

Green Shoe Options in India

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Abstract

The Green Shoe Option (GSO) is one of the price stabilization mechanisms newly came into force since 2003 by which such situation should be managed. SEBI introduced this option with a view to boost investor's confidence by arresting the speculative force, which works immediately after listing and thus result in short term volatility in post listing price. It ensures price stability. A Green Shoe Option means an option of allocating shares in excess of the shares floated in the public issue and operating a post-issue price stabilizing mechanism for a period not exceeding 30 days. This permission has been granted to a company to be exercised with caution through a stabilizing agent. As per this arrangement, an issue could be over allotted to the extent of a maximum of 15% of the issue size.

From an investor's point of view, an issue with green shoe option provides more probability of getting shares allotted to him. It also ensures that the post-listing price will be stable than the market price. This study aims to understand the concept & importance of Green Shoe Options in India, SEBI Guidelines & analyzing Green Shoe Option as a Price Stabilization mechanism. This study is based on survey of individual investors. The green shoe has the ability to reduce risk for the company issuing the shares. It allows the underwriter to have buying power in order to cover their short position when a stock price falls, without the risk of having to buy stock if the price rises. In return, this helps keep the share price stable, which positively affects both the issuers and investors.

Keywords: Green Shoe Option, India, IPO, Primary market.

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1. Introduction ^[1]

The primary market of shares and securities where Initial public offerings (IPO) of securities are issued contributes a vital role in the financial development of an economy by means of mobilizing financial resources from the public and investing these resources in various developmental projects of the economy. Investors would undoubtedly be worried if the price of the shares in the secondary market is gradually declining or highly unpredictable in the period immediately following the listing date.

The Securities and Exchange Board of India (SEBI) has introduced Green Shoe Option (GSO) on 12 Aug 2003, in order to bring the Indian Primary Markets on par with global markets such as US, Canada and others where over 90 percent of the primary issues is through the Book-Building route having the GSO.

Ravi Kapoor, senior vice-president, DSP Merrill Lynch, said, "The amount raised in the form of GSO will be used to stabilize the price of the stock post-listing, raising comfort levels of investors (that price would be stabilized post listing) and encouraging increased participation from investors."

One of the major advantages to the beneficiaries they can buy excess shares for panic selling.

1.1. Meaning ^[1&2]

A Green Shoe Option means an option of allocating shares in excess of the shares floated in the public issue and operating a post-issue price stabilizing mechanism for a period not exceeding 30 days. This permission has been granted to a company to be exercised with caution through a stabilizing agent. As per this arrangement, an issue could be over allotted to the extent of a maximum of 15% of the issue size.

1.2. Need/Importance for a GSO ^[7]

Public Offerings may supply a large number of securities into a market, as a result of which, there is a risk that the price of the securities will be highly volatile immediately after the commencement of the offering. Price volatility is likely to be even greater in the case of an Initial Public Offering (IPO) because there is no established Secondary Market for the securities.

The purpose of an issuer and/or a selling security holder in providing an underwriter with an over-allotment is to allow the underwriter to stabilize the after-market for the issuer's securities in the period immediately after the public offering begins. By allowing an underwriter to obtain additional securities covering an over-allotment and to sell these securities to the public, an underwriter can maintain a balance between the demand for an issuer's securities and the supply of securities available to satisfy market demand.

The term comes from a company, Green Shoe Manufacturing Company, founded in 1919 which made Wellington boots, now called Stride Rite Corporation, which was the first company to permit underwriters to use this practice in its offering in US.

In a company prospectus, the legal term for the green shoe is "over-allotment option", because in addition to the shares originally offered, shares are set aside for underwriters.

The Securities and Exchange Commission (SEC) introduced this option in order to enhance the efficiency and competitiveness of the fund raising process for IPOs.

SEBI introduced this option with a view to boost investor's confidence by arresting the speculative force, which works immediately after listing and thus result in short term volatility in post listing price. It ensures price stability.

One of the benefits of using the green shoe is its ability to reduce risk for the company issuing the shares. It allows the underwriter to have buying power in order to cover their short position when a stock price falls, without the risk of having to buy stock if the price rises. In return, this helps keep the share price stable, which positively affects both the issuers and investors. It is an Investor Protection measure especially for the small investors during post-listing period.

It benefits the Underwriters in both bullish and bearish conditions. In bull market, underwriters will opt for additional allotment of 15% due to index riding high. In a bearish market, the underwriting option may not be exercised or the underwriters may buy upto 15% at prices lower than the issue price from the market.

