Raising Capital in the Securities Market

The sale and purchase of financial assets, such as stocks and bonds, take place in the securities market. The securities market is comprised of both the primary and secondary markets. Most investors are familiar with the operations of the secondary markets where existing securities are traded. The trade is carried out between a buyer and a seller, with the stock exchange facilitating the transaction. Transactions can also occur "over the counter" which is direct trading among broker-dealers. In the secondary market, the company that issues the security is not involved in its sale, as the amount invested by the buyer goes to the seller. However, firms use the primary market to issue new securities, to raise capital for growth and investment. In this article, we will discuss the various methods of raising capital in the primary securities market.

The primary market, where new securities are sold directly to investors, provides a channel for government, companies, or other institutions to raise funds through the issuance of new debt (bonds) and equity (stocks) related securities. A bond is referred to as a fixed-income instrument since bonds traditionally pay a fixed interest rate (coupon) to investors throughout its life. Upon reaching maturity, the holder of the bond will be repaid the principal (also called face value) as well as the last coupon payment. This is the amount of money borrowed by the bond issuer. A company or government may issue bonds to raise funds for the development of large scale, long-term capital-intensive projects as it offers some protection against variable interest rates or economic changes.

On the other hand, companies may prefer to generate equity capital through the sale of shares of company stock. One of the main benefits of raising equity capital is that, unlike debt capital, the company is not required to repay shareholder investment. Instead, shareholders receive returns based on the market's performance in the form of dividends or an increase in the stock's valuation.

Bonds and stocks are then traded in the secondary market once the issue period has been closed.

Methods of Raising Capital in the Primary Markets

Stocks and bonds may be issued in the primary market through a public offering or private placement. In a private placement, securities are not sold to the public directly, instead the entire issue is sold to a qualified investor or to a group of investors, typically large institutions. However, if the firm wishes to raise capital from public investors, the securities must be offered to the public in a new stock issuance through an Initial Public Offering, otherwise known as an IPO.

In addition to an IPO, other methods used to raise capital in the securities market include:

- Further or Additional Public Offer
  This occurs when a listed company makes another public issue to raise capital, after having its securities traded on the securities market. Current investors are offered prorated rights based on the shares they currently own and new investors can participate in the newly issued shares.

- Rights Issue
  Unlike a further public offer, a company can raise funds from its existing shareholders by issuing them new shares at a discounted price within a specified time period. Existing shareholders are entitled to apply for new shares in proportion to the number of shares already held. For example, in a rights issue of 1:5 ratio, the investors have the right to subscribe to one (new) share of the company for every five shares held by the investor

- Underwritten Offerings
  This occurs when an underwriter (a party that evaluates and assumes another party's risk for payment) buys the entire issue and takes the risk of reselling through either of the following;
  - Best Effort Offerings- where the underwriter serves only as a broker and makes a best effort or good faith promise to the issuer to sell as much of their securities as possible. Although, the two parties come to an agreement for the sale of some securities, the underwriter does not guarantee to sell them all or;
  - Firm Commitment- where the underwriter buys all shares or debt and agrees to sell all.

- Shelf registrations
  The issuer files a single document with the regulator that permits additional future issuances. A shelf offering allows a company to register a new issue with its regulator, with the requirement that it must be sold within the specified time-period. The issuer can sell portions of the issue over the period without re-registering the security or incurring penalties. The company maintains any unissued shares as treasury stock, where they remain "on the shelf" until offered for public sale. A shelf offering enables an issuer to access markets quickly, with little additional administrative paperwork, when market conditions are optimal for the issuer.

- Auction
  Price discovery through bidding is frequently used in the issuance of government bonds. Government bonds are issued through an electronic auction system at the Central Bank of Trinidad and Tobago. The auction is typically opened for two weeks, and the purchase can be made by the public on a competitive or non-competitive basis.

There are a variety of options available for investors to raise capital in the securities market, whichever method is utilised, the TTSEC commits to fostering an environment that allows for fair and transparent sale of securities in both the primary and secondary markets.

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For more information on the securities market and the role and functions of the TTSEC, please visit our corporate website at www.ttsec.org.tt. To become a smart investor, download our IPA via the Google Play and Apple Stores. You can also take the investor education online course on our investor education website, www.InvestUcateTT.com, and test your knowledge in our interactive investing game InvestorQuestTT at www.InvestorQuest-tt.com, and remember, to connect with us via Facebook; Twitter, Instagram, LinkedIn or You Tube.

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