4 Primary market

4.1 Learning outcomes

After studying this text the learner should / should be able to:

- Understand the organisational structure of the equity market.
- Explain the differences between the primary and secondary equity market.
- Evaluate the economic function of the primary market.
- Comprehend the motivation and advantages or the listing of share capital.
- Explain the disadvantages of being listed.
- Know of the existence of listing requirements.
- Identify the types of companies that list.
- Describe the listed products other than shares.
- Explain the methods of listing.
- Provide an exposition of the steps involved in a listing.
- Comprehend the contents of the prospectus.
- Evaluate the arguments for and against underwriting a share issue.
- Describe the other sources of primary market issue of listed equity.
- Appreciate the role played by the exchange in terms of capital raised.

4.2 Introduction

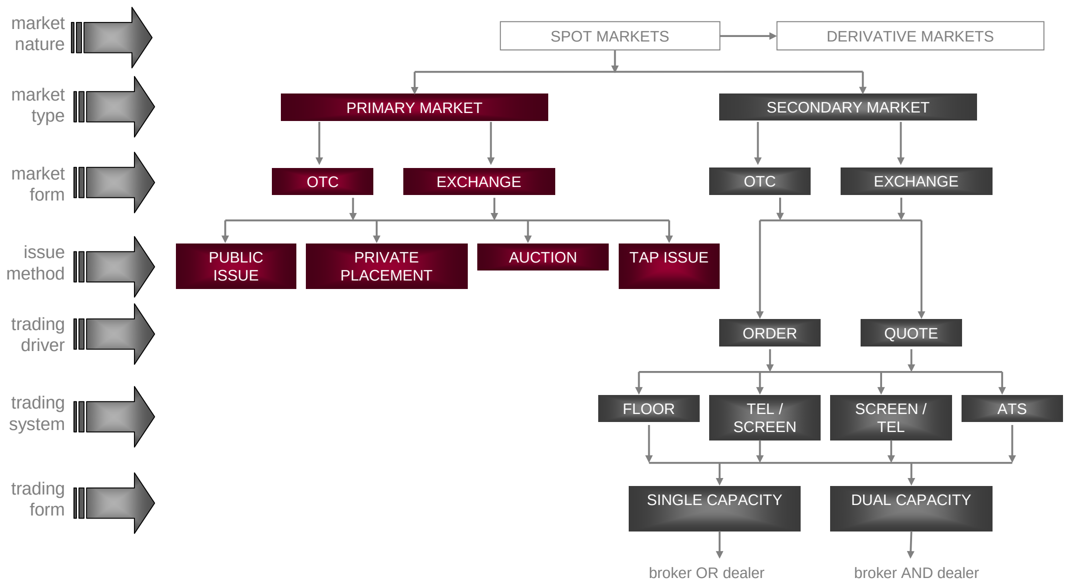

Figure 1: Organisational structure of spot financial markets

Figure 1 serves as an introduction to this section. All financial markets have primary markets, but not all have secondary markets. For example, there is a primary market for savings deposits, but the holders are not able to sell these financial instruments. Marketable securities have secondary markets.

Listed equities are marketable and the equity market therefore has a *primary market* and a *secondary market*. The primary equity market is the market for the issue of newly created equities, and the secondary market the market for the trading of existing securities. Thus, in the case of primary market issues the issuing companies are funded to the extent of the number of shares issued times the price of the shares (see Figure 2).

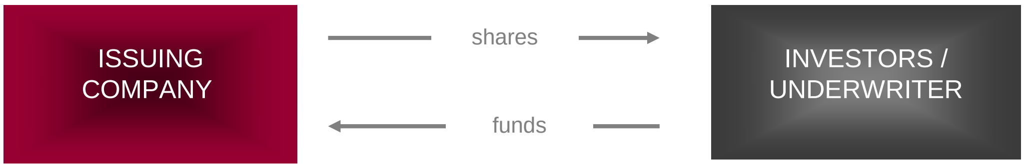

Figure 2: exchange of value in primary equity market

In the secondary market the companies whose shares are being traded are not additionally funded. The seller of the (existing) shares (an investor) is merely paid for the shares by the buyer (an investor), via a broker, and the consideration paid is the number of shares times the price negotiated for the shares (see Figure 3).

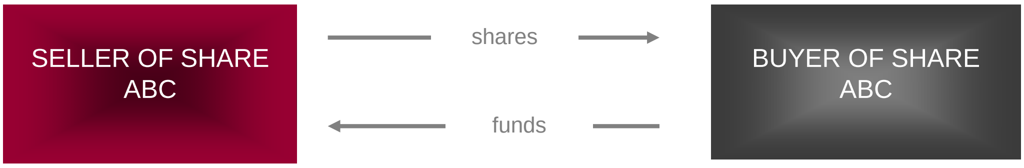

Figure 3: exchange of value in secondary equity market

The primary market for *unlisted shares* is straightforward. In the case of a new company, the owners would simply have the shares created by an accountant/lawyer and the funds (par value of shares) placed in a bank account opened for the company. If the unlisted company requires additional funding, it will approach investors, armed with a prospectus, and if successful, place the shares with them, and place the funds raised in the bank account.

However, in the case of a *listed* company, the primary market is not uncomplicated. In the pages that follow, the primary market is covered in some detail under the following sections:

- Economic function of primary market.
- Motivation for listing (advantages).
- Disadvantages of being listed.
- Listing requirements.
- Types of companies that list.
- Listed products other than shares.
- Methods of listing.
- Steps involved in a listing.
- The prospectus.
- Underwriting a share issue.
- Other sources of primary market issue of listed equity.
- Capital raising.

4.3 Economic function of primary market

The economic benefit / function of the primary equity market is to channel surplus funds into productive investment at a price that is commensurate with the risk assumed by the buyer of the equity. The issue price paid is a function not only of the perceived risk and expected return, but also of the fact that a secondary market exists for the trading of the equities, i.e. a means of exit from the investment exists. For this reason, the primary and secondary markets are inextricably linked.

It will be apparent that most companies have their shares listed on an exchange with the intention of utilising the acquired (permanent) capital for long-term investment (additions to a production facility and/or equipment) that will yield a respectable return for the company and therefore for its shareholders. However, this capital will not be readily available if no secondary market for equities exists.