2. METHODOLOGY

The data for this study is collected both from primary and secondary sources and graphs are used to show the data more clearly.

Sample Size – 50 respondents of Individual investors.

Data Collection:

Primary Data – Sample Survey.

Secondary Data: Articles, Websites.

3. OBJECTIVES OF THE STUDY

- To understand the concept & importance of Green Shoe Option.
- To understand the SEBI Guidelines of Green Shoe Option.
- To analyze Green Shoe Option as a Price Stabilizing mechanism.
- To suggest Green Shoe Option as an effective tool for IPOs in companies.

4. LIMITATION OF THE STUDY

- The study is limited to Green Shoe Options in India only.
- Survey is limited to 50 people.

5. REVIEW OF LITERATURE

Reena Aggarwal, in the article on “Stabilization Activities by Underwriters after Initial Public Offerings”,^[3] revealed that more than half of IPOs, a short position of an average 10.75 percent of shares offered is covered in 22 transactions over 16.6 days in the aftermarket, resulting in a loss of 3.61 percent of underwriting fees. Underwriters manage price support activities by using a combination of aftermarket short covering, penalty bids, and the selective use of the over allotment option.

Vasant Sivaraman, Shweta Singh & Jyoti Abrol, in their “Shoe Option: Can It Mitigate Mispricing?”^[5] attempted to examine if the GSO, which has been introduced in India as a tool for book build issues since Aug 2003 (subsequently modified in May 2004), can play an effective role in the area of fair pricing of IPOs.

Ravi Kapoor ^[9]. Senior vice-president, DSP Merrill Lynch, said, “The amount raised in the form of GSO will be used to stabilise the price of the stock post-listing, raising comfort levels of investors (that price would be stabilized post listing) and encouraging increased participation from investors.”

5.1. TYPES OF GSO ^[9]

There are three types of GSO viz., Full, Partial and Reverse Green shoes. The number of shares the underwriter buys back determines if they will exercise a partial Green shoe or a full green shoe. A Partial Greenshoe is when the underwriters are only able to buy back some shares before the price of the shares increases. A Full Greenshoe occurs when they are unable to buy back any shares before the price goes higher. At this point, the underwriter needs to exercise the full option and buy at the offering price. The option can be exercised any time throughout the first 30 days of IPO trading.

Reverse GSO has the same effect on the price of the shares as the regular GSO, but instead of buying the shares, the underwriter is allowed to sell shares back to the issuer. If the share price falls below the offering price, the underwriter can buy shares in the open market and sell them back to the issuer.

5.2. SEBI GUIDELINES RELATED TO GREEN SHOE OPTION ^[8]

GREEN SHOE OPTION denotes an option of allocation of shares, in excess of shares included in the public issue. W.e.f 28.05.07, the concept of Green Shoe option has been extended to all public issue in accordance with the provision of chapter VIII A of SEBI Guidelines.

SEBI introduced this option with a view to boost investor’s confidence by arresting the speculative force, which work immediately after listing and thus result in short term volatility in post listing price. It ensures price stability.

There are some guidelines related to Green Shoe option by Security & Exchange Board of India.

- An issuer company making a public offer of equity shares can avail of green shoe option for --Stabilizing the post-listing price of its shares. –
- Possibility of allotment for the shares to the stabilizing agent at the end of stabilizing period. A company shall appoint one of the merchant bankers from amongst the issue management team, as a stabilizing agent who will be responsible for the price stabilization process.
- The stabilizing agent (SA) shall enter into an agreement with the promoters or pre-issue shareholders who will lend their shares specifying the max. no of shares shall not be in excess of 15% of total issue size.
- The details of the agreement shall be disclosed in the draft prospectus, draft red herring prospectus, red herring prospectus and final prospectus.
- Lead Merchant bankers by constitutions with stabilizing agent, shall determine the amount of shares to over allotted with public issue.
- The draft prospectus, draft red herring prospectus, red herring prospectus and final prospectus shall contain following additional disclosures: - --Name of Stability agent. --The max. no of shares proposed to be over allotted by company.

