Sebi's New IPO Rules: A Throwback to the CCI Days

While the markets regulator isn't deciding the pricing of public issues, it controls many levers that determine price

Govardhana.Rangan
@timesgroup.com

Mumbai: As investment bankers and fund managers were preparing to open the champagne bottle after a bumper year for initial public offerings, the Securities & Exchange Board of India (Sebi) chairman fired a warning shot that tempered their celebrations.

Ajay Tyagi followed up his December 22 speech on worries about the happenings in the primary equity markets with measures that appear to have sapped the enthusiasm of those expecting the party to continue well into 2022. "Appropriate pricing of the issue is a crucial aspect," Tyagi said at the annual summit of the Association of Investment Bankers titled Indian Capital Market – A Leap Ahead. "A proper balancing act between the issuers' aspirations and investors' interests is required. The merchant bankers need to engage with a wider set of potential investors."

ET ANALYSIS

While this speech rang alarm bells, the belief was that it was more an oral warning from the referee than a booking for a serious foul play. But what followed was actually a red card for a practice that was consigned to the dustbins of capital market history.

Sebi on Tuesday capped at 35% of IPO for acquisitions and corporate purposes where the takeover target is not final. There are new restrictions on how much an existing holder can sell in the IPO. Furthermore, it extends the lock-in period for anchor investors to 90 days for at least half their holdings. And the discredited rating companies are assured of another revenue stream as they get to monitor IPO spends. The regulator hasn't directly touched pricing or valuations, but various other things that determine them.

These follow a record year for IPOs. About 63 companies raised ₹1.18 lakh crore through the mainboard this year, up four-and-a-half times from Rs26,613 crore through 15 IPOs a year earlier, and double of the previous best in 2017, data from Prime Database show.

The Sebi chairman said the "growth in the primary market is accompanied by various challenges including in the form of non-traditional business models of issuers, disclosure requirements for new-age technology companies and valuation-related apprehensions".

While the worries may be justified

from a regulatory point of view, it has backpedalled in history to address these issues when it could have prevented them in the first place if only it had not diluted the implementation of rules on the public float — without succumbing to the demands of investment bankers and private equity funds.

To be sure, the Indian primary market is more transparent than many advanced markets. That the book building mechanism is open is itself a testimony to that. It came up with an important rule in June 2010 that mandated at least 25% public float for any company to be listed on stock exchanges. That was to ensure there are enough shares in the market for better price discovery.

If today chairman Tyagi is worried about IPO valuations, the blame lies at the door of the Sebi itself for diluting the minimum float for companies with a potential market value of ₹4,000 crore and providing many exemptions undermining the spirit of its own listing rules. It compounded it with a lock-in of anchor investors' shares. Elementary economics says it is demand and supply that determines the price of a product. By permitting less float at the time of IPOs, it restricted the supply that automatically pumps up valuations. Would the market value a company at the same level if 25% is sold?

Then comes the lock-in for anchor investors and a big chunk to institutions that have good relationships with investment bankers. Both reduce the float at listing, making just less than 5% of the company available for trading.

To address the market imbalances created by its own actions, the Sebi has come up with new measures that could only compound the problems of pricing. After 30 years of moving towards disclosure-based norms, it is back to merit-based ones, intentionally or unintentionally.

For a generation of investment bankers and investors who grew up ignorant of the Controller of Capital Issues (CCI), it's back to school.

The latest move is nothing short of a throwback to the days of the CCI that decided the price at which shares are sold in an IPO and the quantum of the funds to be raised based on the project proposal.

Those were the days when mutual funds did not exist. There were no foreign institutional investors either. It was difficult to trace companies in the address mentioned or many just peddled lies about joint ventures and technical collaborations.

Today, the IPO market is not occupied by just the greedy ill-informed middle-class Indians of the 80s and 90s. BlackRock, Canadian pension funds, and Fidelity are investing. Sebi with its new rules has implied that it has a better handle on stock valuations than a BlackRock or Fidelity or a manager from ICICI Prudential or HDFC Mutual Fund that buy into these IPOs.

Enforcing its own principle-based minimum float of 25% at the time of IPO could be a better tool to safeguard investor welfare than tinkering with more rules.

To be sure, Tyagi has said the regulator doesn't want to go back to the days of CCI. The Sebi isn't deciding the pricing of IPOs, but controls many levers that determine it.