SEBI's Attempt to Regulate Pricing of New Age Company IPOs

Why in news?

The stock market regulator, SEBI is trying to improve the disclosures made by new age technology companies approaching the primary market for listing.

What are the issues over the new age technology companies?

- The digital companies tend to give precedence to growth over profitability and, therefore, are mostly loss-making when they approach primary markets.
- Traditional accounting ratios mandated to be disclosed by the SEBI's ICDR Regulations under "basis for issue price" such as earnings per share, price to earning ratio and return on net worth of the company are not applicable to these loss-making companies and do not help investors in their decision-making process.
- The shares of many recently listed new-age tech firms crashed heavily during the stock market correction.
- Investors who picked up the Zomato, Nykaa and Paytm (One97 Communications) IPOs suffered heavy losses as their shares collapsed.
- Investors blame irrational valuations for these losses and SEBI seeks to tighten IPO-pricing rules for new-age technology companies.

What are SEBI's new rules for IPO pricing of shares of new-age tech firms?

- SEBI will set up a mechanism for transparent IPO pricing of new-age firms.
- After SEBI approves these proposals, it will ask new-age companies to justify how they arrived at the pricing of their issue.
- SEBI observed that many companies filing their offer documents for IPOs under ICDR Regulations do not have a track record of profits for at least three years.
- Many of these are new-age tech firms, and SEBI wants non-traditional information such as trends in Key Performance Indicators in the past to justify future profitability.
- Moreover, SEBI seeks information on the company's past fundraising rounds, disclosure of all presentations made to investors before the IPO, and compare share sales before the IPO.

What suggestions can be given to improve the SEBI's

approach mandate disclosure of alternate metrics?

- **Metrics followed by companies**- The new age digital companies use different metrics such as app downloads, website registrations and traffic, subscribers, etc. to project growth while valuing their shares**.**
- It would be difficult for SEBI to list all these metrics for disclosure.
- **Listing key performance indicators**- An easier option would be to ask these companies to share in the offer document the key performance indicators shared with investors in the pre-IPO funding rounds.
- Mandating that these metrics be certified by an independent chartered accountant will lend more credibility to the numbers.
- **Look back period**- A three year look-back period for these disclosures appears enough since many of the companies are likely to be start-ups and going back beyond three years may also not present an accurate picture.
- **Global comparison**- It is imperative that the key performance indicators of the issuer are compared with global peers listed overseas since domestic listed companies in the digital technologies segment are few.
- Being aware of the risk premium being attributed to such companies in other markets will greatly help domestic investors.
- **Disclosures-** The weighted average cost of acquisition of shares issued or allotted in the pre-IPO period can be disclosed in the prospectus as it will alert investors regarding allotment to related parties or companies prior to the issue.

References

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