The secondary market not only provides an exit mechanism for the investment (many investors invest only for the short term), but also provides real clues as to the correct pricing. The large investors in the equity market are the professional investors (called the "institutions"), and smaller investors take comfort from the fact that the market is usually priced correctly, and that the professionals have brought this about.

4.4 The law, the equity exchange and listing

When marketable equity is issued it is listed on the financial exchange of the country (there may be more than one exchange). What does this mean? All[17] countries have equity exchanges and all exchanges are licensed under a statute. The statute usually defines an exchange and its functions and has many provisions regarding the listing of equities.

In South Africa, for example, the Securities Services Act (SSA) **defines an exchange** as (section 1):

> **"…**means a person who constitutes, maintains and provides an infrastructure –
> a) for bringing together buyers and sellers of securities;
> b) for matching the orders for securities of multiple buyers and sellers; and
> c) whereby a matched order for securities constitutes a transaction…"

In respect of the **general functions of an exchange** the SSA (section 11) determines:

Section 11 determines:

> "…(1) An exchange –
> a) must enforce the exchange rules and listing requirements;
> b) must supervise compliance by authorised users with this Act and the exchange rules;
> c) may issue directives;
> d) may amend or suspend the exchange rules in terms of section 61, and may amend its listing requirements in consultation with the registrar;
> e) (i) must make provision for the clearing and settlement of transactions in listed securities effected through the exchange;
> (ii) may appoint a clearing house licensed in terms of section 66 to perform clearing house services for the exchange in accordance with the exchange rules;
> (iii) must consult with an appointed clearing house when making or amending exchange rules pertaining to clearing and settlement;
> f) must supervise compliance by issuers of listed securities with the listing requirements, the exchange rules and this Act…"

In respect of **listing requirements** the SSA (section 12) determines:

> "…(1) An exchange must…make listing requirements which prescribe –
> a) the manner in which securities may be listed or removed from the list or in which the trading in listed securities may be suspended;
> b) the requirements with which issuers of listed securities and of securities which are intended to be listed, as well as such issuers' agents, must comply;
> c) the standards of conduct that issuers of listed securities and their directors, officers and agents must meet;
> d) the standards of disclosure and corporate governance that issuers of listed securities must meet…
> (6) An exchange –
> a) must keep a list of the securities which may be traded on the exchange;
> b) must receive and consider, and may grant, defer or refuse, subject to its listing requirements and any other conditions that it may determine, applications for the inclusion of securities in the list;
> c) may include securities issued by it in its own list subject to the approval of and the conditions prescribed by the registrar…"

The SSA also determines that the exchange will be managed by the Rules and Directives of the exchange which must be approved by the Registrar (the licensing body).

The details of the listing requirements are contained in a separate *Listings Requirements* document. Box 1 presents the sections of this document which provides a hint of the requirements.

The share listing requirements are onerous, because the listing and trading of listed shares *is* the business of exchange. South Africa is also moving towards international best practice in this regard, leading to greater disclosure, in an effort to perfect local and foreign investor confidence in the equity market.

Introduction
Definitions
Authority of the committee
Sponsors
Continuing obligations
Conditions for listing
Methods and procedures of bringing securities to listing
Pre-listing statements
Listing particulars
Financial information
Transactions
Transactions with related parties
Circulars and announcements
Mineral companies
Property companies
Special types of issuer
Investment entities
Documents to be submitted to the committee
Listing and other fees
Dual listings and listings by overseas companies
STRATE
Transitional requirements
Schedules

Box 1: Sections covered in JSE (Equities Division) listings requirements document

We will return to the listing requirements later.

4.5 Motivation for listing (advantages)

4.5.1 Introduction

There are many reasons / advantages for listing on an exchange:

- Enhanced ability to raise capital.
- Acquisition of capital at the best possible price.
- Incentive for employees.
- Incentive for owners.
- Credibility and reliability of the company.
- Source of information.

4.5.2 Enhanced ability to raise capital

It is easier to raise capital if a company's shares are listed. This is because substantially more investors will be aware of the primary issue, and this is because a primary issue to be listed is advertised widely in the press and by the members of the exchange, particularly by the sponsoring broker.

Investors generally prefer to hold listed shares because they have an exit mechanism, i.e. they have the benefit of being able to dispose of the shares if they so desire.

The company is also better able to raise other forms of finance such as bank loans, and funds from the issue of bonds. This is because creditors are better disposed toward a listed company, and this springs from the knowledge that listed companies are subjected to the scrutiny of the public and the exchange.

A credible listed company is also able to raise additional equity finance for acquisitions and takeovers. This may be substantially cheaper than alternative forms of finance.

4.5.3 Acquisition of capital at the best possible price

Apart from the improved access to capital, a company that lists its shares on an exchange is able to raise capital at a reduced price. There is a premium for marketability. This is because the *investment horizon of the investor is rendered flexible* by listed shares. In the case of unlisted shares the investors in effect make an investment for an indefinite period (remember shares are similar to perpetual bonds, but with uncertain returns). However, in the case of listed shares the investor may hold on to them for as long as s/he desires.

Investors also have the comfort of knowing that there are many professional analysts that will be monitoring the share to be listed, which does not apply in the case of unlisted shares. Also, investors in a new issue will generally regard the initial pricing to be fair because it is known that the professional investors will most likely also be taking up the shares.

4.5.4 Incentive for employees

Many companies offer their employees benefits in the form of a parcel of shares in the company either directly or via a share incentive scheme. If the shares are listed or if a listing is planned, the company will attract a better quality of managing director, executive directors and other management. With high quality management, the company will perform better than otherwise.

4.5.5 Incentive for owners

The original owners of a company have two main incentives to list:

- Provides an opportunity to cash in a portion of their investment in their company and diversify their portfolios.
- In the case of older owners (when experiencing more frequent senior or senile moments) to retire and to replace themselves with competent management.

4.5.6 Credibility and reliability of the company

A listed company is seen to be more credible than a non-listed company in the same line of business. This improves the prospects for business. Also, the public draws comfort from the fact that analysts and the exchange carefully monitor the listed company.

