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Cryptocurrency

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Abstract: *Cryptocurrency is a digital payment system that doesn't rely on banks to verify transactions. It's a peer-to-peer system that can enable anyone anywhere to send and receive payments. Instead of being physical money carried around and exchanged in the real world, cryptocurrency payments exist purely as digital entries to an online database describing specific transactions. When you transfer cryptocurrency funds, the transactions are recorded in a public ledger. Cryptocurrency isstored in digital wallets*

Keywords: Cryptocurrency

I. INTRODUCTION

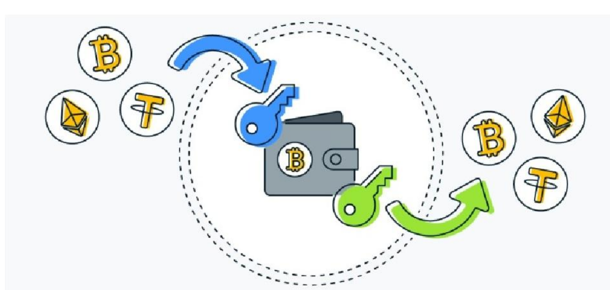
What is Cryptocurrency?

Cryptocurrency is a digital payment system that doesn't rely on banks to verify transactions. It's a peer-to-peer system that can enable anyone anywhere to send and receive payments. Instead of being physical money carried around and exchanged in the real world, cryptocurrency payments exist purely as digital entries to an online database describing specific transactions. When you transfer cryptocurrency funds, the transactions are recorded in a public ledger. Cryptocurrency isstored in digital wallets.

Cryptocurrency received its name because it uses encryption to verify transactions. This means advanced coding is involved in storing and transmitting cryptocurrency data between wallets and topublic ledgers. The aim of encryption is to provide security and safety.

The first cryptocurrency was Bitcoin, which was founded in 2009 and remains the best known today. Much of the interest in cryptocurrencies is to trade for profit, with speculators at times driving pricesskyward.

How does cryptocurrency work?



Cryptocurrencies run on a distributed public ledger called blockchain, a record of all transactions updated and held by currency holders.

Units of cryptocurrency are created through a process called mining, which involves using computer power to solve complicated mathematical problems that generate coins. Users can also buy the currencies from brokers, then store and spend them using cryptographic wallets.

If you own cryptocurrency, you don't own anything tangible. What you own is a key that allows youto move a record or a unit of measure from one person to another without a trusted third party.

Although Bitcoin has been around since 2009, cryptocurrencies and applications of blockchain technology are still emerging in financial terms, and more uses are expected in the future.

Transactions including bonds, stocks, and other financial assets could eventually be traded using thetechnology

Cryptocurrency examples

There are thousands of cryptocurrencies. Some of the best known include:

Bitcoin:

Founded in 2009, Bitcoin was the first cryptocurrency and is still the most commonly traded. The currency was developed by Satoshi Nakamoto – widely believed to be a pseudonym for an individual or group of people whose precise identity remains unknown.

Ethereum:

Developed in 2015, Ethereum is a blockchain platform with its own cryptocurrency, called Ether(ETH) or Ethereum. It is the most popular cryptocurrency after Bitcoin.

Litecoin:

This currency is most similar to bitcoin but has moved more quickly to develop new innovations, including faster payments and processes to allow more transactions

Ripple:

Ripple is a distributed ledger system that was founded in 2012. Ripple can be used to track different kinds of transactions, not just cryptocurrency. The company behind it has worked with various banksand financial institutions.

Dogecoin :

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Dogecoin features the face of the Shiba Inu dog from the "doge" meme as its logo and namesake. Itwas introduced on December 6, 2013, and quickly developed its own online community, reaching a peak market capitalization of over US$85 billion on May 5, 2021. As of 2021, it is the sleeve sponsorof Watford Football Club

What Are The Advantages of Cryptocurrency?

Cryptocurrency has gained popularity among investors globally. With technological involvement and industrialization, digital currencies are obtaining a satisfactory position over others, for example, Bitcoin. By using Cryptocurrency it gets easy to transfer money without any involvement of banks and other financial institutions.

Let us see a few more advantages of it:

Inflation Protection

Due to inflation, the value of many currencies decline. Many folks see cryptocurrency as offering protection against inflation. Bitcoin has a hard cap on the whole number of coins that will ever be minted. For example, as the growth of the money supply overtakes the growth in the supply of Bitcoin, the price of Bitcoin shall increase. Many other cryptocurrencies use the same mechanism to cap supply as well as can act as a safeguard against inflation. In terms of quantity, there are only 21 million Bitcoins released as specified by the ASCII computer file. Therefore, because of an increase in demand, the value will rise which might keep up with the market and prevent inflation in the long run.

Transactional Speed

If you wish to transfer money to your loved ones for example, in the United States, there are a few ways to move assets or funds from one account to another very quickly. Cryptocurrency transactions are done in a matter of minutes and that is appealing to many. Within U.S. financial institutions, most of the transactions are settled in three to five days and wire transfers take at least 24 hours.

Cost Effective Transactions

Cryptocurrencies can help transfer funds globally. The transactional cost with the help of cryptocurrency can be minimal or zero. It is negligible as it eliminates the need for third parties like VISA to confirm transactions.

Decentralization

Cryptocurrencies are a portrayal of a brand-new decentralization model for money. They also help to combat the monopoly of a currency and free money from control. No government organizations can set the worthiness of the coin or flow, and that crypto enthusiasts think makes cryptocurrencies secure and safe.

