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Readability of IPO Disclosures and SEBI Audio Video Mandate

India's IPO market has seen an increase in volume and retail investor participation, despite nearly one-third of IPOs declining on their opening day. Retail investors in India possess limited resources and the aptitude to decode the distorted information flow from an IPO-bound company. These distortions are caused by weak financial quotient, complex disclosures in the prospectus and regulated media intervention. Amidst concerns

about complicated prospectuses, financially unaware investors, and an impactful media presence, SEBI has made it mandatory for companies to publish audio-video disclosures in a bilingual manner. Through this article, the author has outlined the need for such a disclosure mandate, its possible impact, and alternatives.

Introduction

The Indian capital market saw a 72% increase in IPOs from 2022 to 2023. Wall Street has endorsed India as the prime investment destination for the next decade. The wave of deals has allowed individual investors to take part in India's unprecedented wealth boom making IPOs a lucrative asset class for investors. IPO debut gains have been about one-third of the five-year average, and an index of newly listed small stocks has fallen 11% in the past month. SEBI is cautious about the risk of a bubble. Regulators are concerned that novice investors are buying into a bubble, backing small companies with limited track records, and being spun by an investment industry determined to churn out short-term stock winners. Many of the firms going public on India's small-cap exchanges have high valuations even though they are very "ordinary" (Preeti Singh et al., 2024).

To calm the frenzy, regulators are targeting "finfluencers" who promote IPOs through online videos

in which they quickly scroll through prospectuses and highlight data points with a red marker.

As a part of the move, the Securities and Exchange Board of India (SEBI) has recently issued new regulations for companies launching Initial Public Offerings (IPOs). The regulator has mandated that disclosures in prospectuses and price band advertisements for main-board public issues should be made in audio-visual (AV) format for ease of understanding. The AV content must also include a warning not to rely on any other document, content, or information provided by financial influencers on the internet or other platforms. The guidelines aim to make it easier for investors to understand the features of the public issue and the company. The video will be accessible on the issuer's website, social media channels, website of the Association of Investment Bankers in India and can also be found within offer documents via a QR code. The AV content must be factual, non-repetitive, and non-promotional. The ten-minute video should

provide details about the issue and the inherent risk. The lead manager should create the presentation in a bilingual version, i.e., both English and Hindi (SEBI, 2024).

The guideline is voluntary for companies filing prospectuses from July 1, but is mandated for draft documents filed after October 1. SEBI aims to boost investor confidence and protection in capital markets by offering standardised, reliable video disclosures. SEBI aims to target and refine the IPO information flow, reducing distortion caused by externalities to benefit retail investors.

It becomes pertinent to comprehend the IPO information flow and its barriers to comment on the probable effectiveness of the order. A brief model of the information flow is presented in Figure 1. IPO information flow is affected by factors such as:

- Readability of IPO prospectus
- Media Impact
- Financial Literacy and Financial Attitude

Retail Investors, Financial Literacy and Financial Attitude

Information asymmetry is exaggerated during IPO owing to lack of historical information about an IPO bound company. Due to the gap of information available, the prospectus becomes the key source of information for all external stakeholders. The Signalling theory entails investor resource misallocation due to the existence of information asymmetry. To compensate for the asymmetry and to attract investments, IPO going firms convey information in a numeric and textual manner in corporate disclosure documents (Mariani et al., 2023).

The information asymmetry doesn't affect all investors equally; institutional and retail investors possess different levels of information. Institutional investors have the resources to evaluate a company's fundamentals and are thus better informed than retail investors. This leads to different sentiments about the prospects of the IPO firm. On the other hand, retail investors lack the resources to comprehensively analyse and value a company, and hence are heavily

influenced by noise. Retail investors heavily rely on professional advice and secondary information sources.

