Source : www.livemint.com Date : 2022-01-20

THE TRENDS AND CONCERNS PERTAINING TO INITIAL PUBLIC OFFERS IN INDIA

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

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2021 witnessed a surge in IPOs (initial public offers) in India and globally. As per the 2021 Ernst and Young Global IPO Trends Report, 2,388 IPO deals mobilised $453.3 billion globally in 2021 which is 60 % more in terms of volume and proceeds as compared to 2020. In India, 63 companies mobilised 1.19 trillion through IPOs, which is more than four times the amount raised in 2020 (26,628 crore).

Key drivers which propelled the IPO market in India are new-age technology start-ups, extended low interest rate environment, strong retail participation and the Indian growth story. Of the amount raised through IPOs, a substantial part (75,736 crore) was towards Offer for Sale (OFS) and this is a matter of concern. Also, the objectives of an IPO is ‘general purpose’ which means that investors will not be able to assess how the money will be used by the company. To address these concerns, market regulator, the Securities and Exchange Board of India (Sebi) has introduced some reforms recently, including a cap on OFS by existing shareholders and barring the use of IPO amount for acquisition unless the target is identified in the prospectus.

Resources mobilised through IPOs are either fresh issuances, OFS or both. In a fresh issuance, proceeds of the issue flow to the company while in the case of OFS, securities held by the existing shareholders of an unlisted company are offered to the public.

The funds raised by fresh issuance are likely to spur economic activity and contribute to employment and returns to all factors of production. But, the amount raised through OFS will mostly go into the hands of existing shareholders which may or may not flow back for further investment. In case of fresh issuance, company benefits from additional capital at its command, while in an OFS, the proceeds are pocketed by existing shareholders.

In 2021, the fresh issuances worth 44,146 crore constituted 36.82 % of the total money raised (only 4 out of 63 issues were 100% fresh issue without OFS component). The stated objective of these fresh issuances was to raise capital for expansion of production capacity; general corporate purpose; reduce aggregate outstanding borrowings and to achieve the benefits of listing. These objectives bode well with the theory that IPOs enable economic growth of a country.

As many as 59 issues were a combination of fresh issue and OFS. The OFS component of the issues during 2021 is 75,736 crore. From the economic development point of view, there is no visibility on how this sum will be deployed. There were 15 companies which raised resources through 100% OFS route while the issue size of 49 companies had more than 50% of the OFS component (Table 2).

It is observed that around 50% of the total IPOs in 2021 provided exit to private equity (PE) and venture capital (VC) firms or early investors. This trend is being observed in the Indian IPO market since last 6-7 years. This trend suggests that Indian capital market facilitates start-up movement by providing exit to PEs amd VCs which could be helpful to the new generation entrepreneurs.

A substantial part of the money raised by public issues is helping PE/VCs or family offices to withdraw capital and there is no visibility on whether funds so withdrawn are being ploughed back into constructive investments. Perhaps, to address this issue, Sebi recently proposed that in an OFS, majority shareholders (defined as holding at least 20 % of the pre-issue stake) can only sell up to 50 % of the stake.

The capital garnered through public issues should be deployed productively. Sebi’s reform measure capped the percentage of funds allocated to the acquisition of unspecified businesses, or state specific targets in the prospectus. More specifically, there would be a cap of 35 % of the total issue size on the combination of allocation to future inorganic growth and “general corporate purposes". The cap on allocation of funds for unidentified acquisitions only is set at 25 % of the issue size. It is also proposed that credit rating agencies may monitor utilization of public issue proceeds.

Another important trend is retail participation. Cumulative demat accounts have increased from 36 million in March 2019 to 77 million as of November 2021. The retail individual investor applications have simultaneously increased from 8 million in 2019-20 to more than 70 million in November 2021. The concern is whether retail investors investing in IPOs understand the underlying objective of the offer. Perhaps, it could be the participation of anchor investors/QIBs which is providing confidence to retail investors to subscribe to IPOs. To ensure that the participation of anchors is not misleading, Sebi recently increased the lock-in period to 90 days from 30 days for a part of the shares held by the anchor investors. Further, as the time elapse between allotment in an IPO and listing on the stock exchange is just 7 days, retail investors who do not have a thorough understanding of the business model of the issuing company should wait for the listing and take a decision to buy or not to buy those shares based on how markets have evaluated the company.

It would be interesting to see how the IPO market will adapt to the recent reform measures announced by Sebi.

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