A Case for Compulsory Discount for Retail Investors

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The primary capital market in India has gone through a tremendous change in a span of 3 decades.

The objective of regulating the Indian capital market in tune with international market practices was given an initial thought in 1988. The Indian capital market regulator was put in place w.e.f. 29/05/1992 when the Controller of Capital Issues (Exemption Order) 1947 was repealed. In May 2013 the capital market regulator Securities & Exchange Board of India (SEBI) had celebrated its Silver Jubilee indicating the 25 years of existence, in service to capital market.

The developing nations like India definitely required a system which can integrate with highly developed sophisticated capital markets. Since the establishment of the Securities & Exchange Board of India (SEBI), the Indian Capital Market has undergone a phenomenal change. The process in the capital market has also been totally changed and the directions changed. If, one where to analyse the contrast between the CCI regime and the SEBI regime, one could find 3 areas which had under gone a total change.

- Permission
- Price
- Participants

Any Corporate desirous of raising resources from the capital market need to obtain permission which is presently changed to giving full disclosures. Permission is no longer required but clearance from SEBI is to be obtained with proper disclosures. Hence we started with Disclosure for Investor Protection (DIP) Guidelines which is presently Issue of Capital & Disclosure Requirements (ICDR) Guidelines 2009.

As against the controlled price i.e. the price at which an equity can be issued was decided by the Controller of Capital Issues which incidentally proved to be beneficial to the retail investors as against today's free pricing.

All the market participants required a registration from SEBI. No intermediary can involve in any capital market transaction involving the investors at large without obtaining registration from SEBI. This means right from Investment Banker, Brokers, Underwriters, Registrar & Transfer Agents etc. have to obtain the registration.

Since we are looking at a case of compulsory discount for retail investors we shall confine our discussion on the price determination and the related areas. In the year 2000 when the SEBI had put in place the 'Book Building Process' and the 'Price Discovery Mechanism', classification of investors was made as Qualified Institutional Buyers (QIBs), High Networth Individuals (HNIs) or also called as Non Institutional Investors (NIIs) and the Retail investors. Reservation to the extent of 50% of the IPO size was made to the QIBs including the Foreign Institutional Investors (FIIs) & 15% for the HNIs & 35% for the Retail Investors.

Without getting into much details about the Book Building process let us focus on the Retail Investors Group. The Indian Primary Capital market has its own peculiarities as compared to any other international market. The retail participation in Initial Public Offering has always been enthusiastic. For various reasons the individual investors did not prefer to participate in the equity market through the Mutual Funds but however believed in their own capabilities and investing in the markets directly. May be when the Unit Trust of India established in 1964, had a large role to play in harnessing domestic savings from individuals and had participated in the capital market whether primary or secondary, the retail investors in UTI as a Mutual Fund was little aware about the investment mechanism. It was only when the Unit Trust of India & the FII had a set back and was disgraced, the private mutual funds and mutual funds promoted by Banks had started their operations in the capital markets in a big way. The Life Insurance Corporation was a passive investor in the markets became aggressive and exhibiting the capabilities to invest huge amounts. With the fund requirements by the centre the necessity to raise resources to meet the ever growing Government expenditure this had compelled the centre to dilute a portion of the equity held by the Government to the investors to raise resources. With the process of Government diluting its equity put in place the depth of the capital market and available equities in the stock market started increasing. The deal sizes started becoming bigger. Typically it was the first experience of the Government to raise resources from the capital market by filing an offer document, by appointing a Merchant Banker with SEBI. Many of the PSUs could garner the support of retail investors especially because of providing discount to the offer price to the retail investors.

On an analysis of the companies which had entered the capital market in the last 3 years and who had offered discount to retail, it is observed that out the 16 issues for the period from 2010 to first quarter 2015 there were 4 issues from the PSUs which had offered discount to the retail investors and had given adequate gain. To just take an example Coal India which had entered the capital market in October 2010 had an issue price of Rs.245/-. The equity shares got listed at a price of Rs.342/- and closed at the same price on that day. Presently the price ranges between Rs.405/- to Rs.409/- (As at the end of June 2015). The rest of the cases which had offered discount in the private corporate sector were two and they had also offered a discount of 4% that means on an issue price of Rs.325/- had offered a discount of Rs.15/- which was in March 2015 and the closing price of the share was Rs.430/- on listing.

What is clearly indicated is that the retail investors had not exited in large numbers on the first day of listing gains in respect of these issues which had shown substantial appreciation. What retail investors need is comfort and not protection. In the context of free pricing which is in vogue today there is a fit case for introducing a compulsory discount for the retail investors. One should appreciate that because of the peculiarities of the Indian Capital Market especially in the equity offering where large retail investors come and participate possibly a 35% reservation has been there for over 14 years since book building was put in place. Many would argue that the retail participation in equity should be cut down and more reservation should be given to institutional investors. If an analysis made of the participation by the QIBs in IPOs one can see no difference between retail and an institution. The institution also sells on the listing day when they get listing gains. Atleast the retailers have the patience and watch the company for a quarter or two quarters of the financial results and then accordingly takes a call. Individually the investment are insignificant but collectively it is large and the saving propels the economy when they participate in project related IPOs. Atleast when free pricing was not there the investor had better comfort as these issues were to be compulsorily issued at par. However, when free pricing it has become a tough call. Grass root projects and loss making ventures demand premium based on future. The retail is not disturbed as institutional investors are paying a high price for equity in the IPO but he is concerned only to the limited extent that if you want the retail support the differential pricing mechanism should definitely operated. You may offer the shares at a price of 'X' to the retail institutional investors but what retail expects is atleast 5% to 10% less than that price so that he can participate in the issue and this is essential and should be made compulsory because of the free pricing.

Last but not the least, the argument for a case for compulsory discount to retail investors augurs well especially in the context of free pricing. Whether the price is controlled, monitored and determined by an authority taking into consideration the past performance, the track record and purpose and objects of resource raising through an IPO, a case for compulsory discount may not be relevant. But in today's scenario where the capital market transaction would continue to be market related free pricing, there is bound to be misleading situation for a retail investor. It is harsh considering the Indian market to push retail to come through Mutual Funds and arguing a case to reduce reservation to retail investors. This probably is not the correct solution. The retail investors should have freedom and liberty to have his choice of investment. There is definitely a strong case in the Indian context that the retail investors be entitled to discount on the shares and this has to be made compulsory. The IPO market presently not supported by the retail & there has been selective participation by them indicating their assessment of an IPO. It should be remembered that even large issues earlier had the capacity to be subscribed atleast by more than a time only by the retail.

Definitely there is a fit case for compulsory discount for the retail investors.