The fears are unfounded

Criticism of the new rules for public issues is based on personal interests, not principles of fairness

Prithvi Haldea

Over the past two months, I have been writing repeatedly in this space about the inequities in the public issue system. Now that Sebi has corrected some of those imbalances, I feel vindicated. Some market players, though, feel hard done in by these changes. Their reservations, my responses.

Reservation 1: Domestic qualified institutional buyers (QIBs) can talk to Sebi, foreign QIBs can't.
They can -- and they do through their powerful local representatives. Discretionary allotment to QIBs isn't democratic, proportionate allotment system is. Preferential issues in the garb of a public issue will finally come to an end.

Reservation 2: A stock will crash after listing, as 'bad quality' QIBs will rush to book profits.
Votaries of the discretionary system claim it lets issuers select long-term investors. If a QIB sold on listing, it might find it hard to get allotments in future IPOs. In proportionate allotment, though, there will be no such incentive, and they will sell on listing.

Has anyone monitored post-listing sales? If long-term holding was really the stated objective, why wasn't it ever used as a condition of allotment? In this case, 'quality' or 'long-term holding' can't be defined or justified. It's a foolish fund manager who will sit on 100 per cent listing gains. In any case, what is wrong with selling? For every seller, there's a buyer. It might actually be a good thing, as it will make IPO investing a serious business, not a lottery.

Reservation 3: Not assured of big allotments and forced to pay upfront money, FIIs will stay away from the primary market, causing its collapse.
The number of active QIBs is small. With half the issue reserved for QIBs, they can still get big allotments. The margin requirement was essential. Rigging of IPO books was reportedly rampant -- QIBs sometimes put huge bids to inflate subscription figures or increase their chances of allotment. The QIB portion of Syndicate Bank was oversubscribed an absurd 56 times, IDFC 54, Provogue 52, Gokaldas Exports 50… see a pattern.

Critics say most FIIs don't pay margins back home and that US regulations bar investment trusts and pension funds from paying upfront. Therefore, the margin norm will put them off. Let them change their charters or let the investment bankers put up the margin on their behalf.

Internationally, books are built in a single day, only QIBs participate, allotments are made immediately, and listing follows. However, in India, as the book is also open for retail investors, the process is longer. The upfront margin for QIB is justifiable because of this process. Now that the taboo against margining is gone, let's move to 100 per cent margin for QIBs, like it is for other investors.

Since bidders will now have to take a call on allotment, subscriptions will present a truer picture of demand. Ultimately, money will chase quality paper, processes notwithstanding. FIIs will adjust if they see money-making opportunities.

Reservation 4: Since QIB bids will mostly come in on the last day, retail investors won't get demand and price cues.
Retail investors can continue to use the cut-off option. In any case, 97 per cent of them have done just that over the past two years. Plus, QIB demand was inflated.

These reforms are in the larger interest of the market. That they come in the early days of a new Sebi regime leads one to believe that more changes might follow. Some of the areas in the primary market Sebi needs to look into, as I have mentioned before, are adopting the Dutch Auction method for price discovery, lowering QIB reservation to 25 per cent and simplifying and shortening the IPO process for the retail investors.

BOX

The new rules

- QIBs will have to pay a 10 per cent margin at the time of placing their bids
- Discretionary allotment for QIBs scrapped, replaced with proportionate allotment
- 5 per cent of issue reserved for mutual funds in the 50 per cent QIB category; funds can bid for the balance also