Diversity

Investments in cryptocurrency can generate profits. The market has extended immensely over the past decade. There is a limited history of the price activity of the cryptocurrency markets, so far they appear unrelated to other markets like stocks or bonds. That makes cryptocurrencies a fine source of portfolio diversification. If you combine assets with less price correlation, you can have more stable returns. For example, if your stock collection goes down, your crypto asset might go high and vice versa. However, cryptocurrency is normally very volatile and in the end, might increase your portfolio's volatility if your asset allocation is heavy on cryptocurrency.

Accessibility

Investors just need a computer or a smartphone with an internet connection to use cryptocurrency. There's no identification verification, credit check, or background to open a cryptocurrency wallet. It is way faster and easier compared to old financial institutions. It also allows individuals to effortlessly make internet transactions or send funds to someone.

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Safe And Secure

No one can access your funds unless they gain access to your crypto wallet's private key. In case you forget or lose your key then you cannot recover your funds. Further, the transactions are secured by the blockchain system along with the scattered network of computers that verify the transactions.

It's more secure if investors keep crypto assets in their own wallets. The transactions are secured by the usage of public and private keys, proof of work or proof of stake and other various forms of incentive systems.

Transparent

With the decentralized nature of blockchains, one can view the money transfer transactions by simply using blockchain explorer on the platform to track live transfers. This open and transparent system is a relief among investors and is corruption-free.

Private

There is no third-party intervention due to which your account has a level of privacy. On the blockchain, investors have an identifier and your wallet address as the transactions are pseudonymous and nothing personal about you

Currency Exchanges Are Done Effortlessly

Investors can purchase cryptocurrency using currencies like the U.S. dollar, Indian rupee or European euro. Various cryptocurrency exchanges and wallets help investors to trade in crypto and convert currencies with minimum transaction charges across different wallets.

What Are The Disadvantages of Cryptocurrency?

Investing in cryptocurrency might look appealing and profitable but investors should also consider a few downsides to it.

• Cryptocurrency claims to be an anonymous form of transaction, but they are actually pseudonymous which means they leave a digital trail that the Federal Bureau of Investigation can decode. So, there's a possibility of interference from federal or government authorities to track the financial transactions of normal people.

• On a blockchain, there is a constant risk of a 51% attack which means It is a situation when a miner or group of them gets more than 50% of the network's mining hash rate control. While in control, an ill-natured group can reverse the transaction that is completed, pause the transaction in process, double spend coins, prevent new transactions from getting validation and much more. Nevertheless, this attack is only a risk to recently hard-forked networks and new blockchains.

• The majority of blockchains work on the proof-of-work consensus mechanism. Network participants are required to use powerful ASIC computers and the right hash to make a block added to the network. Due to this, there is excessive power consumption and countries are taking majors to lower its impact on the environment.

• The lack of key policies related to transactions serves as a major drawback of cryptocurrencies. The no refund or cancellation policy can be considered the default stance for transactions wrongly made across crypto wallets and each crypto stock exchange or app has its own rules.

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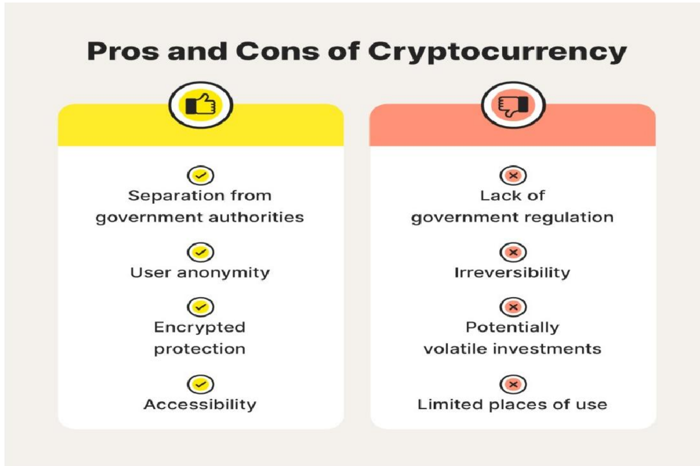

Are Cryptocurrencies Legal In India?

Cryptocurrencies as a payment medium are not regulated or issued by any central authority in India. There are no guidelines laid down for sorting disagreements while dealing with cryptocurrency. So, ifyou wish to trade in crypto, do it at your own risk.

Nirmala Sitharaman, the Finance Minister of India, initiated a tax on digital assets that has increasedthe discussion on the cryptocurrency legality in the country.

Given the stance of the Reserve Bank Of India (RBI) Governor and other key ministers from time to time, it can be safe to state cryptocurrency is not banned in India. Till 2022, cryptocurrency was unregulated in the country. This changed after the government set forth a 30% and 1% tax on profits from cryptocurrencies and tax deducted at source respectively in the Union Budget of 2022. This
event marked the Indian government's official regulation of cryptocurrency in the country.

While many supported the decision as it marks the very start of the road to getting cryptocurrency recognition, the Government of India still has to issue an official note for cryptocurrencies to be considered legal in India

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Tax on Cryptocurrency in India

Tax on cryptocurrency is one of the most confusing investment aspects in India. In the beginning years, there was no income tax or goods and services tax (GST) on cryptocurrencies in India but in the recent Union Budget 2022, a tax regime for digital or virtual assets that include cryptocurrencyhas been introduced.

Crypto investors are required to keep a well-calculated record of losses and gains as a part oftheir income.

On the earnings from the transfer of virtual or digital assets, a 30% tax will be charged. The tax includes cryptocurrencies, NFTs, etc.