- The period for which the company propose to avail of the stabilizing mechanism. --The max. increase in capital of company and the shareholding pattern, post issue, is required to allot for the shares to the extend of over allotment in the issue.
- The max amount of fund to be received by company in case of further allotment and the use of these funds in final document to be filled with ROC.
- In the case of initial public offer by the unlisted company, the promoter and the pre issue share holders or incase of listed company having shareholding more than 5 % shares , may lend the shares subject to provision of SEBI.
- The Stabilizing Agent shall borrow shares from the promoters or prs issue share holding to extend of proposed over allotment. The allocation of these shares shall be on pro rata basis. The stabilization mechanism shall be available for the period, which shall not exceed 30 days from the date of trading permission, was given by exchange(s).
- The SA shall open a special account with the bank to be called SPECIAL ACCOUNT for GSO proceeds ofCompany. For the money received from applicants against over-allotments in GSO shall be kept in GSO bank A/c for the purpose of buying shares from market during stabilization period, credited to the GSO Demat A/c(shares brought from markets by SA). The share brought from market and lying in GSO Demat A/c shall be return to promoter immediately in any case not later than 2 working days after the close of the stabilization period.
- The Prime-responsibility of SA shall be stabilizing post-listing price of share. The SA shall determine the timing of buying the shares, quantity to be brought and the prices at which the shares are to be brought.
- On the expiry of stabilization period, in case of SA does not buy shares, the issuer company shall allot shares to the extend of shortfalls in dematerialization form to GSO Demat A/c with in 5 days of closer of Stabilization period.
- The shares returned to promoter shall be subject to remaining lock in period as applicable to promoters holding. The SA shall remit an amount equal to Issuer Company from GSO Bank A/c. The amount left in this account shall be transferred to investor's protection fund. The SA shall submit a report to stock exchange on daily basis during the stabilization period.
- The SA shall also submit a final report to SEBI in specified format. The SA and the company shall sign this report The SA shall maintain the register in respect of each issue and must retained for the period at least 3 years from the date of end of stabilization period. The register contains:
 1. Each transaction effective.
 2. Details of Promoters from whom the shares are to be brought.
 3. Details of allotments.

6. PRICE STABILISATION MECHANISM ^[6]

The mechanism by which the GSO works to provide stability and liquidity to a public offering is described in the following example:

The price for the shares is determined by an agreement between the sellers (the company's owners and directors) and the buyers (the underwriters and their clients). A part of the responsibility of the lead underwriter in running a successful offering is to ensure that once the shares begin to publicly trade, they do not trade below the offering price.

Step 1: Assume that the company wants to issue 100 shares and the price discovered through the book-building mechanism is Rs 10 per share. The company has also made a provision of 15 percent GSO to the underwriters of the issue.

This means, at the discretion of underwriters, the company will further issue 15 shares at the same price of Rs 10 to the specific underwriter, who, in turn, will act as the Stabilization Agent (SA) for the issue. The option is valid only for a period of one month post listing of the IPO. The amount raised by selling these 15 shares will be in the escrow account, to which the underwriter has the access.

Step 2: On the closure of IPO, the underwriter issues 115 shares (minimum IPO size 100 shares). The shares can be a loan from the promoter or any existing shareholder of the company.

Step 3: If the stock price goes up, Post listing, the SA is not required to stabilize the price and will exercise the GSO, whereby the company will issue further 15 shares to the underwriter and collect money for the same at the book-build price (offer price).

In case the stock price goes down below the issue price post-listing, then the underwriter uses the money from the escrow account up to the extent of 15 shares to buy shares from the secondary market and the issue size remains at 100 shares. The underwriter, in this case, returns the 15 shares to the lender.

7. Findings & Suggestions

7.1. Findings

- The GSO facility is restricted to 15% of over allotment & 30 days stabilization period (flow of shares period) without the guarantee that this stabilization program would be successful. In these circumstances, the fear of Retail Individual Investors would only increase.
- The issues where GSO is opted may not indicate the correct share prices and it will deprive “Value Investor” from purchasing shares from other investors when the price falls.
- Merchant banks that are designated as Stabilising Agents get high fees for availing of the GSOs. Such high fees for merchant banks were felt to be unjust as they face limited risk in implementing GSOs.
- The legal and regulatory compliances are burdensome, due to this, the issuer companies and merchant bankers are not ready to take additional responsibility.
- In a survey conducted by The Economic Times; a typical response was “Unlike in the US, SEBI does not permit merchant bankers to make money in trading. They will have to buy the stock if the price falls below the offer price, but they are not allowed to sell even if the stock value goes up. We are required to stabilize the price around the offer price for which we get a fixed fee”.
- From the analysis only 50% of investors are strongly agree of awareness of stock market, agree are 20% & strongly disagree are 0%.
- From findings 20% strongly agree of trading procedure in stock market, 30% agree & 10% strongly disagree.

