Efficiency over hero worship

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Written by MS Sahoo

April 14, 2008 21:21 IST

The core objective of financial market reforms, particularly in the securities market, is to reduce information asymmetry. This is expected to be achieved by assigning a greater role to the market and letting participants seek more information. Regulation can strengthen this framework by providing appropriate legal backing to the quest for higher quality information. India has shifted from an era of controlled pricing of public issues to a sort of ?free float? system with enhanced disclosure requirements to empower investors. This has generated arguments that some ?free floats? are buoyed by sentiment more than intrinsic business value, adding volatility to the primary market. In this view, the central role of capital markets, to enhance resource allocation efficiency, has been injured by ?spiky? pricing. This can be blamed on the absence of consolidated information on forthcoming public issues for a reasonable time horizon (say, a minimum one year), and the consequent ?muddled? use of funds by investors. It is ironical that while we continuously raise the bar on disclosure requirements, enormous information asymmetry persists between issuers and investors. This asymmetry leads to suboptimal allocation of funds in both the micro and macroeconomic sense?it distorts investment portfolios and causes resource misallocations between sectors.

Individual investors are budget bound, and so often end up with funds blocked in particular issues (even if they do not get subscription), leaving them unable to apply for other IPOs. With the probability of getting allotment low, this results in high opportunity costs. Refunds take about 15 days. Institutional investors have vastly larger sums at their disposal, and have to pay only 10% of the bid amount with their subscription. Only for issues oversubscribed more than 10 times do they fail to get the shares (and are refunded). Some issues, though, are oversubscribed as much as 100 times. As a result, even with proportional allotment, many investors do not get any allotment. To increase the probability of allotment, they apply for more shares than they want (individuals often use multiple accounts to get around subscription limits), which leads to ?notional? oversubscription. It?s a vicious circle.

Now, when an investor applies for a particular issue, he is not aware of the choices available to him the next month or next quarter. He is in intense competition with other retail investors for allotment. Issuers, however, have a seller?s market?a near monopoly?for the IPO window period, and are aware of other issues lined up.

From a theoretical perspective, the market is well equipped to discover the ?best price?. However, the way the primary market operates, it does not necessarily ensure a flow of resources to the project which would give the best returns. This is possible only if the market has full information about all the issuers who are selling slightly differentiated, but competing products, and investors have an opportunity to compare these products. Investors should be in a position to rank various products in terms of their appetite and opportunity to bid for all them in order of priority, without blocking their resources in a particular issue. They should also have reasonable assurance that they would get allotment of shares of their choice.

All issuers planning to access the market during a quarter ought to enter the primary market together, on a predetermined date. They should compete among themselves for subscription, and investors will subscribe for shares in their order of preference. This would reveal a proper picture of demand and supply. If an investor does not get shares in the company of first choice, the money should be considered for allotment of shares in an issuer of second choice, and so on. This will prevent funds from being blocked, and smoothen the retail end of IPOs. This will also reduce the incentive to use benami accounts to apply for more shares than he really wants possession of. Such a ranking and choice method would relegate the less-fancied companies to the bottom of the subscription pyramid, which is desirable from the angle of macro allocation efficiency.

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Nifty Bank	50,351.95 AD Ratio: 2.25	172.40 0.34%
Nifty Next 50	67,556.65 AD Ratio: 0.82	148.00 0.22%
Nifty 100	24,311.15 AD Ratio: 0.83	-54.90 -0.23%
Nifty 200	13,196.70 AD Ratio: 0.79	-23.70 -0.18%

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The proposed model needs an IT-enabled centralised mechanism with a consolidated application form for a bunch of issues. This will allow investment options to be compared with one another and will thereby result in relatively efficient allocation of funds?the whole point of the capital market. This would also reduce the basic cost of issues, as all issuers would share transaction costs (even if marketing costs rise). Thus a ?planned? system of public issues through a quarterly calendar and a centralised mechanism can promote allocation efficiency and deliver greater investor satisfaction. On the whole, this would mean better fund utilisation in the economy as a whole.

Another benefit: it would obviate the ?hero worship? of a few companies that manage to manipulate market sentiment at suitable junctures to their cash advantage, leaving the entire economy worse off.

?*The authors are civil servants. These are their personal views*

First published on: 14-04-2008 at 21:21 IST

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| ADANI ENTERPRISES SHARE PRICE | ADANI PORTS AND SPECIAL ECONOMIC ZONE SHARE PRICE
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| TITAN COMPANY SHARE PRICE | LARSEN & TOUBRO SHARE PRICE | POWER GRID CORPORATION OF INDIA SHARE PRICE
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| SILVER RATE TODAY | SILVER RATE IN BANGALORE | SILVER RATE IN AHMEDABAD | SILVER RATE IN HYDERABAD | SILVER RATE IN CHENNAI
| SILVER RATE IN JAIPUR | SILVER RATE IN MUMBAI | SILVER RATE IN DELHI | SILVER RATE IN NOIDA | SILVER RATE IN LUCKNOW
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| PETROL PRICE IN CHENNAI | PETROL PRICE IN KOLKATA | PETROL PRICE IN PUNE | DIESEL PRICE | DIESEL PRICE IN DELHI
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