Big hype about pre-IPO hype

IPO pricing is determined through QIBs, whose decisions aren't affected by noisy campaigns

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The issue of pre-IPO hype is back in the news, with Sebi stating it will soon set guidelines to contain this 'malpractice'. As usual, many issues are getting mixed up. Concerns are that pre-IPO 'good news' like issuers' strategic stake sales and expansion plans could influence market perception about issuers, who overprice IPOs. Investors lose money, and, in turn, become sceptical about future IPOs.

These beliefs don't hold water. IPO pricing today is determined by QIBs, with whom hype doesn't work. And retail investors look at the QIB subscription level for comfort. Secondly, mostissues have given investors an exit opportunity at a profit after listing. Thirdly, while media and analysts often cite the huge losses in overpriced IPOs, the under-pricing argument is used selectively to further unrealistic economic theories.

What's to blame?

Both means of communications, advertising and editorial, need a different approach.

Advertising. In the 1980s and 1990s, issuers used innovative media, even balloons and mailers to publicise IPOs; they got away with making false promises since content wasn't regulated. Sebi reacted in 1996 with comprehensive guidelines, which, among other things, prescribed that issue ads could use only information contained in the prospectus. Celebrity endorsements were out. Issuers now have to deal with stringent entry norms, public scrutiny of offer documents and substantive due diligence by stock exchanges.

Editorial. This is the real concern. Issuers and merchant bankers often talk to the media about matters outside the prospectus. While they can be deterred, the bigger problem is with non-company people like writing or talking about IPOs. Television, for instance, is flooded with analysts voicing views and recommendations. Channels invite managements of issuer companies. Worse, while issuers cannot talk about their day-to-day over-subscription details, channels broadcast them hour on hour.There are other issues like paid editorials and the practice of exchanging shares for advertising space. The ideal way would be for Sebi to formulate a code of conduct for media, even probe media that colludes to mislead investors.

Promoters' prism

If companies can hype new launches, why shouldn't they be allowed to market thier IPOs, if they have all the requisite clearances and if the 'good' news is within the domain of prospectus information?

Source document. It is fine to raise fingers at pre-IPO 'good' news, but what about the feel-good financials most companies show in prospectuses. Going forward, it is important to improve the quality of information in the prospectus and make disclosures more investor-friendly.

On another front, if there is some significant development between filing of the prospectus and the closing of the issue, the issuer should inform Sebi and also be allowed to inform potential investors about it.

Redundant quiet period. Some want the quiet period to be long enough to ensure the absence of 'noise' when investors are looking at hard numbers. But is the world so perfect that an investor would receive all the information available say, up to 10 days before an IPO and then shut himself up to understand the information before he applies? As long as advertising and media reports are about matters disclosed in the prospectus, they should be allowed till issue closure.

Another reason for the use of hype is because issuers can't make projections. This regulation was made in the 1990s, after many companies lured investors with rosy projections and then decamped with their money. Now, the markets have changed and companies should compulsorily give at least three-year financial projections in prospectus. Ironically, the prospectus talks of futuristic matters like new products and expansions, but the regulation does not allow these to be converted into numbers.

It is amazing that IPO pricing is normally done on forward multiples, but investors are left clueless about future earnings and are, instead, asked to invest on the basis of past information. The irony is that the QIBs are made privy to projections in private meetings, but small investors. Mandatory projections will enable analysts to discuss their validity, as well as put pressure on companies to come out with promise-versus-performance reports.