- As per analysis 10% strongly agree of awareness of portfolio management, agree are 20% & strongly disagree are 20%.
- As per findings buying & selling procedure of stock & scrips strongly known investors are 30%, agree are 20% & strongly disagree are 10%.
- From analysis only 20% are strongly agree of awareness of book building, 10% are agree & 10% are strongly disagree.
- From the opinion survey of Green Shoe Option 0% for strongly agree, 10% are agree & 10% strongly disagree.
- From the survey it reveals that 30% are interested in commodity market, 20% interested in derivative market & 50% are interested in share market.
- As per analysis 40% are interested in Regular investment, 30% are seasonal investment & 30% in periodical investment.
- As per findings investors transaction are 10% in 0-6 months, 5% in 12 months, 1-2 years 30% & 2 years & above 55%.
- According to survey the basis of investment for investors are track record 30%, Present financial performance 20%, nature of business 10% & image of the company 40%.

7.2. Suggestions

- GSO can be made mandatory in case of IPOs to benefit the Investors.
- GSO facility to be increased to 25% from 15% of over allotment.
- The stabilization period to be increased to 45 days from 30 days, to successful and to include all categories of investors.
- Nominal fees to be given to Merchant bankers appointed by company to carry out transactions with code of conduct.
- Legal and regulatory complications to be reduced to give participation to all categories of investors.
- Cumbersome restrictions on Merchant Bankers while availing benefit to be reduced by SEBI.
- GSO to be implemented in all countries to give best opportunity to all investors worldwide.
- GSO in bearish market give opportunity to underwriters to buy more than 15% at prices lower than the issue price from the market.
- As per findings only 50% are aware of stock market, for this SEBI has to give advertisement in mass media not only focusing on some TV channels & Newspapers or magazines it has to be there in every mass media every 10 minutes to create awareness in the mind of investors to avoid their fear about stock market.
- Only 20% are strongly agree of procedure in stock market, for this SEBI has to establish branches everywhere & brokers are to have network to reach to a variety of investors towards stock exchange.
- 10% of investors know about Portfolio management, it means group of securities how investor he can plan & manage & how he gets returns, in spite of this still today in the mind of variety of investors are afraid of stock exchange because of volatility of stock market, it has to overcome by creating a channels of investors, it means if one investor invested in stock market, he has to inform his friends the benefits and how to get return through management.
- 30% of investors known about buying & selling procedures of stock & scrips, remaining investors through brokers they dealt, to overcome this SEBI has to create barrier that knowledge of stock market is necessary to enter into transaction exchange.
- 20% known about Book Building (auction sale), for this SEBI can give another name to give focus for this. It means SEBI has to give simple terminologies.

- 0% investors known about this still its introduced in Aug 2003, awareness should be created amongst the Companies, Merchant Bankers and Investors about the GSO and its importance.
- 50% of investors are invested in share market, it means they are not aware of commodity & derivative market, for this SEBI has to give more scope for these types of markets.
- 40% regular investment, it means other types of investors afraid about returns that have to avoid by giving scope for long term investment.
- 2 years & above having 55%, it means only long term investment, for this SEBI has to create awareness about short term investment through channels.
- 40% of investors are depend on Image of the company, this is not correct because they to see Track record (past performance), present financial position & nature of business based on these only returns will come.

8. Conclusion

The green shoe has the ability to reduce risk for the company issuing the shares. It allows the underwriter to have buying power in order to cover their short position when a stock price falls, without the risk of having to buy stock if the price rises. In return, this helps keep the share price stable, which positively affects both the issuers and investors.

It benefits the Underwriters in both bullish and bearish conditions. In bull market, underwriters will opt for additional allotment of 15% due to index riding high. In a bearish market, the underwriting option may not be exercised or the underwriters may buy up to 15% at prices lower than the issue price from the market.

From the analysis it is found that people aware of the stock market, but a lot of people doesn't know the trading operations. Investors doesn't know different financial instruments and also they don't know about the book building effectiveness and impact happening in the stock market, from that they fail to take an advantage of profitable because of lack of awareness. Almost all many of them are shown their keen to the investment in share market; it reveals that taking advantage of Short term gain by investing more in share market which are static. Investors also given importance to goodwill of the company.

