Rights Issue

drishtiias.com/printpdf/rights-issue

Why in News

Recent reports suggest that several companies, including Mahindra finance, Tata Power, Shriram Transport Finance among others are planning to raise funds through **"rights issue"** amidst the **Covid-19 pandemic**.

Key Points

- **Reason:**
    - Recently, Reliance Industries Limited (RIL) has concluded its rights issue and raised a total of Rs. 53,124 crore and witnessed an oversubscription of 1.59 times.
        - RIL's Rights Issue is India's largest rights issue.
    - The successful rights issue of RIL and the big demand (oversubscription) shows that there is a huge demand in the market for the shares of companies with strong credentials at a good price.
- **Definition:**
    - A rights issue is a mechanism by which companies can raise additional capital from existing shareholders.
    - It is different from **public issue (Initial Public Offer) and private placement.**
- **Advantages:**
    - A company would offer a rights issue in order to raise capital which can be used to clear its debt obligations, acquire assets, or facilitate expansion without having to take out a loan from a bank.
    - It is a more efficient mechanism of raising capital. Under it, there is no requirement of shareholders' meeting and an approval from the board of directors is sufficient and adequate.
    - Therefore, the turnaround time for raising this capital is short and is much suited for the current situation (Covid-19 pandemic).

- **Disadvantages:**
  - Raising funds through the right issue might create pressure on the company.
  - Value of each share may get diluted.
  - If the share price decreases post rights issue then investors may lose the holding value.

    Holding value is an indicator of an asset that someone has in his/her portfolio. It is a value which sums the impacts of all the dividends that would be given to the holder in the future, to help them estimate a price to sell or buy assets.
  - Stock exchanges put a restriction on the amount on which a company can raise via the right issue.
- **Reforms Under Rights Issue:**
  - **The Securities and Exchange Board of India (SEBI)** has provided some permanent reforms in the rights issue, it has also provided some temporary relaxations in the wake of Covid-19 pandemic.
  - **Permanent Reforms:** In November 2019, SEBI streamlined the rights issue process and the timelines for completion was significantly reduced from T+55 days to T+31 days — a 40% cut in the time.
    - The 'T' stands for transaction date, which is the day the transaction takes place.
    - It has also reduced the notice period of rights issue to at least 3 working days from 7 days earlier.
  - **Temporary relaxations:** SEBI relaxed certain guidelines for right issues that open on or before 31st March, 2021.
    - It reduced the eligibility requirement of average market capitalisation of public shareholding from Rs. 250 crore to Rs. 100 crore for a fast track rights issuance.

      Market capitalisation is the value of a company that is traded on the stock market. It is calculated by multiplying the total number of shares by the present share price.
    - It reduced the minimum subscription requirement from 90% to 75% of the issue size.
    - Listed entities raising funds upto Rs. 25 crores (erstwhile limit was Rs. 10 crores) through a rights issue are now not required to file draft offer documents with SEBI.

      Listed Entity means an entity which is listed on a recognised stock exchange(s).

Source: IE