

Being vigilant pays

Before investing in an IPO, go through the rating agency's IPO grading report for an understanding of corporate governance issues

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AFTER THE Satyam scandal, corporate governance has emerged as an important concern among investors. CRISIL Research has recently revealed that of the 29 initial public offerings (IPO) graded by the rating agency since May 2007, corporate governance structures were found to be weak in close to 50 per cent of companies.

CRISIL's IPO grading methodology includes an assessment of corporate governance and management quality, apart from other criteria such as industry and business prospects and financial performance. Shareholding structure, board composition and processes, disclosure standards and related-party transactions are some of the aspects analysed while examining the quality of corporate governance.

Only 10 per cent of the 29 companies assessed

by CRISIL had robust corporate governance structures; 25 per cent were average; and 15 per cent were above average. In 45 per cent of the companies with relatively weak governance scores, independent directors exhibited less than expected awareness about the company's businesses or other businesses of the promoter group, or even IPO-related plans and strategies of the company. In 15 per cent of the cases, the independence of the board from promoters or management was an area of concern. In about 55 per cent of the companies, related-party transactions or presence of group companies in similar lines of business was an issue.

Explaining this state of affairs, S. Venkataraman, senior director, CRISIL, says: "This is not altogether surprising. When a company goes for an IPO, it is its first step into welcoming a wider investor base, and opening itself up to greater outside scrutiny. When they go in for an IPO,

companies are expected to meet tighter corporate governance standards than what can pass for a closely held company."

What should investors do?

IPO gradings are especially significant in the case of lesser-known companies. Commenting on the impact of corporate governance quality on IPO grading, Chetan Majithia, head-equities, CRISIL Research says: "While not the sole determining factor, the quality of corporate governance may significantly influence the CRISIL IPO grade, beyond what the company's business prospects and financials may suggest. A view on the corporate governance standards is particularly relevant for IPOs, since investors may have only limited information on the company or the promoter's track record."

While an IPO grading comments on the fundamentals of a company, it is up to the investor to as-

Key takeaways

- Go through the report on IPO grading
- Be especially vigilant in the case of lesser-known companies
- The report will shed light on the company and promoter's track record
- Stay vigilant even after investing in the IPO

sess whether the risk and the pricing are appropriate for him. Even after investing in the IPO, investors need to stay watchful. "Corporate governance is not something static. IPO grading is a point-in-time assessment relevant at the time of the IPO. Investors need to look at it post-investment as well. Going through CRISIL's IPO grading report will familiarise the investor with the key risks, including corporate governance issues. They will also get an independent evaluation of the company. This will enable them to monitor subsequent developments in the company better," adds Venkataraman.

Moreover, individual investors have limited access to company-specific information. Says Vishal Dhawan, a Mumbai-based financial planner, "Most IPO investors engage in short-term trading to make a quick buck. They, therefore, do not really investigate the company in-depth. Corporate governance is a key, or rather number one, criterion in investment decision-making. Given the limited information that individual investors have, they are not equipped to ask the right questions from the management. So, individual investors should either read documents such as the annual reports, notes to account, etc. properly, or they should invest through mutual funds, which have access to adequate information about the company." ♦

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