Our Views

Appropriate Price discovery in IPO - Semi Public Market could be a solution

With 3 IPOs (Initial Public Offerings) this week, it seems like the IPO season is back. The last year displayed a distinct split in terms of the IPO market, with the first half characterised by a sluggish pace and limited new offerings, followed by a dramatic upswing in activity during the latter part of the year. There was a decline of 30% in 2023 (INR 41,095 crore raised through 46 IPOs) compared to 2022 (INR 59,302 crore raised through 40 IPOs) and of more than 50% compared to 2021 (INR 1,18,723 crore raised through 63 IPOs). Therefore, there is bullishness in the IPO market after a sluggish 18 months.

The IPO market is usually cyclical. One of the reasons for the cyclicality is irrational price discovery at the time of issuance. In some situations, it is extremely liberal in anticipation of a big pop on listing and in some situations it is too tightly priced. There are several cases of more than 100-300% appreciation on the listing day and conversely there are many cases of negative return ranging -50 to -60%. This is due to a lack of scientific and rational price discovery in IPOs. This challenge is further aggravated for startups and very high growth companies. At times, there is a conflict between public and private market investors. Such a situation exists not just in India but across most capital markets.

The challenge of appropriate valuations for both investors and issuers is a pressing issue. This topic has been debated over a period of time and various different solutions such as book building process for price discovery, pre IPO institutional investor placements or even involvement of Private Equity investors have been tried.

To address these challenges, regulators / financial market players globally have been coming up with innovative ways to bridge the pricing gap and ensure a more rationale price discovery. Some of these are -

- In the US, new financial products like index funds tracking late-stage venture-backed companies have been introduced with companies like SpaceX listed for trade.
- Nasdaq, along with a few investment banks, announced a joint venture to establish a centralized secondary trading venue for private company stock, known as Nasdaq Private Market.
- In Europe, to revitalise the listing market, PISCES, London (Private Intermittent Securities and Capital Exchange System) aims to bridge the gap between private and public markets, enabling private company shareholders to sell stakes and access a broader investor base.

An alternative for India

A good solution could be the creation of a semi public market/ platform just for the purpose of trading. At present, the public exchanges grant access to IPO subscriptions and stock trading to anyone with a DEMAT account.

However, a Semi public market can function as follows:

1. The semi public market could permit only pre registered accredited/ Institutional investors to participate
2. It would be a market place only for the trading and not for fund raising
3. Clearing and settlement system for securities would be on the exchange platform

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4. When a company or an investor in consultation with the company offers its shares of an unlisted company for trading, it should comply with a standard disclosure requirement. The current requirement of GID / KID process of offer document by SEBI should be sufficient. This process is a fantastic light touch but comprehensive disclosure mechanism
5. IPO-bound companies could opt to trade for 6 months on the Semi Public platform
6. A company should attempt to come out with an IPO within one year or in a reasonable time of its opting to trade on the Semi Public platform
7. Once the company is listed on the public market, it will automatically delist from the Semi Public Market/ platform

This approach will facilitate price discovery with larger participation of institutional and accredited investors and would also give time to a company to prepare for the public listing compliance. By combining elements of both public and private markets, this innovative approach aims to enhance liquidity, transparency, and access for stakeholders while promoting efficient capital formation and market development.

Advantages

✓ The semi-public market model offers early liquidity for companies whose capital is tied to private equity. By allowing investors to trade stocks on this exchange, the fair value of the company can be assessed based on stock performance and its trading. This will facilitate transparent valuation and liquidity at the time of IPO.

✓ Setting a time duration between the two listings would help prevent stock price manipulation by issuers and lead private investors. This safeguards against undue influence on stock prices and ensures a fair practice. As a result, the semi-public market model promotes market integrity and investor confidence.

Challenges

× Companies would need to adhere to regulatory procedures twice, increasing both expenses and the duration required to go public. This duplication of regulatory processes not only amplifies costs but also prolongs the timeline for public listing. Such inefficiencies could deter companies from utilising this approach, as they seek faster and more cost-effective routes to accessing public markets.

We would like our IPO markets to be less volatile, consistent and offer more scientific price discovery. Therefore, there is a need for an alternative and Semi Public market could be a very final solution.

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