Cost of acquisition along with no deduction will be permitted while reporting gains from thetransfer of virtual or digital assets.

A tax of 1% on tax deducted at source (TDS) on the buyer's payment if it crosses thethreshold limit.

If someone receives cryptocurrency as a gift or it is transferred then it is subjected to tax at
the beneficiary's end.

If investors face any loss from the virtual or digital asset investment, it cannot be recoveredagainst other income

FINANCIAL MARKETS

What is Financial Markets ?

Financial markets refer broadly to any marketplace where securities trading occurs, including the stock market, bond market, forex market, and derivatives market. Financial markets are vital to the smooth operation of capitalist economies.

Financial Markets are functionally classified as having two parts, namely,The Primary Market
The Secondary Market

Primary Market comprises of the new securities which are offered to the public by new companies.It is the mechanism through which the resources of the community are mobilized and invested in various types of industrial securities. Whenever a new company wants to enter the market it has tofirst enter the primary market.

Secondary Market comprises of further issues which are floated by the existing companies to enhance their liquidity position. Once the new issues are floated and subscribed by the public thenthese are traded in the secondary market. It provides easy liquidity, transferability and continuousprice formation of securities to enable investors to buy and sell them with ease. The volume of activity in the Secondary Market is much higher compared to the Primary Market

Understanding the Financial Markets :

Financial markets play a vital role in facilitating the smooth operation of capitalist economies by allocating resources and creating liquidity for businesses and entrepreneurs. The markets make it easy for buyers and sellers to trade their financial holdings. Financial markets create securities products that provide a return for those with excess funds (investors/lenders) and make these funds available to those needing additional money (borrowers).

The stock market is just one type of financial market. Financial markets are created when people buy and sell financial instruments, including equities, bonds, currencies, and derivatives. Financial markets rely heavily on informational transparency to ensure that the markets set prices that are efficient and appropriate.

Some financial markets are small with little activity, and others, like the New York Stock Exchange (NYSE), trade trillions of dollars in securities daily. The equities (stock) market is a financial market that enables investors to buy and sell shares of publicly traded companies. The primary stock market is where new issues of stocks are sold. Any subsequent trading of stocks occurs in the secondary market, where investors buy and sell securities they already own.

Types of Financial Markets

There are several different types of markets. Each one focuses on the types and classes of instruments available on it.

Stock Markets

Perhaps the most ubiquitous of financial markets are stock markets. These are venues where companies list their shares, which are bought and sold by traders and investors. Stock markets, or equities markets, are used by companies to raise capital and by investors to search for returns.

Stocks may be traded on listed exchanges, such as the New York Stock Exchange (NYSE), Nasdaq, or the over-the-counter (OTC) market. Most stock trading is done via regulated exchanges, which plays an important economic role because it is another way for money to flow through the economy.

Typical participants in a stock market include (both retail and institutional) investors, traders, market makers (MMs), and specialists who maintain liquidity and provide two-sided markets. Brokers are third parties that facilitate trades between buyers and sellers but who do not take an actual position in a stock.

Over-the-Counter Markets

An over-the-counter (OTC) market is a decentralized market—meaning it does not have physical locations, and trading is conducted electronically—in which market participants trade securities directly (meaning without a broker). While OTC markets may handle trading in certain stocks (e.g., smaller or riskier companies that do not meet the listing criteria of exchanges), most stock trading is done via exchanges. Certain derivatives markets, however, are exclusively OTC, making up an essential segment of the financial markets. Broadly speaking, OTC markets and the transactions that occur in them are far less regulated, less liquid, and more opaque.

Bond Markets

A bond is a security in which an investor loans money for a defined period at a pre-established interest rate. You may think of a bond as an agreement between the lender and borrower containing the loan's details and its payments. Bonds are issued by corporations as well as by municipalities, states, and sovereign governments to finance projects and operations. For example, the bond market sells securities such as notes and bills issued by the United States Treasury. The bond market is also called the debt, credit, or fixed-income market.

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Money Markets

Typically, the money markets trade in products with highly liquid short-term maturities (less than one year) and are characterized by a high degree of safety and a relatively lower interest return than other markets.

At the wholesale level, the money markets involve large-volume trades between institutions and traders. At the retail level, they include money market mutual funds bought by individual investors and money market accounts opened by bank customers. Individuals may also invest in the money markets by purchasing short-term certificates of deposit (CDs), municipal notes, or U.S. Treasury bills, among other examples.

Derivatives Markets

A derivative is a contract between two or more parties whose value is based on an agreed-upon underlying financial asset (like a security) or set of assets (like an index). Rather than trading stocks directly, a derivatives market trades in futures and options contracts and other advanced financial products that derive their value from underlying instruments like bonds, commodities, currencies, interest rates, market indexes, and stocks.

Futures markets are where futures contracts are listed and traded. Unlike forwards, which trade OTC, futures markets utilize standardized contract specifications, are well-regulated, and use clearinghouses to settle and confirm trades. Options markets, such as the Chicago Board Options Exchange (Cboe), similarly list and regulate options contracts. Both futures and options exchanges may list contracts on various asset classes, such as equities, fixed-income securities, commodities, and so on.

Forex Market

The forex (foreign exchange) market is where participants can buy, sell, hedge, and speculate on the exchange rates between currency pairs. The forex market is the most liquid market in the world, as cash is the most liquid of assets. The currency market handles more than $7.5 trillion in daily transactions, more than the futures and equity markets combined.

As with the OTC markets, the forex market is also decentralized and consists of a global network of computers and brokers worldwide. The forex market is made up of banks, commercial companies, central banks, investment management firms, hedge funds, and retail forex brokers and investors.