4.5.7 Source of information

As noted above, analysts and the public in general are trading in the company's shares on a daily basis, reflecting thus their collective judgement of the share (risk free rate plus premium for risk). This is a valuable source of information in respect of:

- The public's impression of the company.
- The receptiveness of the market for further issues, i.e. the timing of further issues of shares when required.

4.6 Disadvantages of being listed

4.6.1 Introduction

Associated with being listed are certain drawbacks, responsibilities and costs:

- Price of issue is made at a discount to perceived market value.
- Monetary cost.
- Disclosure of strategic information to competition.
- Pressure by public shareholders.
- Costs after listing.

4.6.2 Price of issue is made at a discount to perceived market value

A listing usually takes place at a price that is a discount to the "normal" price at which the company's shares should trade. Companies price their listing with reference to listed companies that they regard as their peers, and the discount could be 10–20% below what should be the market price, in order to ensure that the listing is successful.

4.6.3 Monetary cost

The monetary cost incurred by the company in listing is substantial. The firms involved in a listing are broker/s, attorney/s, banker/s accountant/s and sponsor/s. The time expended by the management of the company itself, including the "road show" to introduce the company to the institutions, is also usually of substantial (indirect) monetary cost.

4.6.4 Disclosure of strategic information to competition

Because listing requirements on most exchanges are strict in terms of disclosure, much information about the company is made public. This is a positive factor, but the information is also available to competitors.

4.6.5 Pressure by public shareholders

A listed company desires to be seen to be responsible in respect of, for example, social issues. This may not always be in the interests of the company (and its shareholders). Certain fanatical shareholders at Annual General Meetings may pressurise a listed company on this and various other issues.

Another piece of information that is made available to the public is the remuneration of directors, which is particularly pertinent under Corporate Governance requirements. Shareholders may object to remuneration that is considered by them to be too generous, which may prevent the appointment of the best man for the job.

4.6.6 Costs after listing

There are numerous additional costs after a listing has taken place, including the costs of annual and interim reports, public notices such as cautionary announcements, and time spent with broker-dealer analysts.

In addition, the company is required to comply with the listings requirements of the exchange, which impose harsh requirements on the company beyond those required by the statute relating to companies. More management time is required to comply with the exchange requirements.

If listed companies breach the listings requirements, they can be sanctioned by the exchange. If this knowledge becomes public it could have a negative effect on the share price. (This of course can be seen as a positive factor rather than a negative factor.)

4.7 Listing requirements[18]

4.7.1 Introduction

The listing requirements differ from exchange to exchange, and from "board" to board" within exchanges, and they are usually onerous. One of the major requirements is the financial requirements that companies are obliged to disclose in the prospectus, which they are required to issue (see below). Before discussing this and other issues related to listing, we need to take a look at the segmentation of an exchange.

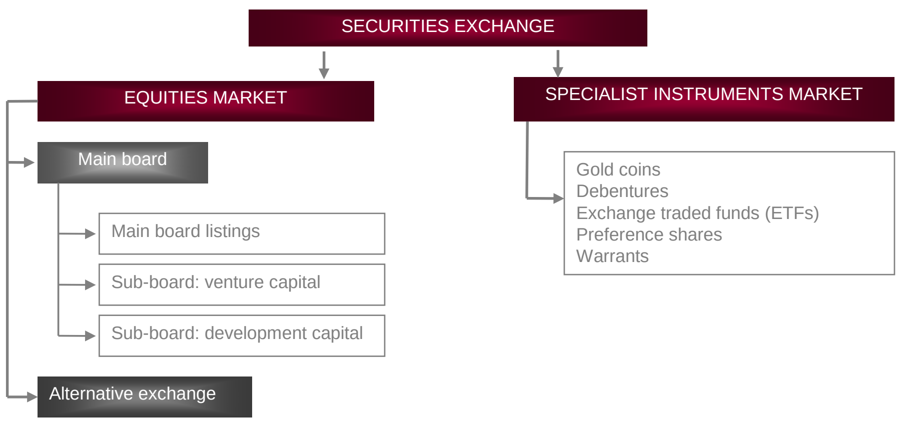

Figure 4: segmentation of an exchange

Many equity exchanges have an Equities Market and a Specialist Instruments Market. The latter will include instruments such as gold coins, warrants, ETFs, preference shares and so on (as indicated in Figure 4).

The Equities Market will usually have a Main Board (for the large companies) and an Alternatives Exchange (for smaller companies). Examples of the latter are AIM in the UK and Alt-X in South Africa. There could also be sub-boards such as a Venture Capital Board and a Development Capital Board.

The term "board" originates from the use in the past (and still used in some countries) of a physical board upon which prices were recorded as member brokers made offers and bids. The listing requirements of the *Main Board*, the two *Sub-boards*, and the *Alternative Exchange* are discussed briefly below.[19]

4.7.2 Main board

The requirements in summary for a *Main Board* listing are as follows:

- A subscribed capital (including reserves but excluding minority interests, and revaluations of assets and intangible assets that are not supported by a valuation by an independent professional expert acceptable to the Committee prepared within the last six months) of at least R25 million.
- The company must have a satisfactory profit record for at least the preceding three years, the last of which must be an audited profit before taxation of at least R8 million.
- The public must hold a minimum of 20% of each class of share. Obviously this means that in the offer at least 20% of shares must be offered to the public.
- The number of the public shareholders (excluding employees and their associates) of listed securities must be at least: 500 for equity shares, 50 for preference shares and 25 for debentures.
- The minimum initial issue price of shares is required to be not less than 100 cents per share. This of course means that there will not be less than 25 million shares in issue.
- Companies are obliged to disclose much detail in their prospectus and financial statements.

- The listed company must appoint a sponsor on a permanent basis. The sponsor must be independent of the company, and ensure that the listing requirements are adhered to at all times. Any information on the company of relevance to the public and the JSE (trading statements, financial information, press announcements) must be disseminated through the sponsor.
- All annual, interim provisional reports must be audited, and comply with GAAP (Generally Accepted Accounting Practice) or IFRS (International Financial Reporting Standards).
- Abridged annual financial statements are released on SENS (see below) on the day the statements are released.
- Disclosure of directors' emoluments in all forms (share options, fees, basic salaries, bonuses, material benefits, performance-based payments, etc.).
- Compliance with some of the principles of the King Code of Corporate Governance, including the splitting of the functions of chairman and chief executive, the appointment of an audit and remuneration committees (majority to be non-executive and independent), appointment of a risk committee (depending on the nature of business), appropriate board structure, non-share trading periods, etc.