GSO though introduced in 2003 and nearing a decade, still it is in infantry stage in India. A very few companies have gone for GSO and reaped the benefit of price stabilization. It is high time that awareness programs are conducted to educate the companies about the importance of GSO.

9. References

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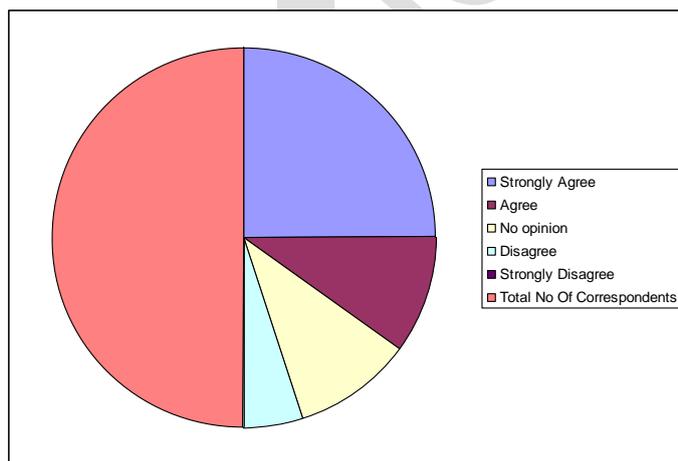
10. Annexures:

Data Analysis & Interpretation

(1) I am aware of Stock Market.

Strongly Agree	50	50
Agree	20	20
No opinion	20	20
Disagree	10	10
Strongly Disagree		0
Total No Of Correspondents	100	100

Chart No 1



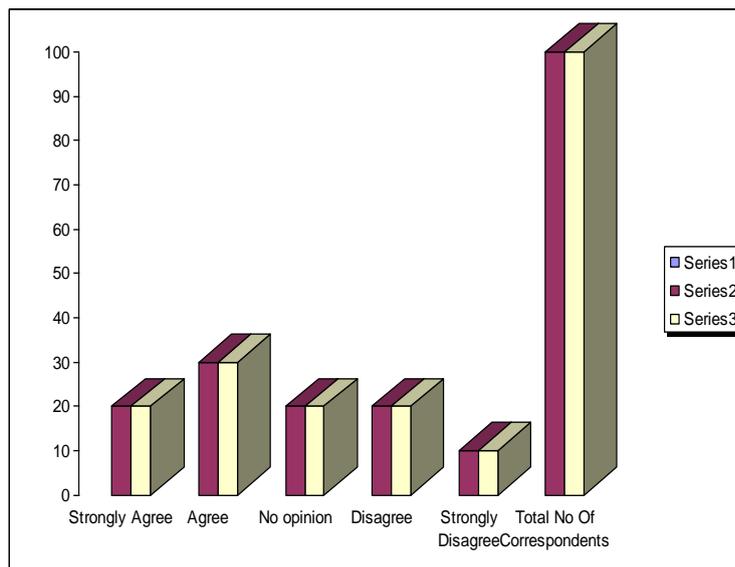
Analysis & Interpretation

As per table, 50% strongly agree & 0% strongly disagree.

(2) I am aware of Trading Procedure in Stock market.

Strongly Agree	20	20
Agree	30	30
No opinion	20	20
Disagree	20	20
Strongly Disagree	10	10
Total No Of Correspondents	100	100

Chart No 2



Analysis & Interpretation

From above table, 20% strongly agree & 10% strongly disagree.

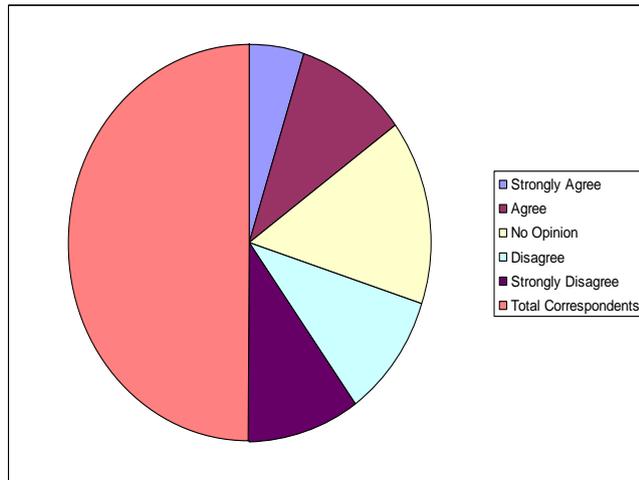
Even though they know about stock market but many of them they don't know about the trading operations, it shows lack of knowledge.

