The changes are working

Because of two well-thought out changes, subscription figures in recent issues reflect real demand, not hype

Asking QIBs to pay margin money and doing away with discretionary allotment has reduced the hype in the new issue process

Prithvi Haldea

In August, Sebi made two important changes in the new issue process. One, it asked qualified institutional buyers (QIBs) to pay 10 per cent of the application amount at the time of applying. Two, it banned discretionary allotments to QIBs, replacing it with proportionate allotments. These changes were to apply to offer documents filed with Sebi after September 19. Although that cut-off excluded most issues made in the past three months, the first results of the new rules show the changes are spot on.

Getting real

A primary objective of these two changes was to reduce hype. In the earlier system, since QIBs didn't have to pay any money upfront, they were often persuaded to put in huge bids when the issue opened just to create hype about it, so that small investors would be drawn to it. The perception being: the greater the oversubscription, the better its quality. With a prior understanding in place, many of these bids were later scaled down drastically or no allotments were made to them.

It's common knowledge that such excesses contributed to the thumping response all issues received. Illustratively, the QIB portion of Syndicate Bank was oversubscribed 56 times, IDFC 54, Provogue 52, Gokaldas Exports 50. In the first few minutes of opening itself, an issue would be oversubscribed.

Till December 6, three issues had hit the market under the new guidelines: Repro India (issue size: Rs 38 crore), AIA Engineering (Rs 148 crore) and ICICI Bank (Rs 6,000 crore). Their opening day collections pale before what some earlier issues managed. Repro could sell only 2 per cent of its issue on the first day, AIA 39 per cent, ICICI Bank 69 per cent (See table: Down to earth). Inferior quality of issues doesn't explain this difference. A truer picture of demand does. Because they have to pay money upfront and cannot negotiate preferential treatment from merchant bankers anymore, QIBs put in only serious bids.

Quality matters

When the changes were introduced, several market players had argued that FIIs, not assured of big allotments and forced to pay upfront money, will stay away. I put forth two counter-arguments. Firstly, the number of active QIBs is small. With more than half the issue reserved for them, they will still get big allotments. Secondly, and more importantly, money will always chase quality paper, processes notwithstanding. FIIs will adjust if they see money-making opportunities. They have. After a slow start, the QIB potion of the ICICI Bank issue was finally oversubscribed 13 times. The QIB response to Repro and AIA was also good.

Now, a new fear is being propagated -- that only 'bad quality' FIIs will enter the market. Votaries of the discretionary system claimed it allowed issuers to select long-term investors. Again, it's a thin argument. Firstly, every FII is registered with Sebi, and no one can make a call on good and bad FIIs. Secondly, has anyone monitored post-listing sales? If long-term holding was really the stated objective, why wasn't it ever used as a condition of allotment? In this case, 'quality' or 'long-term holding' can't be defined or justified. In any case, what is wrong with selling? For every seller, there's a buyer.

Another fear was that since QIB bids will mostly come in on the last day, retail investors won't get demand and price cues. The ICICI issue shows the fear is unfounded. QIB response started coming in from the first day and continuously built up. In any case, retail investors, as in the past, will use cut-off option. In the issues made in the past two years, 97 per cent of retail bids came in at the cut-off price. In the ICICI issue, the figure was 93 per cent.

The new system is, in fact, good news for retail investors. QIB response will not be based on hype, but on bids backed by money. So, the whole purpose of reservation for QIBs -- to validate the issue and the offer price for small investors -- will now be met. If the retail portion of ICICI Bank did not get fully subscribed, it was on account of two factors. One, follow-on public offerings (FPOs) don't enthuse retail investors as much as they did till a few months back. Two, at Rs 2,000 crore, the size of the retail portion was very large.

Down to earth

	Day 1 (1)
Under old rules	
Sasken Communication	15.37
Suzlon Energy	15.12
IDFC	14.01
Syndicate Bank	13.53
IL&FS Investmart	7.94

Talbros Automotive	6.51
Shree Renuka Sugars	6.34
Nectar Lifesciences	6.04
Shoppers' Stop	5.29
Under new rules	
Repro India	0.02
AIA Engineering	0.39
ICICI Bank	0.69
(1) Times subscribed on Day 1	