The JSE has the right to list companies that do not strictly comply with the above requirements, but this will only occur in exceptional circumstances.

Investment entities and property and mineral companies that are listed on the Main Board have certain modified criteria for listing. These will not be elucidated here.

4.7.3 Development capital market

The Development Capital Market (DCM), according to the JSE, was created in 1984 in recognition of "…the need to encourage the growth of small to medium sized businesses and companies which are not able to list on the Main Board…"[20] The criteria to be met by companies applying for a listing on the DCM are less onerous than those of the Main Board.

The main requirements of a listing on the DCM include:

- A subscribed capital, excluding revaluations of assets, of at least R1 million, in the form of not less than one million shares in issue.
- A satisfactory profit record for the preceding two years (or in exceptional circumstances, a lesser period), the last for which the company reported an audited profit level of at least R500 000 before taxation (mineral companies are exempt from this requirement).
- A minimum of 10% of each class of equity shares in issue is to be held by the public.
- The company must have a minimum of 75 public shareholders.
- The minimum initial issue price must be not less than 50 cents per share.

4.7.4 Venture capital market

4.7.4.1 Introduction

The Venture Capital Market (VCM), according to the JSE, was formed in 1989 "To assist companies specialising in venture capital projects (venture capital conglomerates) or single venture companies ..."[21] The record of the success of companies listed on the VCM has not been respectable. Consequently the requirements are relatively onerous.

4.7.4.2 Pre-application submission

The JSE requires that companies desirous of listing on the VCM submit a memorandum prior to the submission of an application for listing. The memorandum is required to contain details on the following:

- A synopsis of the nature of business of the company
- The modus operandi of the company
- The company's business plans and prospects

The company may only make a formal application for a listing if the executive committee of the JSE approves the memorandum.

A *single venture company*, in addition to the above, is required to provide an analysis of its prospects, based on its market segment growth, an analysis of the competitive environment in which it operates and its estimated market share. It is required to present a three-year business plan, including forecast balance sheets, profit and loss accounts and cash flows.

A *venture capital conglomerate* must satisfy the JSE that it has as its dominant business the professional operation of a company that holds and will continue to hold a portfolio of investments in ventures, each of which is characterised by the fact that the venture capital conglomerate:

- Has an investment in each underlying venture which is substantially an equity investment
- Is able to add value to each of its underlying venture projects through providing support services and proper financial disciplines.
- Has conducted adequate research into the management strength and commercial viability of each of its underlying ventures.
- Has drawn up a business plan for the next three years in respect of each underlying venture and of the combined portfolio, with forecast balance sheets, profit and loss accounts and cash flow statements.

4.7.4.3 Key requirements of a VCM listing

- The company must have a subscribed capital, excluding revaluations of assets, of at least R500 000, in the form of not less than one million shares in issue.
- The JSE will not list securities held by the entrepreneurs of the VCM company amounting to 75% of their shareholding/s (as held immediately prior to any marketing of securities in conjunction with the application for listing) for a period of at least two years subsequent to listing being granted. This is to ensure that the entrepreneurs to remain financially committed to the VCM company.
- A profit history is not required but the company should indicate credible returns on capital that on a time-weighted basis are above average in its analyses of future earnings.
- The public must hold a minimum of 5% of each class of equity shares.
- The company must have a minimum of 75 public shareholders.
- The minimum initial price of the shares must be not less than 50 cents per share.
- The majority of directors and managers must have had successful records of achievement in their respective rules.
- The company is required to have a warning of the speculative nature of investment in such a company at the beginning of its prospectus, or pre-listing statement.

4.7.5 Alternative exchange

Many countries have "Alternative Exchanges", which essentially are divisions of exchanges that have less-onerous listing requirements. We present the South African example: the Alternative Exchange (ALT^X) was launched in August 2003 and started trading in October 2003. According to the launch brochure of the ALT^X of the JSE:

"The Alternative Exchange, ALT^X, is a division of the JSE…ALT^X is the JSE's exciting 'parallel' market for small to medium and growing companies. It offers investors opportunities to invest in a myriad of companies and is designed for investors who understand the nature of the market and are prepared to accept the potential risk and rewards of investing in growing companies. Companies can join to issue new shares, raise funds, widen their investor base and have their shares traded on a regulated market. ALT^X is designed to appeal to a diverse range of companies in all sectors including:

- Young and fast-growing businesses including start-ups
- Management buy-outs and buy-ins
- Family-owned businesses
- Black economic empowerment companies
- Junior mining companies."

As to "why and how ALT^X has been developed", the JSE reports:

"Securities exchanges should be natural sources of capital at every stage of development and it is appropriate that they make provision for younger companies as well. In effect, ALT^X neatly fills this gap, providing smaller companies access to much-needed capital and facilitating smoother growth than they could previously have expected. In a symbiotic process, the investment horizons for investors are proportionately expanded. The knock-on effect helps fuel the SME sector in particular and the economy in general. Another positive role of the Alternative Exchange is that of a breeding ground for vigorous younger companies – listed firms are the potential powerhouses of the future. Intensive research into global high growth securities exchanges was conducted – 'best practice' of the most successful is therefore built into from day one."

The Alternative Exchange has alternative listing requirements to those that apply to the main Board. The requirements include:

- Appointment of a Designated Adviser
- No profit history required (but not more than R8 million)
- A share capital of R2 million
- Appointment of a financial director
- At least 100 public shareholders, who must hold at least 10% of the issued shares
- Announcements must be made on SENS and the ALT^X website (press advertising is encouraged but is not compulsory)
- At least 25% of the directors must be non-executive.

The Designated Advisors are the Sponsors that apply in the case of the Main Board, but they have additional responsibilities. According to the JSE:

"ALT^X has created the role of the Designated Adviser. Going public is a fairly complex process and Designated Advisers will play a key role in ensuring companies comply with the listing requirements thereby providing reassurance to investors…. In addition, Designated Advisers is built on a culture of relationship management, which aims to enhance the quality of companies listed as well as ensuring maximum information dissemination for investors to make informed investment decisions."

