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Issuers still prefer graded IPOs

To ease regulatory prerequisites and help revive primary market, Sebi had made IPO grading voluntary earlier this year

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Companies tapping equity capital markets continue to get their issues graded by rating agencies, despite the Securities and Exchange Board of India (Sebi)'s relaxation in this regard.

To ease regulatory prerequisites and help revive the moribund primary market, Sebi had made grading of initial public offerings (IPOs) voluntary earlier this year. However, investment bankers and rating agencies have indicated companies will continue to insist on grading to ensure positive investor sentiment. They say grading helps provide better visibility, especially among small investors.

"IPO grading gives retail investors a certain comfort level about a good but relatively unknown company. It shows the company is transparent and bold enough to get itself evaluated by an independent agency," said D R Dogra, managing director and chief executive, CARE Ratings.

MAKING THE GRADE

- Concept of IPO introduced by Sebi in May 2007
- Sebi makes IPO grading voluntary in February 2014 to help boost primary market
- Issuers seen continuing with IPO grading despite relaxation
- Grading helps in better valuations and visibility, say experts
- Not getting issue graded could lead to doubts being raised about issue-quality, fear companies

"The layman investor does not have the depth or the reach to analyse a company's financial performance. This is why companies choose to get their IPOs graded," he added.

Grading also helped issuers get the right valuations, said market players.

George Joseph, chairman of Wonderla Holidays, which plans to launch an IPO next week, said, "It (IPO grading) helps a company in two ways—-it gives a certain level of comfort to investors that the issue is reliable and second, it helps the company get higher valuations."

IPO pricing is a contentious issue between the issuer company and the merchant bankers handling the issue. An IPO is graded on a scale of one to five, with one being the lowest.

Some say IPO grading only helps separate the good from the bad, but doesn't guarantee whether an issue will deliver higher returns after the listing, something critical for IPO investors. According to a 2012 study by Indian Institute of Management-Ahmedabad, IPO grading does not guarantee higher pricing.

"There is no evidence to support the idea of an improvement in IPO pricing due to grading. This is contrary to the evidence reported by some earlier studies. This suggests the failure of grading as an IPO certification," Joshy Jacoby and Sobhesh Kumar Agarwalla said in their report titled 'Mandatory IPO grading: Does it help pricing efficiency'. Officials said the time and costs incurred for such grading were very small in comparison to its benefits. Typically, getting an IPO graded costs a company Rs 5-10 lakh and the entire process takes three-four weeks, say officials.

Some believe IPO grading is unavoidable, as companies do not want to be seen breaking away from an ethical practice. Satyen Shah, head (equity capital markets), Edelweiss Financial Services, said it was likely issuers would continue with IPO grading, as it provided some comfort about the quality of the issue. "Dropping IPO grading might raise doubt on the issue quality. As the cost in grading an IPO isn't much, it isn't so much of an issue," he said.