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PSU IPOs: The Government is the biggest gainer

Good beginnings have already been made with the floatation of two PSU IPOs, NHPC and Oil India, which were in the pipeline for nearly two years now. Regrettably, the next one is still nowhere in sight. Though several announcements have been made, no other PSU has yet even filed its offer document with SEBI.

This is the best time, as ever for the government to divest aggressively. There is nothing as on “opportune time”. The government waited for months to float the IPOs of NHPC and Oil India, for the market conditions to improve in the hope of getting better valuations. Private promoters can be greedy, government should not be. Even if it is looking for gains, it should realize that the real and substantive gains would accrue to it later. As an example, let us look at the recent past 5 years which had 4 PSU IPOs (NTPC, PFC, PGC and REC). The value of the government holding, courtesy the market, has gone up nearly 3 times from Rs. 80,791 crore on the issue date to Rs.2,27,181 crore presently (as on 9th September,2009) , despite the huge downfall in the market from its peak. In one specific case-NTPC, the value of the 89.5 per cent government holding on the IPO date was Rs.45,754 crore. Today, this holding is worth Rs.1,51,356 crore, a gain of 231 per cent. At its peak price of Rs. 291, this holding had become worth Rs. 2,14,747 crore, a gain of 369 per cent. It is not just the government that has made gains; this means that investors in these IPOs too have made similar gains.

It is, therefore, very disconcerting that even now, the government keeps talking of better market conditions to float subsequent IPOs. It continues to state its intentions of maximizing the proceeds, as one of the latest statements shows: “We will list PSUs as soon as the markets are in good shape. We want to gain maximum advantage of the markets”.

Some discomfort has arisen in the market and in the government on the post-listing performance of the NHPC IPO. It is the pure speculators who have lost money, ones who were looking at gains on the listing date. Given the long-term prospects of this company, there should be no cause of concern for the investors, and the government should not get unduly worried about this. The fact that the IPO sold more than 24 times clearly shows that the market found the price attractive, and if at all, the government can be accused of under-pricing. The example of REC may also be worth recounting. This company, which made an offer at Rs. 105, got listed on 12th March 2008 with a small premium and continued to quote marginally above the offer price for the next 3 months. However, it then continued to slide down and hit a low of as less as Rs. 55, almost half of the offer price, and quoted below the offer price for a long 10 month period (2nd June 2008 to 17th April 2009). However, since then, the stock has done very well and is currently quoting at Rs. 204, a return of over 94 per cent on the offer price!

When the Oil India IPO hit the market, several so-called market experts branded it as a much overpriced IPO. Again, the fact that this IPO has received over 31 time oversubscription shows that the market believed it was in fact underpriced. It appears that there are vested interests who by these kinds of pressures either want the government to significantly under-price the future PSU IPOs or they just not want more good-quality floating stock so that they can continue to manipulate the existing shallow stock market.

There are many more arguments in favour of PSU offerings. This is totally criticism-free; allotments are to anonymous investors. PSU divestments help bridge the fiscal deficit or meet priority programmes. Raising fresh capital through the listing process can help PSUs in their plans of modernization/ expansion/ diversification. Moreover, an initial listing helps the company to raise more capital easily and efficiently. Listing also raises a company's public profile with customers, suppliers, investors, financial institutions and the media.

Importantly, listing also increases transparency and accountability, in better corporate governance and in higher efficiencies. Listing probably also helps in changing the attitude of the government towards such companies; the government would want such companies to perform better than ever before as the accountability of the government has gone up. As such, the various proposals of such companies, which require governmental approvals, would find a greater favour with the government. The above benefits accruing to the PSUs probably explain the huge increase in the performance and the valuations of such companies.

Equally importantly, the public offering route can provide the much needed depth and width to our capital market; a grave scarcity of good listed companies and listed capital continues to exist which causes excessive speculation and volatility. As the past shows, during bear periods, even the losses on PSU scrips are lesser.

Finally, the household savings of millions of retail investors can be brought to the capital market to help grow the economy. Despite rising savings, less than 5 per cent of household savings are currently invested in the capital market and worse, in a country of over 120 crore, we have at best only 1 crore equity investors. Moreover, PSU IPOs can actually be the instrument for reviving the sentiments; remember that it was a PSU divestment- Maruti in June 2003- that had earlier led the recovery of the market.

There are as many as 159 profitable CPSEs. In many cases, these are a monopolies/ market leaders. Implicit government support is available to CPSEs, and for ever. Only 45 out of the 159 profit-making CPSEs are listed; the scope, therefore, for PSU IPOs is huge.

To make the huge divestments happen, there is a need to be pragmatic. A radical new approach is warranted, which will also require a relaxed regulatory framework. We should do this under a new Public Participation in Public Enterprises (PPPE) programme. The PSU IPOs should be made only to the retail investors. The retail depth has now been proven beyond any doubts. An only retail policy will have a major positive impact: a very wide distribution reduces post-listing selling pressure; large sales by institutional investors often destabilize the prices. Also, this policy would be politically correct; what better opportunity to please millions! The retail offerings should be made at reasonable prices. This shall surely not maximize returns for the government. It should, however, be first recognized that in this manner, the wealth created by public enterprises through domestic public resources shall be shared rightfully only with the public. In any case, true price discovery post listing, as demonstrated in the past, would get government much larger gains than the small loss it may incur in pricing the IPOs low. Moreover, there would be no post-listing price pressures/embarrassments; the PSUs would forever be in the investors' Thank You list! Moreover, only the fixed price route should be used as the retail investors are ill-equipped for bookbuilding. Finally, allotments in physical mode should be allowed. Investors would be saved from the hassles of opening demat accounts and from custodial charges; many investors may like to hold the "family silver" for long periods. Only for selling, demat account may be mandated.

The divestment process can begin with a bang and continue to create new milestones. With all these offerings, the shape and size of the Indian capital market will change for ever, and for good! It would be a pity if these got stalled because of government's greed or regulatory hurdles. Let the coming 5 years be remembered as the golden period of disinvestments through public offers, of having increased the market size, number of investors and trade volumes, as also bringing stability to the market, and truly spreading the equity cult in India.