(3) I am aware of Portfolio Management.

Table No 3

Strongly Agree	10	10
Agree	20	20
No Opinion	30	30
Disagree	20	20
Strongly Disagree	20	20
Total Correspondents	100	100

Chart No 3



Analysis & Interpretation

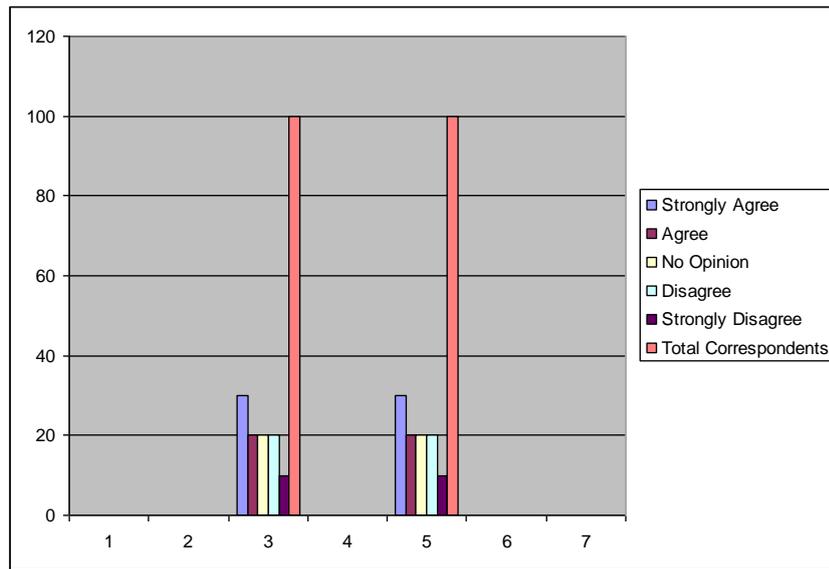
As per table 10% strongly agree & 20% strongly disagree which is more.

It shows that even though investors are keen to invest but individually don't know about the diversification of risk.

I am aware of Buying and selling procedure of stock and scrimps.

Table No 4		
Strongly Agree	30	30
Agree	20	20
No Opinion	20	20
Disagree	20	20
Strongly Disagree	10	10
Total Correspondents	100	100

Chart No 4



Analysis & Interpretation

As per above table strongly agree are 30% & strongly disagree are 10%.

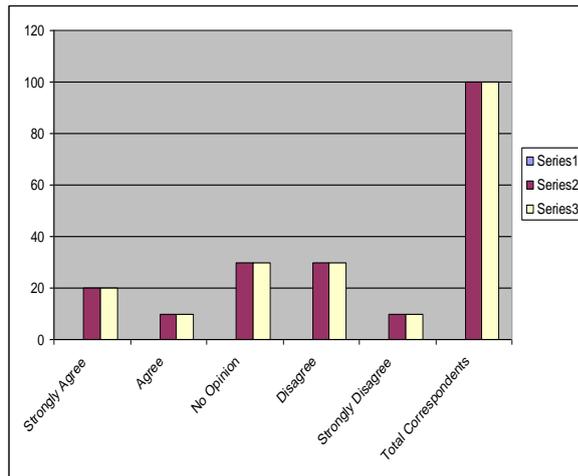
The graph depicts investor’s potentiality but they are not aware of different financial instruments.

(5) I am aware of Book Building in stock market.

Table No 5

Strongly Agree	20	20
Agree	10	10
No Opinion	30	30
Disagree	30	30
Strongly Disagree	10	10
Total Correspondents	100	100

Chart No 5



Analysis & Interpretation

As per table strongly agree are 20% & strongly disagree are 10%.