Other relevant information on the ALT^X:

- Listing fees are substantially lower compared with the main Board (R20 000 per annum).
- There is a focus on the enhancement of the skills of directors of companies through a compulsory education programme termed the "Director Induction Programme." This programme is presented by market practitioners and it covers corporate governance, listing requirements, the Companies Act, etc.
- Trading of shares is on the same system as the Main Board.
- Market surveillance is vigorous in order to eliminate irregularities.
- Settlement of securities through takes place through STRATE, (the authorised CSD for the electronic settlement of financial instruments in South Africa).

According to the JSE, it is envisaged that the Alternative Exchange will replace the DCM and the VCM in time.

4.8 Types of companies that list[22]

In most markets the companies that are permitted to list their shares on an exchange are *public limited liability companies*. These are companies whose shareholders' liability is limited to the purchase price of their shares. Clearly then, close corporations, partnerships, sole proprietorships and proprietary limited companies are not permitted to list.

Not all public limited liability companies are candidates for a listing on a share exchange. The companies that are candidates are generally those that need to utilise the benefits attached to a listing, the main one being the ability to raise capital at a relatively cheap price. This does not apply to companies/firms such as rating agencies and auditors. Apart from not requiring much capital, such companies/firms need to remain completely objective in the conduct their business (which means of course that they cannot have any shareholders other than the persons that work for the companies/firms).

The companies that list on exchanges vary greatly in terms of nature of business. Table 1 presents the listed company industry classification system (called the *industry classification benchmark* – ICB) created in 2004 by index companies FTSE and Dow Jones, and adopted by many exchanges around the world. As will be seen, in the ICB there are:

- 10 industries
- 18 supersectors
- 39 sectors
- 104 subsectors.

Industry	Supersector	Sector	Subsector
Oil & gas	Oil & gas	Oil & gas producers	Exploration & production
			Integrated oil & gas
		Oil equipment & services	Oil equipment & services
			Pipelines
Basic materials	Chemicals	Chemicals	Commodity chemicals
		Chemicals	Specialty chemicals
	Basic resources	Forestry & paper	Forestry
			Paper
		Industrial Metals	Aluminium
			Nonferrous metals
			Steel
		Mining	Coal
			Diamonds & Gemstones
			General mining
			Gold mining
			Platinum & precious metals
Industrials	Construction & materials	Construction & materials	Building materials & fixtures
			Heavy construction
	Industrial goods & services	Aerospace & Defence	Aerospace
			Defence
		General industrials	Containers & packaging
			Diversified industrials
		Electronic & electrical equipment	Electrical Components & Equipment
			Electronic Equipment
		Industrial engineering	Commercial vehicles & trucks
			Industrial machinery
		Industrial transportation	Delivery Services
			Marine Transportation
			Railroads
			Transportation Services
			Trucking
		Support services	Business support services
			Business training & employment agencies
			Financial administration
			Industrial suppliers
			Waste & disposal services
Consumer goods	Automobiles & parts	Automobiles & parts	Automobiles

Industry	Supersector	Sector	Subsector
			Auto Parts
			Tires
	Food & beverage	Beverages	Brewers
			Distillers & Vintners
			Soft Drinks
		Food producers	Farming & fishing
			Food products
	Personal & household goods	Household goods	Durable household products
			Nondurable household products
			Furnishings
			Home construction
		Leisure goods	Consumer electronics
			Recreational products
			Toys
		Personal goods	Clothing & accessories
			Footwear
			Personal products
		Tobacco	Tobacco
Healthcare	Healthcare	Health care equipment & services	Health care providers
			Medical equipment
			Medical supplies
		Pharmaceuticals & biotechnology	Biotechnology
			Pharmaceuticals
Consumer services	Retail	Food & drug retailers	Drug retailers
			Food retailers & wholesalers
		General retailers	Apparel retailers
			Broadline retailers
			Home improvement retailers
			Specialised consumer services
			Specialty retailers
	Media	Media	Broadcasting & entertainment
			Media agencies
			Publishing
	Travel & leisure	Travel & leisure	Airlines
			Gambling
			Hotels
			Recreational services
			Restaurants & bars

Industry	Supersector	Sector	Subsector
			Travel & tourism
Telecommunications	Telecommunications	Fixed line telecommunications	Fixed line telecommunications
		Mobile telecommunications	Mobile telecommunications
Utilities	Utilities	Electricity	Electricity
		Gas, water & multiutilities	Gas Distribution
			Multiutilities
			Water
Financials	Banks	Banks	Banks
	Insurance	Nonlife insurance	Full line insurance
			Insurance brokers
			Property & casualty insurance
			Reinsurance
		Life insurance	Life insurance
	Financial services	Real estate	Real estate holding & development
			Real estate investment trusts
		General Financial	Asset managers
			Consumer finance
			Specialty finance

Industry	Supersector	Sector	Subsector
			Investment services
			Mortgage finance
	Investment instruments	Equity investment instruments	Equity investment instruments
		Non-equity investment instruments	Non-equity investment instruments
Technology	Technology	Software & computer services	Computer Services
			Internet
			Software
		Technology hardware & equipment	Computer Hardware
			Electronic Office Equipment
			Semiconductors
			Telecommunications Equipment
Basic data obtained from: www.jse.co.za			

Table 1: FTSE / Dow Jones industry classification system (industry classification benchmark – ICB)

This table provides an excellent view of the types of companies that are candidates for a listing. Few countries, however, are able to boast the full list provided in Table 1.

4.9 Listed products other than shares

4.9.1 Introduction

In addition to shares, many exchanges also have other products listed. South Africa, for example, has a *Specialist Instruments (or Securities) Market* and the following instruments are listed:

- Kruger rands
- Debentures
- Exchange traded funds (ETFs)
- Preference shares
- Warrants.

4.9.2 Kruger rands

There are 4 Kruger rands listed: one ounce, half ounce, quarter ounce, and one-tenth ounce.

4.9.3 Debentures

Only a few debentures are listed on the JSE. A debenture is a fixed-interest debt security issued by a company. These instruments are falling into disuse as companies are more inclined to issue bonds. A listing requirement is that the number of public shareholders (excluding employees and their associates) must be at least 25.

