Give more to small investors

The public issue allotment structure has high reservation for the moneybags -- for no good reason

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Normally, the deprived deserve and are granted reservations. In our primary market though, reservations have been wrested by the rich. Despite the government's stated objective to encourage small investors to invest in equities, it's strange that more than half of a public issue is reserved for a chosen few institutional investors (qualified institutional buyers or QIBs, as they are called). By comparison, 35 per cent (till recently, 25 per cent) is kept aside for small investors, and the remaining for high net worth individuals. Three reasons are cited in defence of this tilt towards QIBs. Not one is tenable.

Small is big

One, small investors are not interested enough in stocks to see an issue through. Really? Of the 33 book-built IPOs (initial public offerings) since January 2003, retail subscription exceeded even the issue size in 27. In four others, including the two Rs 5,000-crore plus issues (TCS and NTPC), it was more than 70 per cent of the issue size. If the retail quota was bigger, processes were simpler and issues marketed better, chances are, small investors would have participated in even greater numbers.

Two, high QIB participation validates an issue for small investors. There's merit in this argument, but validation can also be had with a smaller quota for QIBs -- say, 25 per cent.

Three, QIBs help issuers, and the market, during a bear phase. On paper, yes; in reality, no. History shows that hardly any public issues are made during bearish phases. The handful that come are of high quality and priced conservatively, and are therefore well-received by all categories of investors.

The absence of any defensible logic, coupled with allotment patterns, leads one to conclude that preference for book-building and the huge quota for QIBs is aimed at allowing 'preferential allotments' to large investors.

Each time there is a demand to reduce the size of the QIB quota, a fear psychosis is created that it will drive FIIs away. Fact is, QIBs will buy if the quality is good, as they do in the secondary market. Significantly, the 60 per cent QIB figure in book-built issues is arbitrary. In any case, 60 per cent means different amounts across issues. Among recent issues, it ranged from a meagre Rs 16 crore in Emami to a huge Rs 4,278 crore in ONGC. The argument that small amounts will not be of interest to QIBs is, therefore, not valid.

Capital ideas

As it is, the total amount of capital a company has to offload to the public to list has declined substantially – from 75 per cent in the seventies to 10 per cent now. Back then, the entire issue was for small investors; now, they get only 35 per cent. Between January 2003 and June 2005, of the total capital of the issuing companies of Rs 3,06,909 crore, only Rs 42,879 crore (14 per cent) was offered to the public. Despite the huge interest shown by them, small investors got just Rs 9,174 crore –22 per cent of the public issue amount or just 3 per cent of the issuing companies' capital. They should get more.

Also, there is an urgent need to get companies to offer more shares to get listed. In the late-nineties, the cut-off was reduced from 25 per cent to 10 per cent, as an issue size of 25 per cent was huge for some companies, who might have struggled to sell it to investors. Even if they managed to, they might not have needed all that money. So, for companies whose issue size exceeded Rs 100 crore, the listing threshold was reduced to 10 per cent. While that argument remains valid, given the changing market scenario and the need for a larger floating stock, the cut-off should be increased from Rs 100 crore to, say, Rs 250 crore. Only if a company's issue size exceeds Rs 250 crore should it be allowed to list by offloading only 10 per cent of equity; anything less should be pegged to at least 25 per cent of equity.

At the same time, the retail allocation should be higher. While PSU issues should be only for small investors, the retail allocation in other issues should be 75 per cent. A QIB allocation of 25 per cent is large enough to validate the quality and price of an issue. Further, to address the increasing discontent among domestic institutions of being edged out of allocations, the QIB portion should be equally divided between the FIIs and domestic institutions.

Box

Small Changes

Persistent demand has led to the retail quota in public issues being increased from 25 per cent to 35 per cent, along with an increase in application size from Rs 50,000 to Rs 1 lakh. More needs to be done to give them a greater allocation.