Commodities Markets

Commodities markets are venues where producers and consumers meet to exchange physical commodities such as agricultural products (e.g., corn, livestock, soybeans), energy products (oil, gas, carbon credits), precious metals (gold, silver, platinum), or "soft" commodities (such as cotton, coffee, and sugar). These are known as spot commodity markets, where physical goods are exchanged for money.

However, the bulk of trading in these commodities takes place on derivatives markets that utilize spot commodities as the underlying assets. Forwards, futures, and options on commodities are exchanged both OTC and on listed exchanges around the world, such as the Chicago Mercantile Exchange (CME) and the Intercontinental Exchange (ICE).

Cryptocurrency Markets

Thousands of cryptocurrency tokens are available and traded globally across a patchwork of independent online crypto exchanges. These exchanges host digital wallets for traders to swap one cryptocurrency for another or for fiat monies such as dollars or euros.

Because most crypto exchanges are centralized platforms, users are susceptible to hacks or fraudulent activity. Decentralized exchanges are also available that operate without any central authority. These exchanges allow direct peer-to-peer (P2P) trading without an actual exchange authority to facilitate the transactions. Futures and options trading are also available on major cryptocurrencies

PRIMARY MARKET-GENESIS AND GROWTH

When a business entity needs money the general course of action that it follows is that it goes to the bank. However banks may not be ready to provide huge finance for a long time especially if the returns are not fixed. The best way to raise money is through offer of shares and for this PRIMARY MARKET is used.

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The Primary Market deals with the new securities which were previously not tradable to the public. The main function is to facilitate the transfer of resources from savers to entrepreneurs seeking to establish or to expand and diversify existing events. The mobilization of funds through the Primary Market is adopted by the state government and corporate sector. In other words the Primary Market is an integral part of the capital market of a country and together with the securities market. The development of security as well as the scope for higher productive capacity and social welfare depends upon the efficiency of the Primary Market.

What is an IPO?

The first public offering of equity shares or convertible securities by a company, which is followed by the listing of a company's shares on a stock exchange, is known as an 'Initial Public Offering'. In other words, it refers to the first sale of a company's common shares to investors on a public stock exchange, with an intention to raise new capital.

The most important objective of an IPO is to raise capital for the company. It helps a company to tap a wide range of investors who would provide large volumes of capital to the company for future growth and development. A company going for an IPO stands to make a lot of money from the sale of its shares which it tries to anticipate how to use for further expansion and development. The company is not required to repay the capital and the new shareholders get a right to future profits distributed by the company.

Companies fall into two broad categories: Private and Public.

A privately held company has fewer shareholders and its owners don't have to disclose much information about the company. When a privately held corporation needs additional capital, it can borrow cash or sell stock to raise needed funds. Often "going public" is the best choice for a growing business. Compared to the costs of borrowing large sums of money for ten years or more, the costs of an initial public offering are small. The capital raised never has to be repaid. When a company sells its stock publicly, there is also the possibility for appreciation of the share price due to market factors not directly related to the company. Anybody can go out and incorporate a company: just put in some money, file the right legal documents and follow the reporting rules of jurisdiction such as Indian Companies Act 1956. It usually isn't possible to buy shares in a private company. One can approach the owners about investing, but they're not obligated to sell you anything. Public companies, on the other hand, have sold at least a portion of themselves to the public and trade on a stock exchange. This is why doing an IPO is also referred to as "going public."

Why go public?

Before deciding whether one should complete an IPO, it is important to consider the positive and negative effects that going public may have on their mind. Typically, companies go public to raise and to provide liquidity for their shareholders. But there can be other benefits. Going public raises cash and usually a lot of it. Being publicly traded also opens many financial doors:

• Because of the increased scrutiny, public companies can usually get better rates when they issue debt.

• As long as there is market demand, a public company can always issue more stock. Thus, mergers and acquisitions are easier to do because stock can be issued as part of the deal.

• Trading in the open markets means liquidity. This makes it possible to implement things like employee stock ownership plans, which help to attract top talent.

• Going public can also boost a company's reputation which in turn, can help the company to expand in the marketplace.

ADVANTAGES AND DISADVANTAGES OF IPO

Investing in IPO has its own set of advantages and disadvantages. Where on one hand, high element of risk is involved, if successful, it can even result in a higher rate of return. The rule is: Higher the risk, higher the returns.

Benefits:

• Access to Capital: The principal motivation for going public is to have access to larger capital. A company that does not tap the public financial market may find it difficult to grow beyond a certain point for want of capital.

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• Stockholder Diversification: As a company grows and becomes more valuable, its founders often have most of its wealth tied up in the company. By selling some of their stock in a public offering, the founders can diversify their holdings and thereby reduce somewhat the risk of their personal portfolios.
• Easier to raise new capital: If a privately held company wants to raise capital a sale of a new stock, it must either go to its existing shareholders or shop around for other investors. This can often be a difficult and sometimes impossible process. By going public it becomes easier to find new investors for the business.
• Enhances liquidity: The stock of a closely held firm is not liquid. If one of the holders wants to sell some of his shares, it is hard to find potential buyers-especially if the sum involved is large. Even if a buyer is located there is no establishes price at which to complete the transaction. These problems are easily overcome in a publicly owned company
• Establishes value for the firm: This can be very useful in attracting key employees with stock options because the underlying stock have a market value and a market for them to be traded that allows for liquidity for them.
• Image: The reputation and visibility of the company increases. It helps to increase company and personal prestige.
• Signals from the Market: Stock prices represent useful information to the managers. Everyday, investors render judgment about the prospects of the firm. Although the market may not be perfect, it provides a useful reality check.

