

Firms widen IPO price bands

Change triggered by Sebi discussion paper; difference between upper, lower ends rises to 3.6%

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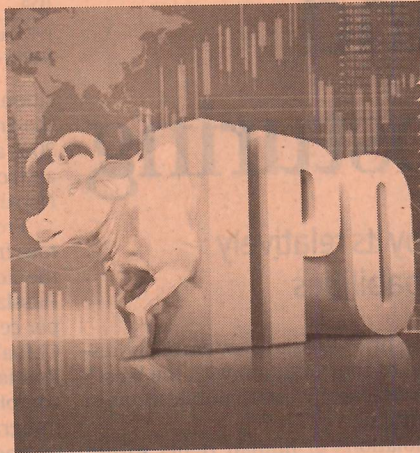
The price band for initial public offerings (IPOs) has widened after a nudge from the Securities and Exchange Board of India (Sebi), with the average difference rising to 3.6 per cent after the regulator issued a discussion paper in this regard.

The average difference between the minimum and maximum price that companies set for 10 IPOs that came before the discussion paper was 2.3 per cent.

In October, Sebi issued a discussion paper highlighting the extremely narrow band companies were fixing for their IPOs. However, the market appeared to have received the message even before the regulator could firm up final rules.

"Bankers typically like to price the issue at the top end of the price band. And, generally, have a good intuition of the what will be acceptable pricing," said V Jayasankar, senior executive director, head of equity capital markets, Kotak Investment Banking.

Under the current rules, IPOs can be made either through book building or fixed price method. In the book-building process, the issuer offers a price band, and the final issue price is determined based on demand. There is a maximum gap of 20 per cent prescribed between the upper and lower end. However, as there is no minimum gap prescribed — several IPOs had a gap of just ₹1-2 between their



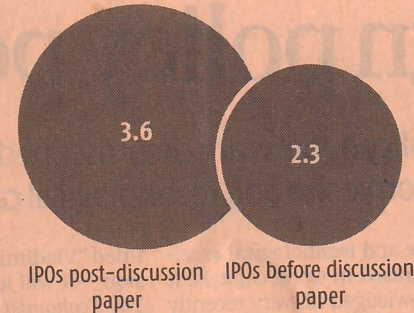
upper and lower ends.

"Lately, it is observed that the price band as provided by the issuer company on the mainboard is extremely narrow, sometimes as small as ₹1, ₹2 or ₹3. An analysis of issues from 2010 demonstrates that the average price band range has reduced significantly. The objective of a fair and transparent price discovery mechanism in a book-built issue appears to have been diluted over time due to evolving market practices," Sebi had said in the discussion paper dated October 4.

It had sought market feedback on maintaining a minimum 5 per cent difference between the upper and lower ends of the price band.

TAKING A CUE

Average difference (%)



Source: PRIME Database
Note: 10 IPOs before and after the discussion paper considered

Investment bankers said the price bands became narrower as price discovery happened during roadshows for institutional investors. And the published price band became a mere legal formality as the book building process became more dependent on institutional investors.

"As a legal process, you need a price band. If you are clear you don't want to do an issue below a particular price, then you keep a band because it's a legal requirement. So, the best way is to keep a price band with a ₹1 or ₹2 difference. To a large extent, every issue is pre-sold," said GS Ganesh, founder, Inga Capital.

According to Sebi regulations, if a company launches an IPO that fulfils the

requirements of minimum average operating profit, net tangible assets, net worth, a maximum of 50 per cent of the shares should be allotted to institutional investors.

In case a company does not fulfil the requirements, the IPO can only be through the book-building process, and at least 75 per cent should be issued to institutional investors. In the case of a fixed-price issue, at least 50 per cent should be issued to retail investors.

One other reason for the course correction by companies is the negative press about the failure of book building.

"Someone has raised an issue asking if fair book building is happening. The whole concept of book building was to determine a price. Today, it is all becoming a fixed-price offering. Where is the band playing a role in the discovery of price? If there is a proper price band, there should be investors even in the middle of the band. Today, investors are there on the upper band, and institutional investors are usually in the upper band," said Ganesh.

Bankers welcomed the Sebi's initiative saying it would give retail investors more say in the IPO's pricing.

"It's a good move by Sebi, especially for retail and HNI investors. It increases their say on the book-building process with a wider price band. With a smaller price band, there was no potential for anybody to participate or do any book building," said Pranjal Srivastava, partner, investment banking, Centrum.