4.9.4 Exchange traded funds

Name of ETF	Index tracked
Satrix 40	ALSI 40 FTSE/JSE index (comprised of the top shares listed on the Main Board of the JSE by market capitalisation)
Satrix FINI	FINI 15 index (comprised of the top 15 companies in the *financial group of sectors*, ranked by market capitalisation)
Satrix INDI	INDI 25 index (made up of the top 25 companies in the *industrial group of sectors*, ranked by market capitalisation)
Satrix RESI	Resources index
Satrix SWIX TOP40	Shareholder weighted Top40 index
NewRand Fund	A rand-hedge fund that tracks a customised new rand hedge index calculated by the JSE (comprised of a number of rand hedge shares)
NewGold Fund	Gold index
Itrix FTSE 100	Top 100 shares listed on the London Stock Exchange in terms of market capitalisation
Itrix Dow Jones Euro Stoxx 50	The 50 most liquid shares in the Eurozone area (for example: Deutsche Bank, AMN Amro)
*Derived from: **S**outh **A**frican **Tr**aded **I**nde**x.** Satrix is owned by the JSE, Deutsche Securities and Sanlam Investment Management.	

Table 2: Exchange-traded funds

Examples of the *exchange-traded funds* (ETFs, but also called *traded index funds*) listed on the JSE (Equities Division) are as shown in Table 2.

An index fund is a fund set up by some financial market participant (for example a bank or the JSE itself) to track a particular index (local or foreign). This means that the fund has liabilities in the form of tradable "shares" (although they are more akin to units of unit trusts), and assets in the form of the specific equities that make up the index, according to their weightings in the index. The price of the shares, while free to find its own level, tends to track the index value.

It will be apparent that an investment in a traded index fund is an inexpensive way of gaining exposure to segments of the market; exposure is gained without having to purchase the individual shares that make up the index. Dividends are also payable to the holders of the shares of the ETF.

4.9.5 Preference shares

There are almost 30 preference share is listed on the JSE. Examples are, i.e. Standard Bank Investment Corporation 6.5%, the AECI 5.5%, the Barloworld 6%, Nampak 6%, and so on. One of the listing requirements for preference shares is that the number of public shareholders must be at least 50.

4.9.6 Warrants

Warrants are put and call warrants on share indices and on specific shares. As noted earlier, these are not call warrants on specific shares issued by the relevant companies (that lead to the issue of new shares when exercised).

An example is the "RM ALSI A2" (the abbreviation found in the newspapers). This translates to:

- RMB = the issuer
- ALSI = the FTSE-JSE all share index
- A2 = the rating
- The abbreviation does not indicate that this is a warrant, but it is[23], and it is most likely a call warrant on the all share index.

Another example is the "SB NPN CDA". This translates to:

- SB = Standard Bank
- NPN = JSE code for the share
- C = call warrant
- D = discount
- A = the first in the series.

4.10 Methods of listing[24]

4.10.1 Introduction

In Figure 1 above that presented the organisational structure of financial markets it was stated that there are four *methods of issuing securities* (i.e. raising capital):

- Public issue.
- Private placement.
- Auction.
- Tap issue.

In many countries there are three principle methods of *obtaining a listing* for ordinary shares on the share exchange:

- An introduction.
- A private placing.
- A public offer:
  - An offer for subscription.
  - An offer for sale.

4.10.2 An introduction

An *introduction* is suitable in the case of a company that does not need to raise capital and satisfies the JSE requirement in terms of the public spread of shareholding, capital size, etc. It is the quickest and cheapest means of listing, as there is no offer to the public and minimum formalities are required.

It will be apparent that the introduction is a method of obtaining a listing, and not a method of issue, because no additional shares are issued.

4.10.3 A private placing

The *private placing* (or private placement) is a common method used to obtain a listing. In this case, shares in the company are offered to prospective shareholders privately. This method of placing is often given effect by the appointed sponsor or corporate advisor (usually a merchant bank that acts in both capacities). A prospectus is required.

With the private placing new shares are issued and capital is raised. Often, the private placing is combined with a *public offer* (see next section) in order to obtain the required spread of shareholding (a listing requirement).

4.10.4 A public offer

A *public offer* is the same as the *public issue* mentioned in the figure on the organisational structure of the financial markets, and this method of issue / method of obtaining a listing may be either:

- An offer for subscription
- An offer for sale.

In the *offer for subscription*, the public is invited to subscribe for a specified number of unissued shares. The *proceeds accrue to the company*.

In the *offer for sale*, existing shareholders invite subscribers to purchase a certain number their shares. The *proceeds do not accrue to the company*, but to the existing shareholders.

The *public offer* method of listing requires the production of a *prospectus*, and this is required to be approved and registered with the Registrar of Companies. The public has a stipulated period within which to submit their applications and payment.

In the event of an over-subscription, the company has to decide on the basis of allocation. In most cases this is agreed in advance because most offers are over-subscribed. The company earns interest on the excess payments received if the offer is over-subscribed until the date of refund. The interest is used to offset the substantial cost of the public offer.

4.11 Steps involved in a listing[25]

4.11.1 Introduction

The listing of shares by a company is a lengthy process and a number of advisors are involved in the process. The following is a rough guide to the steps involved in a listing:

- Appointment of professional advisors
- Time frame for a listing
- Other steps.

4.11.2 Appointment of professional advisors

Because the listing process is elaborate and detailed and the disclosure requirements are onerous, the assistance of experienced professional advisors is required. Much time is expended in finding competent and experienced professional advisors. The categories of advisors are as follows:

- Sponsor
- Corporate advisor
- Legal advisor

- Accountant
- Transfer secretaries (Central Securities Depository Participant – CSDP)
- Public relations consultant
- Technical advisors (in some cases).

The advisors' tasks are as follows:

Sponsor

The appointment of a sponsor is a requirement of the JSE. The JSE approves the sponsors (and a list is obtainable from the Listings Division of the JSE). The sponsor is required to:

- Satisfy itself that the listings criteria are met and that the company is a suitable candidate for a listing
- Guide the company as to the application of the listings requirements
- Explain to the directors of the company the nature of their responsibilities and obligations as directors of a listed company
- Submit the listing documentation to the JSE
- Fulfil a liaison role between the JSE / the public and the company.