• Other advantages:
• Additional incentive for employees in the form of the companies stocks. This also helps to attract potential employees.
• Window of opportunity.
• It commands better valuation of the company.
• Better situated for making acquisitions.

Disadvantages\Costs:
• Disclosure: A public company is required to disclose information to investors and others. Hence, it cannot maintain a strict veil of secrecy over its expansion plans and product market strategies as its non-public counterpart can do. Management may not like the idea of reporting operating data, because such data will then be available to competitors.
• Dilution: When a company issues shares to public, existing shareholders suffer dilution of their proportionate ownership in the firm.
• Loss of Flexibility: The affairs of a public company are subject to fairly comprehensive regulation. Hence, when a non-public company is transformed into a public company there is some loss of flexibility.
• Accountability: Understandably, the degree of accountability of a public company is higher. It has to explain a lot to its investors.
• Public Pressure: Because of its greater visibility a public company may be pressurized to do things that it may not otherwise do.
• Adverse Selection: Investors, in general, know less than the issuers about the value of companies that go public. Put differently, they are potential victims of adverse selection. Aware of this trap, they are reluctant to participate in public issues unless they are significantly underpriced. Hence, a company making an IPO typically has to underprice its securities in order to stimulate investor interest and participation.
• Self dealings: The owner's managers of closely held companies have many opportunities for self-transactions, although legal they may not want to disclose to the public.
• Inactive market low price: If a firm is very small and its shares are not traded frequently, then its stock will not really be liquid and the market price may not be truly representative of the stocks value.
• Control: Owning less than 50% of the shares could lead to a loss of control in the management.
• Costs: Apart from the cost of issuing securities, a public company has to incur recurring costs for providing investors with periodical reports, holding shareholder meetings communicating with institutional investors and financial analysts, and fulfilling various statutory obligations, like filing quarterly reports with the Securities and exchange Board of India. These reports can be costly especially for small firms

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• Other disadvantages:
• The profit earned by the company should be shared with its investors in the form of dividend.
• An IPO is a costly affair. Around 15-20% of the amount realized is spent on raising the same.
• A substantial amount of time and effort has to be invest

RISK FACTOR

Investing in IPO is often seen as an easy way of investing, but it is highly risky and many investment advisers advise against it unless you are particularly experienced and knowledgeable. The risk factor can be attributed to the following reasons:

• UNPREDICTABLE:

The Unpredictable nature of the IPO's is one of the major reasons that investors advise against investing in IPO's. Shares are initially offered at a low price, but they see significant changes in their prices. It might rise significantly, and then steeply.

• NO PAST TRACK RECORD OF THE COMPANY:

No past track record of the company adds further to the dilemma of the shareholders as to whether to invest in the IPO or not. With no past track record, it becomes a difficult choice for the investors to decide whether to invest in a particular IPO or not, as there is no basis to decide whether the investment will be profitable or not.

• POTENTIAL OF STOCK MARKET:

Returns from investing in IPO are not guaranteed. The Stock Market is highly volatile. Stock Market fluctuations widely affect not only the individuals and household, but the economy as a whole. The volatility of the stock market makes it difficult to predict how the shares will perform over a period of time as the profit and risk potential of the IPO depends upon the state of the stock market at that particular time.

RISK ASSESSMENT:

The possibility of buying stock in a promising start-up company and finding the next success story has intrigued many investors. But before taking the big step, it is essential to understand some of the challenges, basic risks and potential rewards associated with investing in an IPO.

This has made Risk Assessment an important part of Investment Analysis. Higher the desired returns, higher would be the risk involved. Therefore, a thorough analysis of risk associated with the investment should be done before any consideration.

For investing in an IPO, it is essential not only to know about the working of an IPO, but we also need to know about the company in which we are planning to invest. Hence, it is imperative to know:
• The fundamentals of the business
• The policies and the objectives of the business
• Their products and services
• Their competitors
• Their share in the current market
• The scope of their issue being successful

It would be highly risky to invest without having this basic knowledge about the company. There are 3 kinds of risks involved in investing in IPO:

• BUSINESS RISK:

It is important to note whether the company has sound business and management policies, which are consistent with the standard norms. Researching business risk involves examining the business model of the company.

• FINANCIAL RISK:
Is this company solvent with sufficient capital to suffer short-term business setbacks? The liquidity position of the company also needs to be considered. Researching financial risk involves examining the corporation's financial statements, capital structure, and other financial data.

• MARKET RISK:
It would beneficial to check out the demand for the IPO in the market, i.e., the appeal of the IPO to other investors in the market. Hence, researching market risk involves examining the appeal of the corporation as per current and future market conditions.

ANALYZING AN IPO INVESTMENT

Potential Investors and Their Objectives

Initial Public Offering is a cheap way of raising capital, but all the same it is not considered as the best way of investing for the investor. Before investing, the investor must do a proper analysis of the risks to be taken and the returns expected. He must be clear about the benefits he hope to derive from the investment. The investor must be clear about the objective he has for investing, whether it is long-term capital growth or short-term capital gains.
The potential investors and their objectives could be categorized as:

• Income Investor:
An 'income investor' is the one who is looking for steadily rising profits that will be distributed to shareholders regularly. For this, he needs to examine the company's potential for profits and its dividend policy/

• Growth Investor:
A 'growth investor' is the one who is looking for potential steady increase in profits that are reinvested for further expansion. For this he needs to evaluate the company's growth plan, earnings and potential for retained earnings.

