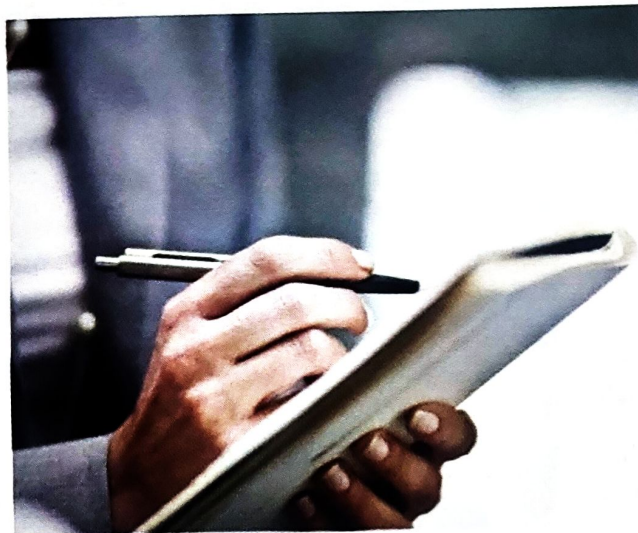


IPO/FPO norms

Goodbye to the good, old days

Sharp drop in and absence of hype surrounding subscription by institutional investors likely

From 1 May 2010, all types of investors would be required to pay 100% of the application money as margin along with the application for securities in all kinds of issues of shares, whether it is initial public offer (IPO), follow-on public offer (FPO) or rights issue. Till now, institutional investors enjoyed the privilege of paying just 10% of the total value of the shares at the time of submitting their bid or application in an IPO or FPO and the balance had to be paid on the allotment of shares.



The rationale behind Securities and Exchange Board of India (Sebi) move is not only to provide a level-playing field to the retail individual investors, who have to pay 100% amount upfront at the time of making the application, but also to curtail the tendency of institutional investors to submit bids for around 10 to 20 times their actual requirement of shares. Heavy oversubscription in the qualified institutional buyers' (QIB) category of IPOs creates an impression among retail investors that the issue is not only of very high quality but also reasonably priced.

Mostly QIBs submit their bid on the very first day of the opening of the issue. Enthused by the response of institutional investors, retail investors also join the party in hordes, leading to the success of the issue. Thereafter, investors hope that the shares would get listed at a hefty premium to the issue price. But, most of the times, this does not happen. Rather, in most of the hyped issues, the market price falls below the issue price within a few days of the listing of shares.

Oversubscription of the QIB portion of an IPO is no assurance to retail investors about the quality of the issue or the company's future prospects. In view of the proposed change, QIBs may wait till the last day of the issue before submitting their bid because they would not like their funds to be blocked for so many days. Thus, the bids from QIBs could be far more muted than

they have tended to be so far. Still it would be a positive development because so far their bids have been unnecessarily inflated and thus misleading. Retail investors would have to bear in mind that the sharp drop in subscription in the QIB category after 1 May 2010 may have nothing to do with the quality of the issue or its pricing. This would be simply because QIBs would have to pay 100% amount as application money.

At present, the book built through subscriptions to an IPO can be seen on the websites of the stock exchanges. The information is updated every hour. Hence, investors are able to track the bids received in an IPO from the various categories of investors. Sebi has now asked the stock exchanges to stop making the subscription numbers public till the closure of the issue.

Retail investors will now not have any means of knowing how much the institutions have bid for. This should not have any adverse impact on the investment strategy of retail investors as they usually invest at the cut-off price or the discovered price and, in the case of alternative book-building the French auction method, at the floor price.

Thus, the proposed system seems to be advantageous to the retail investors but not for institutional investors. Some of the disadvantages of the proposed system for the institutional investors are as follows:-

- 100% of the application money of institutional investors would be blocked for two to three weeks. Thus, they would not be able to gainfully utilise this amount. To resolve this issue, Sebi is proposing the introduction of application supported by blocked amount (ASBA) facility for institutional investors also so that they do not lose interest on application money.

- Fluctuation in foreign exchange rates, i.e. fall in the price of US dollar as against the rupee, from the closure of the issue till the date of receipt of refund or unblocking of ASBA bank account is a problem for

foreign institutional investor (FIIs). Accordingly, they would have to hedge their foreign currency exposure. The premium paid for hedging would add to their cost of acquisition of shares through IPOs. Thus, FIIs may be a bit reluctant to accept the proposed norm. However, no one can deny the fact that India is one of the most attractive investment destinations in the world. Therefore, sooner or later, FIIs would have to adjust to the new norms.

- The proposed move may also have an impact on the capability of QIBs to subscribe to multiple IPOs, which are open at the same period.

- Short-term players who subscribe to IPOs just for listing day gains would also be affected.

Through its efforts, Sebi has reduced the time gap between the closure of the issue and listing of shares from around 30 days to just 15 days. Around 15 years ago this time gap was three months. Now, Sebi is attempting to further reduce this time gap to just one week, which will no doubt increase the strain on intermediaries involved in the processing of IPOs. But, if this is achieved, institutional investors will also not have any complaints. Thus, Sebi's move to provide a level playing field for retail investors is laudable.

—Rajesh Relan