Corporate advisor

A corporate advisor is a person from the *corporate finance division* of an auditor, a stockbroker or a merchant bank, and many companies desirous of listing find it useful to utilise the experience of such an advisor. The corporate advisor's main functions are to:

- Advise the company as to the application of the listings requirements and the directors as to the nature of their responsibilities and obligations as directors of a listed company (similar function as the sponsor's). (It is to be noted that often the sponsor and the corporate advisor are the same person/s.)
- Advise on the method of listing, the marketing of the offer, the size and terms of the offer, and the timing and pricing of the offer.
- Advise on market conditions and the receptiveness of the market for the company's shares.
- Co-ordinate the listing process.
- With the assistance of the company, the legal advisor, accountant and sponsoring broker, draft the listings documentation.
- Approach the investment community with a view to generating a demand for the company's shares.
- Arrange the placing if the method of listing to be adopted is a private placing.
- Underwriting or arranging for the underwriting of the offer if the method of listing to be adopted is a public offer and the offer is to be underwritten.

Legal advisor

Most companies also appoint a legal advisor. The main responsibilities of the legal advisor are to:

- Assist with the drafting of the listing documentation to ensure that all legal requirements are complied with.
- Draft the necessary agreements if there is an underwriting or a placing.
- Prepare the share option scheme for the company if such a scheme is to be introduced.

Accountant

The JSE requires that a registered accountant and auditor report in the prospectus or pre-listing statement, inter alia, on the profits and the financial position of the company over the previous three years.

Transfer secretaries

Transfer secretaries are responsible for setting up the company's register of members, issuing of share certificates, registration of transfers and execution of company actions such as dividend payments, company circulars, etc. In the case of dematerialisation of securities the transfer secretary holds the shareholding in electronic form on behalf of the shareholder (but in his/her name) in its capacity as a Central Securities Depository Participant (CSDP).

The SSA in this regard determines:

"'participant' means a person that holds in custody and administers securities or an interest in securities and that has been accepted…by a central securities depository as a participant in that central securities depository…."

Public relations consultant

Some companies use public relations consultants to assist with the promotion of a positive image for the company prior a listing. This is clearly done in order to ensure a successful listing.

Technical Advisor

Certain companies, such as mining companies, are technical in nature. In these cases, the JSE requires the prospectus or pre-listing statement to contain a competent person's report (i.e. technical advisor's report) on the company and its exploration and/or mining activities.

4.11.3 Time frame for listing

The time frame for a listing normally covers between 9 and 13 weeks, depending on the complexity of the listing and method of listing (assuming that the professional advisors are competent). According to the JSE, the time frame presented in Table 3 is reasonable.

Week	Action
0	Appoint advisors Meet to consider legal, financial and tax implications and method of listing Prepare timetable for listing Commence preparation of accountant's report Commence drafting of documentation
1–3	Arrange meetings to finalise draft documentation (prospectus / pre-listing statement) Finalise accountant's report
4	Draft documentation submitted to the JSE for informal comment and Registrar (if a public offer)
5–8	JSE formal approval, and Registrar's approval (if a public offer) obtained
9	Listing commences if an introduction, or placing or public offer commences
11	Placing closes
12	Listing commences if a placing or public offer closes
13	Listing commences if a public offer
Source: www.jse.co.za	

Table 3: Listing time frame

4.11.4 Other steps

The other steps in the process of listing are significant:

- *Marketing the issue*. The pre-listing statement is a form of advertising the issue to the public. However, the main buyers of any issue are the large institutions. Usually the sponsor and corporate advisor, together with the management of the company to be listed, approach them prior to the issue.
- *Pricing the issue*. This is an important part of the process, and this is where the corporate advisor and sponsor also have an important role to play. Part of the advice is to make the offer at a price that is at a discount to the fair price. This will ensure a successful issue, and a rise in the price after listing, and this will imbue the investor with a "warm, fuzzy feeling" toward the share. This has important positive implications for rights issues in the future.

4.12 The prospectus[26]

Reference has been made to the prospectus and to the pre-listing statement. This requires some elaboration. According to one exchange[27]:

"When a company applies for a listing, it must produce a pre-listing statement containing certain prescribed information concerning the company, its business and its prospectus. While the pre-listing statement may promote investment in the company's shares, it is not an invitation to the public to subscribe for shares, but rather aimed at enabling potential investors to make an informed investment decision regarding the company's shares. If the pre-listing statement contains a public offer, it will also have to comply with the prospectus provisions contained in Section 148 and Schedule 3 of the Companies Act."

As regards the prospectus, the two relevant sections of the Companies Act were discussed earlier. Sections 145 and 146 determine that a prospectus must be prepared and issued in the case of a public offer. A public offer, as noted earlier, is:

- An offer for subscription (the proceeds accrue to the company) (section 145)
- An offer for sale (the proceeds do not accrue to the company, but to the existing shareholders) (section 146).

Section 148 of the Act ("Matters to be stated in prospectus") determines that:

"1 (a) Every prospectus issued in terms of this Act shall contain a fair representation of the state of the affairs of the company, the shares of which are being offered and shall state at least the *matters* specified in, and set out the *reports* referred to in, Part I and Part II of Schedule 3."

The title of Schedule 3 reads: "Matters which must be stated in a prospectus in addition to those specified in the Act". Thus, all information / requirements relating to the prospectus are outlined in three documents:

- Sections of the Companies Act relating to the prospectus
- Part I of Schedule 3 of the Companies Act (matters)
- Part II of Schedule 3 of the Companies Act (reports).

The documents are elaborate; consequently only the headings are provided (see tables 4–6).