• Speculator:
A 'speculator' looks for short-term capital gains. For this he needs to look for potential of an early market breakthrough or discovery that will send the price up quickly with little care about a rapid decline.

INVESTOR RESEARCH:

It is imperative to properly analyze the IPO the investor is planning to invest into. He needs to do a thorough research at his end and try to figure out if the objective of the company match his own personal objectives or not. The unpredictable nature of IPO's and volatility of the stock market adds greatly to the risk factor. So, it is advisable that the investor does his homework, before investing.
The investor should know about the following:

BUSINESS OPERATIONS:

• What are the objectives of the business?
• What are its management policies?
• What is the scope for growth?
• What is the turnover of the labour force?
• Would the company have long-term stability?

FINANCIAL OPERATIONS:

• What is the company's credit history?
• What is the company's liquidity position?
• Are there any defaults on debts?
• Company's expenditure in comparison to competitors.
• Company's ability to pay-off its debts.

• What are the projected earnings of the company

MARKETING OPERATIONS:
• Who are the potential investors?
• What is the scope for success of the IPO?
• What is the appeal of the IPO for the other investors?
• What are the products and services offered by the company?
• Who are the strongest competitors of the company?

IPO INVESTMENT STRATEGIES

Investing in IPOs is much different than investing in seasoned stocks. This is because there is limited information and research on IPOs, prior to the offering. And immediately following the offering, research opinions emanating from the underwriters are invariably positive.

There are some of the strategies that can be considered before investing in the IPO:

• UNDERSTAND THE WORKING OF IPO:

The first step is to understand the working of an IPO and the basics of an investment process. Other investment options could also be considered depending upon the objective of the investor.

• GATHER KNOWLEDGE:

It would be beneficial to gather as much knowledge as possible about the IPO market, the company offering it, the demand for it and any offer being planned by a competitor.

• INVESTIGATE BEFORE INVESTING:

The prospectus of the company can serve as a good option for finding all the details of the company. It gives out the objectives and principles of the management and will also cover the risks.

• KNOW YOUR BROKER:

This is a crucial step as the broker would be the one who would majorly handle your money. IPO allocations are controlled by underwriters. The first step to getting IPO allocations is getting a broker who underwrites a lot of deals.

• MEASURE THE RISK INVOLVED:

IPO investments have a high degree of risk involved. It is therefore, essential to measure the risks and take the decision accordingly.

• INVEST AT YOUR OWN RISK:

Finally, after the homework is done, and the big step needs to be taken. All that can be suggested is to 'invest at your own risk'. Do not take a risk greater than your capacity.

PRINCIPAL STEPS IN AN IPO

The issue of securities to members of the public through a prospectus involves a fairly elaborate process, the principal steps of which are as follows.

1. The board of directors approves the proposal to raise capital from the public and authorizes the managing director (or a board committee) to do all the tasks relating to the public issue.
2. The company convenes a meeting to seek the approval of shareholders and the share holders pass a special resolution under section 81(1A) of the Companies Act authorizing the company to make the public issue.
3. The company appoints a merchant banker as the lead manager (LM) to the issue.
4. The lead manager carries out due diligence to check all relevant information, documents, and certificates for the issue.

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5. The company, advised by the lead manager, appoints various intermediaries such as the registrar to the issue, the bankers to the issue, the printers, and advertiser.
6. The lead manager draws up the issue budget, keeping in mind the guidelines issued by the Ministry of Finance on issue expenses, and the company approves the same (The main components of the issue expenses are fees for lead manager, underwriters, registrar and bankers, brokerage, postage, stationery, issue marketing expenses, etc.)
7. The lead manager prepares the draft prospectus in consultation with management and seeks the approval of the board.
8. The lead manager files the draft prospectus, approved by the board, with SEBI for its observation along with a soft copy. SEBI places the same on its website for comments from the public.
9. The company makes listing application to all the stock exchanges where the shares are proposed to be listed along with copies of the draft prospectus. The draft prospectus is also hosted on the websites of the lead manager and the underwriters.
10. The company enters into a tripartite agreement with the registrar and all the depositories for providing the facility of offering the shares in a dematerialized mode.
11. If the issue is proposed to be underwritten (it is optional in a retail issue and mandatory in a book built issue to the extent of the net public offer), the lead manager makes underwriting arrangements.
12. Within 21 days, SEBI makes its observations on the draft prospectus. The stock exchanges also suggest changes, if any. The company carries out the modifications to the satisfaction of these authorities.
13. The company files the prospectus with the Registrar of Companies (ROC).
14. The lead manager and the company market the issue using a combination of press meetings, brokers' meetings, investors' meeting and so on.
15. The company releases a mandatory advertisement, called the 'announcement advertisement' 10 days prior to the opening of the issue. This has to conform to Form 2A, also called the abridged prospectus.