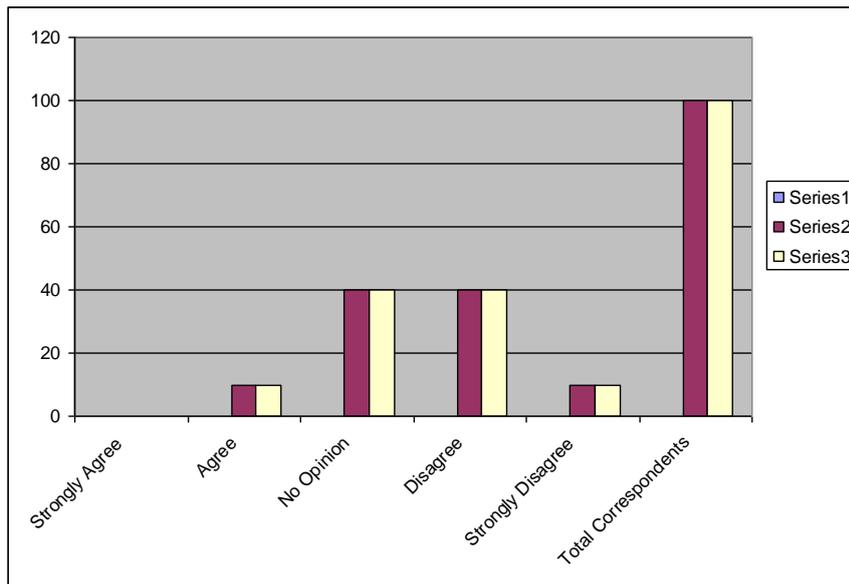
From diagram it shows that many of the people still they don't know about the book building effectiveness and impact happening in the stock market, from that they fail to take an advantage of profitable because of lack of awareness in using the above method.

(6) I am aware of Green Shoe option available in Stock Market?

Table No 6

Strongly Agree	0	0
Agree	10	10
No Opinion	40	40
Disagree	40	40
Strongly Disagree	10	10
Total Correspondents	100	100

Chart No 6



Analysis & Interpretation

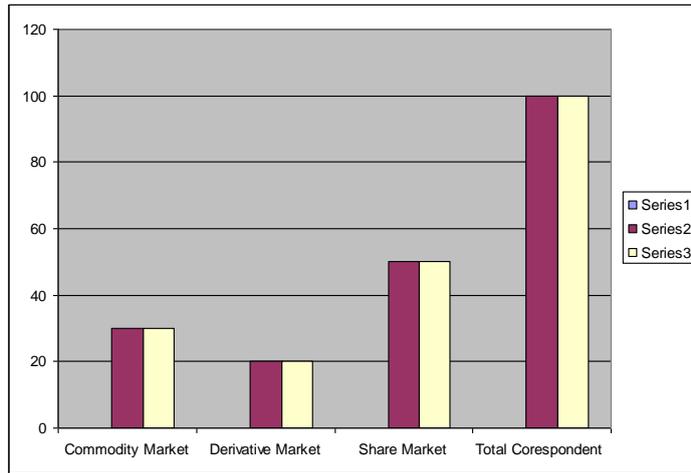
As per table 0% strongly agree & 10% strongly disagree.

The above graph indicates that only 10% are having the awareness of GSO, it shows that they are losing their investment benefits, these are techniques which will help the investors for the individual growth.

(7) The Kind of Market you are interested in.

Commodity Market	30	30
Derivative Market	20	20
Share Market	50	50
Total Correspondent	100	100

Chart No 7



ANALYSIS & INTERPRETATION

As per table 30% are commodity market & 50% share market.

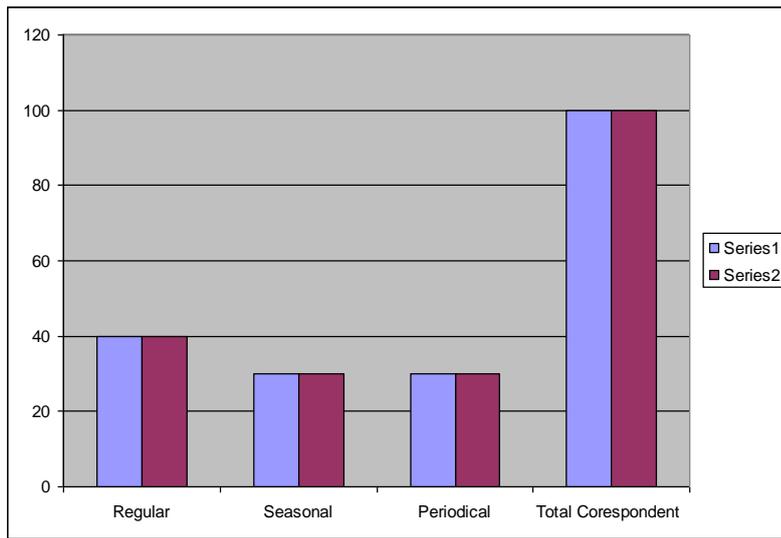
Almost all many of them are shown their keen to the investment in share market; it reveals that taking advantage of Short term gain by investing more in share market.

