

Time for more IPO reforms

The new issue market is more robust than it was three years ago. Eight policy measures that will take it to the next level

The reasons given for abolishing quotas in IPOs are frivolous. Quotas should stay, and retail should get more

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With the secondary market going from strength to strength, the primary market is booming again. A continuous pipeline, big issues, huge over-subscriptions. As many as 86 companies are in an advanced stage of their capital-raising plans to collectively raise about Rs 19,000 crore, and the pipeline is only building by the day.

It is, therefore, an opportune time to look at reforms in the primary market. Two major reforms have already happened. One, the banning of discretionary allotments to QIBs (qualified institutional buyers) and the imposition of margin money on them to prevent fraudulent/pumped up bids. Two, the introduction of ECS for refunds, so that refunds were received by investors not through post, but through an instantaneous credit to their bank accounts. Yet, there's more to be done. Here's my list of eight measures.

Greater reservation for small investors. End the debate on reservations for small investors in IPOs. The demat scam, which is the reason cited for this abolishment, happened because of a lack of a unique identification number. IPOs are the best way to mobilize household savings. Reservations are necessary or else the proportionate allotment system across the issue will edge out all small investors. In any case, this reservation is for all and is made on an anonymous basis. Since compulsory participation by QIBs serves to validate IPOs, the time has come to increase allocation for small investors.

Larger public offer. Public offer as a percentage of a company's equity capital has been brought down gradually from 75 per cent to 25 per cent and, in most recent cases, to just 10 per cent. It gets worse for small investors, as only 35 per cent of an issue is reserved for them. So, if a company offloads 10 per cent, small investors get only 3.5 per cent of its capital. If its issue is hugely oversubscribed, applicants either get tiny allotments or none at all, which discourages them from applying to future issues.

Better pricing method. Surely, an auction system helps an issuer get the best price for his shares. However, only 50 per cent of an IPO -- the portion reserved for QIBs -- should be auctioned. QIBs get the desired quantity of shares at prices they are willing to pay. A one-day auction through a closed book should be done on a top-down bid price basis.

The balance IPO should then be sold through the fixed price route to the retail segment. This fixed price could be the lowest of the QIB allotment price, or average of the bottom five QIB allotment prices, or the average price at which the bottom 25 per cent of the issue was sold to QIBs. Till this happens, the retail portion of an IPO should stay open for an extra day, so that the true QIB response is available to them as a guide. Presently, most bids are uploaded on the system after the close of the application hour.

Simpler processes. Some of the IPO processes continue to be archaic and investor-unfriendly. The application form itself is daunting. Investors are prone to making mistakes, leading to rejection of applications. Multiple entry of elaborate data leads to costs, errors and delays. Several other processes between application and allotment too need to be made investor-friendly.

Better and relevant disclosures in offer documents. Although big strides have been made to ensure better disclosures in offer documents, the abridged prospectus that small investors get doesn't help them make an informed decision. A coordinated effort between the Companies Act and the DIP guidelines is a must to arrive at new disclosure standards and format for small investors.

Utilisation of issue proceeds. The early-90s scam of vanishing funds, and not of vanishing companies, remains unsolved. There are minimum laws on monitoring issue proceeds. Since most companies get the objects of the issue modified through an annual general meeting, they cannot be hauled up for diverting issue funds. When a company wishes to change the objects, it should give a buyback option to minority shareholders.

Compensation to investors. Instances of Sebi taking penal action against defaulters/fraudsters have increased. However, common investors who lose money because of such misdemeanours are not compensated. There is an urgent need for a law on compensation. The IPO scam that happened last year could be a good starting point, and it would be very simple to identify investors who should be compensated.

PSU divestments for retail. Resume PSU divestments, and this time offer them only to small investors. Such offers, which would typically be from bluechip PSUs, should be attractively priced. This can become the most important method of drawing in millions of new investors into the market.