COST OF A PUBLIC ISSUE

The cost of public issue is normally between 8 and 12 percent depending on the size of the issue and on the level of marketing efforts. The important expenses incurred for a public issue are as follows:

• Underwriting expenses: The underwriting commission is fixed at 2.5 % of the nominal value (including premium, if any) of the equity capital being issued to public.
• Brokerage: Brokerage applicable to all types of public issues of industrial securities are fixed at 1.5% whether the issue is underwritten or not. The managing brokers (if any) can be paid a maximum remuneration of 0.5% of the nominal value of the capital being issued to public.
• Fees to the Managers to the Issues: The aggregate amount payable as fees to the managers to the issue was previously subject to certain limits. Presently, however, there is no restriction on the fee payable to the managers of the issue.
• Fees for Registrars to the Issue: The compensation to he registrars, typically based on a piece rate system, depends on the number of applications received, number of allotters, and the number of unsuccessful applicants.
• Printing Expenses: These relate to the printing of the prospectus, application forms, brouchers, share certificate, allotment/refund letters, envelopes, etc.
• Postage Expenses: These pertain to the mailing of application forms, brochures, and prospectus to investors by ordinary post and the mailing of the allotment/refund letters and share certificates by register posts.
• Advertising and Publicity Expenses: These are incurred primarily towards statutory announcements, other advertisements, press conferences, and investor’s conferences.
• Listing Fees: This is the concerned fee payable to concerned stock exchange where the securities are listed. It consists of two components: initial listing fees and annual listing fees.
• Stamp Duty: This is the duty payable on share certificates issued by the company. As this is the state subject, it tends to vary from state to state.

PRICING OF AN ISSUE

The pricing of an IPO is a very critical aspect and has a direct impact on the success or failure of the IPO issue. There are many factors that need to be considered while pricing an IPO and an attempt should be made to reach an IPO price that is low enough to generate interest in the market and at the same time, it should be high enough to raise sufficient capital for the company.

The process for determining an optimal price for the IPO involves the underwriters arranging share purchase commitments from leading institutional investors.

PROCESS:

Once the final prospectus is printed and distributed to investors, company management meets with their investment bank to choose the final offering price and size. The investment bank tries to fix an appropriate price for the IPO depending upon the demand expected and the capital requirements of the company.

The pricing of an IPO is a delicate balancing act as the investment firms try to strike a balance between the company and the investors. The lead underwriter has the responsibility to ensure smooth trading of the company's stock. The underwriter is legally allowed to support the price of a newly issued stock by either buying them in the market or by selling them short. IPO PRICING DIFFERENCES:

It is generally noted, that there is a large difference between the price at the time of issue of an Initial Public Offering (IPO) and the price when they start trading in the secondary market. These pricing disparities occur mostly when an IPO is considered "hot", or in other words, when it appeals to a large number of investors. An IPO is "hot" when the demand for it far exceeds the supply.

This imbalance between demand and supply causes a dramatic rise in the price of each share in the first day itself, during the early hours of trading.

UNDERPRICING AND OVERPRICING OF IPOs

UNDERPRICING:

The pricing of an IPO at less than its market value is referred to as 'Underpricing'. In other
words, it is the difference between the offer price and the price of the first trade.

Historically, IPO's have always been 'underpriced'. Underpriced IPO helps to generate additional interest in the stock when it first becomes publicly traded. This might result in significant gains for investors who have been allocated shares at the offering price. However, underpricing also results in loss of significant amount of capital that could have been raised if the shares were offered at the higher price.

OVERPRICING:

The pricing of an IPO at more than its market value is referred to as 'Overpricing'. Even "overpricing" of shares is not as healthy option. If the stock is offered at a higher price than what the market is willing to pay, then it is likely to become difficult for the underwriters to fulfill their commitment to sell shares. Furthermore, even if the underwriters are successful in selling all the issued shares and the stock falls in value on the first day itself of trading, then it is likely to lose its marketability and hence, even more of its value.

Book building process of price discovery

Book Building is basically a capital issuance process used in Initial Public Offer (IPO) which aids price and demand discovery. It is a process used for marketing a public offer of equity shares of a company. It is a mechanism where, during the period for which the book for the IPO is open, bids are collected from investors at various prices within the price band indicated by the company (the price band mentions the lowest/floor and the highest/cap prices at which a share can be sold). The process aims at tapping both wholesale and retail investors. The offer/issue price is then determined after the bid closing date based on certain evaluation criteria.

According to the book building process, three classes of investors can bid for the shares:

1. Qualified Institutional Buyers: Mutual funds and Foreign Institutional Investors.
2. Retail investors: Anyone who bids for shares under Rs 50,000 is a retail investor.
3. High net worth individuals and employees of the company.

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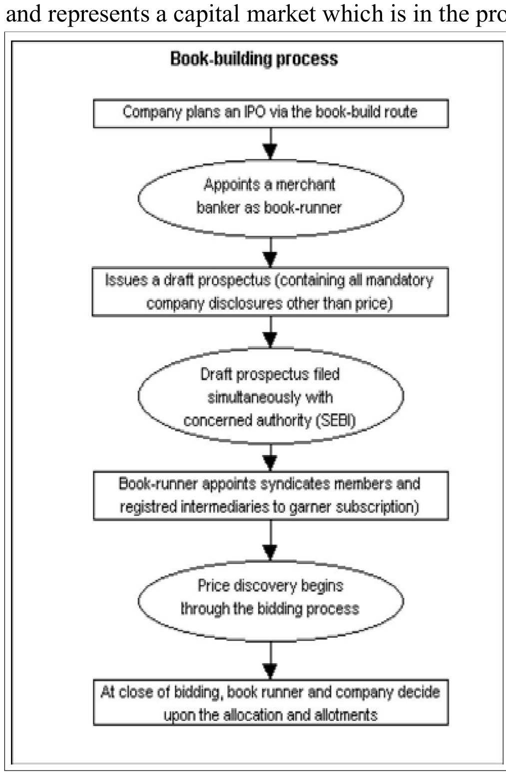
Allotment is the process whereby those who apply are given (allotted) shares. The bids are first allotted to the different categories and the over-subscription (more shares applied for than shares available) in each category is determined. Retail investors and high net worth individuals get allotments on a proportional basis.