(8) The type of Investment you are interested in Stock market.

Table No 8

Regular	40	40
Seasonal	30	30
Periodical	30	30
Total		
Correspondent	100	100

Chart No 8



Analysis & Interpretation

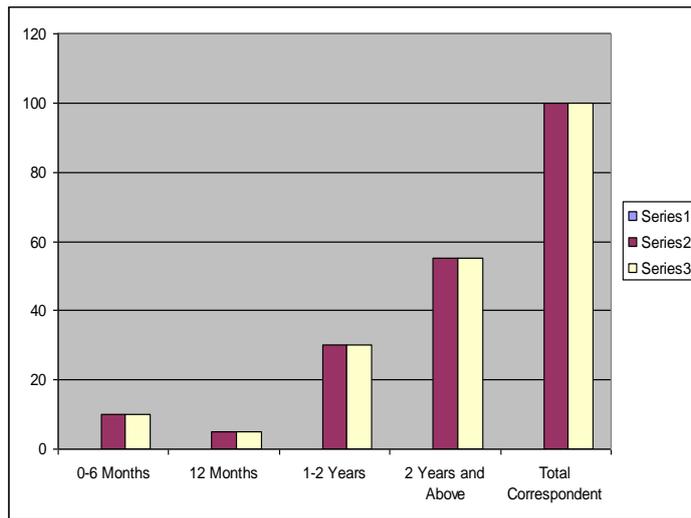
As per the above table Regular investors are 40%, seasonal investors are 30% & periodical investors are 30%.

As per the survey many of the investors are trading regular short term.

(9) How often you transact the Investment?

0-6 Months	10	10
12 Months	5	5
1-2 Years	30	30
2 Years and Above	55	55
Total Correspondent	100	100

Chart No 9



Analysis & Interpretation

From the above table 0-6 months of transaction are 10%, 2 years & above are 55%.

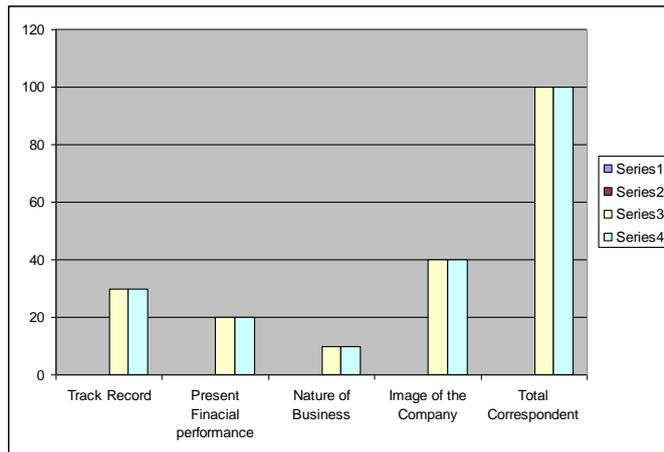
it depicts that many of them are preferably for long term investment usually 2 years and above because to avoid the risk as well it indicates that these kind of investors usually they invest fund where returns are static.

10) The basis for your Investment in Stock market.

Table No 10

Track Record	30	30
Present Financial performance	20	20
Nature of Business	10	10
Image of the Company	40	40
Total Correspondent	100	100

Chart No 10



Analysis & Interpretation

From the above table 30% of investors are depend on Track record, 40% of investors are on Image of the company, it depicts clearly in graph that people see goodwill of the company.

Opinion Survey						
Questionnaire						
Personal Information:						
Name		Occupation				
Mobile No		Email				
Address						
General Event		Strongly Agree	Agree	No Opinion	Dis-agree	Strongly Disagree
1	I am aware of Stock Market?					
2	I am aware of Trading Procedure in Stock market?					
3	I am aware of Portfolio Management?					
4	I am aware of Buying and selling procedures of stock and scrips?					
5	I am aware of Book Building in stock market?					
6	I am aware of Green Shoe option available in Stock Market?					
7	The Kind of Market you are interested in.	a)Commodity Market		b)Derivative Market		c)Share Market
8	The type of Investment you are interested in Stock market.	a)Regular		b)Seasonal		c)Periodical
9	How often you transact the Investment?	a)0-6 Months				
		b)12 Months				
		c)1-2 Years				
		d)2 years & Above				
10	The basis for your Investment in Stock market.	a)Track Record				
		b)Present Financial performance				
		c)Nature of Business				
		c)Image of the Company				