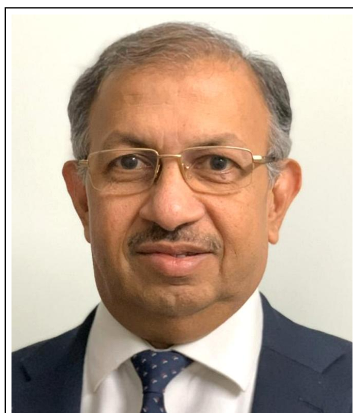
Examining the Role of Anchor Investors



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Anchor investors as a category of investors came into prominence in Indian IPOs since 2009 with the introduction of a provision by SEBI in the then DIP Guidelines. The provisions have been recalibrated over time, based on real-time experiences and today subscription to anchor investor portion in IPOs is an eagerly awaited signal for other classes of investors to plan their investment decisions.

Among the various factors that provide comfort to a rational retail investor investing in an IPO, prior investment by an institutional investor such as a Private Equity or Venture Capital Fund or other marquee investors is a very dominant factor influencing investment decision. Similarly, presence of reputed firm of auditors to certify its financial statements, renowned corporate personalities as independent directors on its Board of Directors, high credit rating of its debt papers by rating agencies are also some of the other factors that positively influence investment decisions. It may be recalled that till a few years back, IPO grading was a mandatory provision under SEBI ICDR Regulations whereby the investor was provided with a cue as to the quality of the IPO through grading of the IPO by Rating Agencies based on certain parameters. However, this was discontinued as no tangible benefits were observed from investor perspective in terms of the post listing performance of the stocks.

While these aforesaid factors, inter alia, do influence an investor decision, the most credible and pressing cue for a retail or HNI investor, or even other institutional investors, could be the anchor investment. As they say, proof of pudding lies in tasting; the anchor investors are actually investing at the price band set by the Company in consultation with Merchant Bankers thereby indicating to the investing class at large that they approve of the price at which the IPO offer is being made. In other words, presence of PE Funds/VC Funds as prior investors or presence of top notch auditors and independent directors may testify as to the credibility of the Company, its business model and its management. But investment even in the best of Companies at incorrect valuation can be an albatross in the investors neck and this is where the anchor investors, through their action of investing one day prior to the opening of IPO, signal huge comfort to other investors in terms of pricing of the IPO.

The role of anchor investors or cornerstone investors as they are called globally, is therefore very crucial to facilitate better price discovery in IPOs thereby minimizing risks of obscene valuation quite often sought by IPO bound companies and even by some Private Equity or Venture Capital Funds seeking exits through IPOs, while also substantially diminishing chances of underpricing of shares which can be an invisible but huge cost to a company going public. This presupposes anchor investors to be well informed investors, better equipped in terms of knowledge, experience, infrastructure, research tools, valuation techniques and market intelligence. Of course, they are also expected to act with prudence and integrity as their decision to invest can be defining moment for most IPOs. In Indian context, the anchor investment portion is carved out of the reservation to Qualified Institutional Buyers (QIBs) and as such FIIs, Mutual Funds, sovereign funds have been among the most active anchor investors.

Presently upto 60% of the reservation to Qualified Institutional Buyers can be taken up by anchor investors, of which one-third is to be reserved for Mutual Funds. Bidding for anchor portion happens one day before the public issue opens and allocation to anchor investors is completed the same day. The details of anchor investments are made available on public domain by the Merchant Banker before the public issue opens, revealing to investors at large the sentiments of institutional investors towards the public issue, in advance.

Anchor investment in IPOs as a concept and practice is prevalent in many markets, especially in South East Asia such as Singapore, Hong Kong and Malaysia. Like in India, in most of these markets, the idea gained prevalence post 2008 sub-prime meltdown and consequent drought in public raise of capital. The regulatory focus then was to instil investor confidence in primary capital markets; and anchor investment by institutional investors in IPO bound companies with discretionary allocation vis-à-vis proportional allocation in IPOs was mooted as a double edged weapon - to entice institutional investors with better chances of allocation and simultaneously harnessing such institutional investment to stimulate retail and HNI investment. The regulatory framework may differ from market to market, but essentially the precept and practice have been similar. For instance, in India the anchor investor lock-in is 30 days post allotment, while in some overseas markets like Hong Kong for instance, it is at least 6 months.

Multiple researches and studies conducted by different scholars based on data of IPOs in India and abroad over varying time periods, have testified to the validity of the anchor investment argument. These studies have specifically endorsed anchor investment to have positive effect in terms of post-listing liquidity and volatility of stocks besides serving its avowed objective of acting as

quality certification to inspire other classes of investors to invest.

While there is no doubt about the role of anchor investors in instilling confidence about an IPO bound Company among general investors, it is also to be borne in mind that all investors have their own rationale, horizon and expectations from their own investments. Same is true of anchor investors too which are but institutions managing funds entrusted to them either by government or its affiliated bodies, HNIs or retail investors. As such their investment patterns are also dictated by the compulsions of their obligations towards respective fund providers and may not exactly mimic the aspirations of a common investor. It is also to be noted that in India anchor investors have statutory obligations of remaining invested only for 30 days post allotment. And their decision to sell a particular share in which they have invested in an IPO as anchor investor, is not required to be made public in advance. Hence a common investor may use the anchor investment only as a guiding star for investment consideration, but a final decision may be based on his own risk appetite, return expectations and time frame.

Our past experience has also revealed that all IPOs boasting anchor investments are not necessarily safe and risk-proof. Despite the undisputed fact that anchor investors are definitely better placed than an ordinary investor to decipher the large volume of data disclosed in the offer documents and can seek relevant clarifications on various aspects of the company's working, prospects and basis of share valuation etc. from the Book Running Lead Manager or the Issuer Company itself before investment, history is witness to several instances of failure too. There have been cases of Companies with huge anchor investor endorsements, which have subsequently faced serious allegations of financial irregularities, obfuscation of financial statements and consequent regulatory penal actions leading to preposterous diminutions in share value. And it is also a recorded fact that such companies have attracted investments from a good number of premier anchor investors. Which brings us to the reality check that eventually an equity investor will need to assess his own risk appetite, be conscious of the cover page warnings in Offer Documents about the inherent risks in any equity investment and use anchor investment data as an additional comfort factor rather than as sole factor guiding his investment decisions.

Further, on the other hand, if anchor investment is meant to foster better price discovery and thereby significantly limit underpricing and save issuers of invisible costs, there are instances of huge disconnect between anchor investor price and listing price, with listing happening at huge premium to the IPO price.

However, it is to be acknowledged that these are exceptions than the rule and anchor investments despite its limitations, are here to stay and rightly so. Suffice to say that Indian equity markets especially primary markets are still in evolutionary stages and with SEBI proactively stepping in to correct situations based on experiences gained, things can only get better from here, both for issuers and investors.