PROCESS:

• The Issuer who is planning an IPO nominates a lead merchant banker as a 'book runner'.
• It then specifies the number of securities to be issued and the price band for orders.
• It also appoints syndicate members with whom orders can be placed by the investors.
• Investors place their order with a syndicate member who inputs the orders into the 'electronic book'. This process is called 'bidding' and is similar to open auction.
• A Book should remain open for a minimum of 5 days.
• Bids cannot be entered less than the floor price mentioned in the price band. And they can be revised by the bidder before the issue closes.
• On the close of the book building period the 'book runner evaluates the bids on the basis of the evaluation criteria which may include -
• Price Aggression
• Investor quality
• Earliness of bids, etc.
• The book runner and the company conclude the final price at which it is willing to issue the stock and allocation of securities.
• Generally, the numbers of shares are fixed; the issue size gets frozen based on the price per share discovered through the book building process.
• Allocation of securities is made to the successful bidders.
• Book Building is a good concept and represents a capital market which is in the process of maturing.



How is the price fixed?

All the applications received till the last date are analyzed and a final offer price, known as the cut-off price is arrived at. The final price is the equilibrium price or the highest price at which all the shares on offer can be sold smoothly.

If your price is less than the final price, you will not get allotment. If your price is higher than the final price, the amount in excess of the final price is refunded if you get allotment. If you do not get allotment, you should get your full refund of your money in 15 days after the final allotment is made. If you do not get your money or allotment in a month's time, you can demand interest at 15 per cent per annum on the money due.

How are shares allocated?

• As per regulations, at least 25 per cent of the shares on offer should be set aside for retail investors. Fifty per cent of the offer is for qualified institutional investors. Qualified Institutional Bidders (QIB) are specified under the regulation and allotment to this class is made at the discretion of the company based on certain criteria.

• QIBs can be mutual funds, foreign institutional investors, banks or insurance companies. If any of these categories is under-subscribed, say, the retail portion is not adequately subscribed, then that portion can be allocated among the other two categories at the discretion of the management. For instance, in an offer for two lakh shares, around 50,000 shares (or generally 25 per cent of the offer) are reserved for retail investors. But if the bids from this category are received are only for 40,000 shares, then 10,000 shares can be allocated either to the QIBs or non-institutional investors.

• The allotment of shares is made on a pro-rata basis. Consider this illustration: An offer is made for two lakh shares and is oversubscribed by times times, that is, bids are received for six lakh shares. The minimum allotment is 100 shares. 1,500 applicants have applied for 100 shares each; and 200 applicants have bid for 500 shares each. The shares would be allotted in the following manner:

• Shares are segregated into various categories depending on the number of shares applied for.

• The final allotment is made by drawing a lot from each category. If you are lucky you may get allotment in the final draw.

• The shares are listed and trading commences within seven working days of finalization of the basis of allotment. You can check the daily status of the bids received, the price bid for and the response form various categories in the Web sites of stock exchanges. This will give you an idea of the demand for the stock and a chance to change your mind. After seeing the response, if you feel you have bid at a higher or a lower price, you can always change the bid price and submit a revision form.

• The traditional method of doing IPOs is the fixed price offering. Here, the issuer and the merchant banker agree on an "issue price" - e.g. Rs.100. Then one have the choice of filling in an application form at this price and subscribing to the issue. Extensive research has revealed that the fixed price offering is a poor way of doing IPOs. Fixed price offerings, all over the world, suffer from `IPO underpricing'. In India, on average, the fixed-price seems to be around 50% below the price at first listing; i.e. the issuer obtains 50% lower issue proceeds as compared to what might have been the case. This average masks a steady stream of dubious IPOs who get an issue price which is much higher than the price at first listing. Hence fixed price offerings are weak in two directions: dubious issues get overpriced and good issues get underpriced, with a prevalence of underpricing on average.

What is needed is a way to engage in serious price discovery in setting the price at the IPO. No issuer knows the true price of his shares; no merchant banker knows the true price of the shares; it is only the market that knows this price. In that case, can we just ask the market to pick the price at the IPO?

Imagine a process where an issuer only releases a prospectus, announces the number of shares that are up for sale, with no price indicated. People from all over India would bid to buy shares in prices and quantities that they think fit. This would yield a price. Such a procedure should innately obtain an issue price which is very close to the price at first listing-- the hallmark of a healthy IPO market.

Recently, in India, there had been issue from Hughes Software Solutions which was a milestone in our growth from fixed price offerings to true price discovery IPOs. While the HSS issue has many positive and fascinating features, the design adopted was still riddled with flaws, and we can do much better.

Documents Required:

• A company coming out with a public issue has to come out with an Offer Document/ Prospectus.

• An offer document is the document that contains all the information you need about the company. It will tell you why the company is coming is out with a public issue, its financials and how the issue will be priced.

• The Draft Offer Document is the offer document in the draft stage. Any company making a public issue is required to file the draft offer document with the Securities and Exchange Board of India, the market regulator.

• If SEBI demands any changes, they have to be made. Once the changes are made, it is filed with the Registrar of Companies or the Stock Exchange. It must be filed with SEBI at least 21 days before the company files it with the RoC/ Stock Exchange. During this period, you can check it out on the SEBI Web site.

• Red Herring Prospectus is just like the above, except that it will have all the information as a draft offer document; it will, however, not have the details of the price or the number of shares being offered or the amount of issue. That is because the Red Herring Prospectus is used in book building issues only, where the details of the final price are known only after bidding is concluded.