Section 148	Matters to be stated in prospectus
Section 149	Statement on face of issued prospectus
Section 150	Consent of person named as director
Section 151	Consent by experts and others
Section 152	Contracts and translations thereof to be attached to prospectus
Section 153	Where the issue is underwritten
Section 154	Signing, date and date of issue, of prospectus
Section 155	Registration of prospectus
Section 156	Time limit for issue of prospectus
Section 157	Advertisement as to prospectus
Section 158	Waiver of requirements of this Chapter void
Section 159	Variation of contract mentioned in prospectus
Section 160	Liability for untrue statements in prospectus
Section 161	Liability of experts and others
Section 162	Offences in respect of untrue statements in prospectus
Section 163	No diminution of liability under any other law or the common law

Table 4: Sections of the companies act relating to the prospectus (sections 148 to 163)

1. Name, address and incorporation
2. Directors and management (names and addresses, term of appointment, remuneration, etc.)
3. Auditor (name and address)
4. Attorney, banker, stockbroker, trustee and underwriter (names and addresses)
5. Secretary (name, address and professional qualifications)
6. History, state of affairs and prospects of company
7. Purpose of the offer
8. Share capital of the company (particulars)
9. Loans (details of material loans)
10. Options or preferential rights in respect of shares
11. Shares issued or to be issued otherwise than for cash
12. Property acquired or to be acquired
13. Amounts paid or payable to promoters
14. Commissions paid or payable in respect of underwriting
15. Preliminary expenses and issue expenses
16. Material contracts
17. Interest of directors and promoters
18. Particulars of the offer (class of shares, nominal value of the shares if applicable, number of shares offered, issue price, and other conditions of the offer.
19. Time and date of the opening and of the closing of the offer
20. Issue price
21. Minimum subscription
22. Statement as to adequacy of capital
23. Statement as to listing on stock exchange
24. Requirements for prospectus of mining company

Table 5: Part I of schedule 3 of the Companies Act (matters to be included in prospectus)

25. Report by auditor of company
26. Report by auditor where business undertaking to be acquired
27. Report by auditor where body corporate will become a subsidiary
28. Auditor not qualified to make reports
29. Qualification in respect of references to period of five years
30. Adjustment of figures in reports
31. Report by directors as to material changes

Table 6: Part II of schedule 3 of the Companies Act (reports to be set out in prospectus)

4.13 Underwriting a share issue[28]

Underwriting is where an institution (usually an investment / merchant bank), for a consideration, undertakes to take up all the shares in an issue in the event of the public not subscribing for the issue (an unusual occurrence). Clearly this also means that in the case of a partial subscription the underwriter will take up the shares not taken up by the public.

The Companies Act covers this obligation by the underwriter. Section 153 of the Act ("Where the issue is underwritten") determines that:

"(1) No prospectus containing a statement to the effect that the whole or any portion of the issue of the shares offered to the public, has been or is being underwritten shall be registered until there is lodged with the Registrar a copy of the underwriting contract and a sworn declaration by the person named as underwriter, or, if such person is a company, by each of two directors of such company, or if such company has only one director, by that director, that to the best of the deponent's knowledge and belief the underwriter is and will be in a position to carry out his obligations even if no shares are being applied for."

An underwriting of an issue has two main advantages (assuming that the underwriter is a prominent institution):

- It gives the potential investor comfort, and thus improves the probability of the issue being successful
- The relevant company is assured of the required amount of capital.

4.14 Other sources of primary issue of listed equity

4.14.1 Introduction

There are a number of other sources of the primary issue of listed equity. As noted above, the main methods of listing are:

- An introduction.
- A private placing.
- A public offer – an offer for subscription.
- A public offer – an offer for sale.

The other sources of primary listed equity are:

- Warrant exercising.
- Convertible bonds.
- Treasury shares.
- Rights offer.
- Renounceable offer.
- Capitalisation issue.
- Issue for cash or acquisition.
- Claw-back offer.

4.14.2 Warrant Exercising

As noted, a warrant (not the South African definition) is a call option to purchase the shares of a listed company for cash on or before the expiry date at a pre-determined price (strike price). Clearly, the option will only be exercised if it is profitable for the holder to do so, i.e. if the price of the share is higher than the strike price.

4.14.3 Convertible bonds

Bonds are sometimes issued with the option to convert the bond into the shares of the issuer of the bond at predetermined conditions.

4.14.4 Treasury shares

Companies are permitted to purchase their own issue of shares up to certain maximum percentages laid down and as agreed by shareholders at an AGM (subject to the requirements of the Companies Act). It will be apparent that when the company buys its own shares on the exchange, the number of shares in the market falls. These shares, however, are not cancelled in most cases but held as "treasury shares (or stock)". The company has the right to re-issue these shares in exchange for cash or for the exchange of shares (in a takeover or acquisition). This action will add to the number of shares in the market.

4.14.5 Rights issue (offer)

A rights issue (or rights offer) is an offer of additional shares (part or all of the *unissued* shares under the control of the directors) by a listed company to existing shareholders in proportion to their shareholding in the company. This is done by means of the issue of a document (usually a *letter of allocation* or a *letter of rights*), and the letter may be "renounceable", i.e. to relinquish the right to the shares. The document is tradable as either "nil paid" or "fully paid" for a stipulated period (usually 3 weeks).

4.14.6 Renounceable offer

A listed company can make a renounceable offer. This is where the listed company has the rights to the shares of an issuer (already listed or the applicable shares are to be listed), in proportion to its shareholding in the issuer, and it renounces part or all of the rights to the issuer's shares, in favour of its shareholders in proportion to their shareholding.

4.14.7 Capitalisation issue

A capitalisation issue is where a listed company makes an offer of new shares to existing shareholders in lieu of dividends. This is usually done to retain the liquid capital of the company. A capitalisation issue can also be made from the reserves of the company, but this is unusual because the shareholders have the right to the reserves in any case.

4.14.8 Issue for cash or acquisition

An issue for cash or acquisition is where a listed company is given approval by existing shareholders (general mandate or specific mandate) to issue new shares for the purpose of acquiring new funds or for the purposes of a merger or an acquisition (in which case the shares are issued in consideration for the shares of the company purchased or taken over).

4.14.9 Claw-back offer

A claw-back offer is where the listed company offers new shares for cash to a third party, and the third party offers them to the listed company's shareholders as in the case of a rights offer, i.e. in proportion to their shareholding.

4.15 Summary

The primary equity market is the market for the issue of new shares, and it plays an important role in the economy in terms of the raising of capital for business. The listing of new equity on an exchange has many advantages, one of which is the raising of capital easily and at a cheaper price, but there are disadvantages, such as the cost. One of the major cost items is the number of professionals that are required to be involved. The financial requirements are also onerous.

However, in many countries these disadvantages are lessened by the formation of a "board" for the listing of smaller companies.

There are three methods of listing and for all a detailed prospectus (= one of the major costs) is required. There are a number of other sources of primary market issue of equities, such as rights offers, convertible bonds, warrants and so on.

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