSO Demat Account free from all liens, charges and encumbrances.

(b) On receipt of instructions from the Stabilising Agent on or prior to Bid/ Issue Closing Date, to transfer the Loaned Shares to the GSO Demat Account.

(c) The Green Shoe Lender must not recall or create any lien or encumbrance on the Loaned Shares until the completion of the settlement under the stabilisation.

4.3 Example

A Ltd. proposes to float an IPO of 10,00,000 equity shares at a price of Rs. 10 + 40 per share. The issue is oversubscribed and it receives applications for 17,00,000 equity shares. It has a GSO up to 15% of the issue size = 11,50,000 shares, i.e., 1,50,000 shares for the GSO. The over allotment to the tune of 1,50,000 shares would be used for stabilising the post-listing price of the shares of A Ltd.