Not only resources, but also financial unawareness, affects the information absorption ability of retail investors. Financial illiteracy and a negative attitude can lead to poor fiscal decisions, which can drastically affect an individual's financial well-being. Abstract knowledge and wrong opinions about the financial system lead to erroneous financial decisions, irrational stock market participation, poor borrowing behaviour, accumulation of less wealth with no optimal retirement plans, and a higher likelihood of entering high-cost transactions. Investors need to be aware of the risks associated with every type of investment and have realistic expectations of returns. A lack of financial awareness can lead to a subsequent financial market bust (Gaurav & Singh, 2012).

Readability of IPO Prospectus

According to Warren Buffett, "As noted for more than forty years, I've studied the documents that public companies file. Too often, I've been unable to decipher just what is being

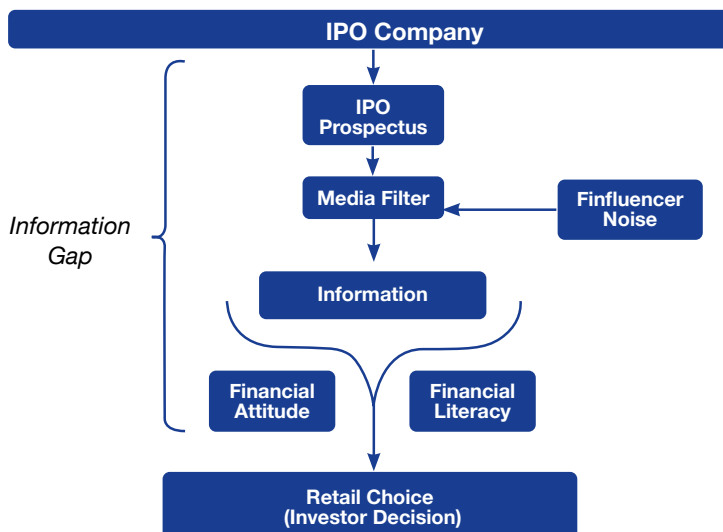
said or, worse yet, had to conclude that nothing was being said. In some cases, moreover, I suspect that a less-than-scrupulous issuer doesn't want us to understand a subject it feels legally obligated to touch upon." (Rachappa Shette, 2019).

Readability can be defined as the ability of written sentences to convey information in a clear and concise manner. Readability is measured by various proxies, such as word count, file size, sentence length, Fog Index, and Bog Index, among others. The growing research on readability has highlighted that poor readability of corporate disclosures indicates lower profitability of over- or under-investment, and it can impact market response. Lower readability can undermine investors' trust in a source and lower their assessment of a firm and its managers. The readability of IPO prospectuses determines the effectiveness of this signal by making it easier to read, mitigating information asymmetries, and enhancing investors' confidence during the IPO process. Retail investors favour firms with easily readable disclosure documents. Ensuring an appropriate level of readability can help all investors make well-informed decisions. A strong positive association exists between the tone of the prospectus and market reaction (Tao et al., 2018).

Media impact

The ability of media to collect, filter and disseminate information has enhanced its role in the financial market. Media drives investment decisions by providing attention-oriented information instead of holistic and prudent insights. Media and similar stakeholders tend to change their tone and readability based on the economic environment. The tone becomes positive during a non-crisis period and the opposite during a negative one. Misreporting or biased reporting by the media can affect the investment decisions of

Fig 1. Factors that affect IPO confirmation



Source: Author's Compilation

“The Securities and Exchange Board of India (SEBI) has recently issued new regulations for companies launching Initial Public Offerings (IPOs). The regulator has mandated that disclosures in prospectuses and price band advertisements for main-board public issues should be made in audio-visual (AV) format for ease of understanding.”

retail investors drastically (Bhardwaj & Imam, 2019).

In addition to formal communications through IPO prospectuses, soon-to-be public firms are increasingly utilising social media channels to showcase their social commitments and foster customer relationships. Social media can help firms disseminate information quickly, create information asymmetry, attract more investors, and ultimately provide them with access to resources such as financial capital and partnerships. An IPO prospectus requires expertise to comprehend, understand and make investment decisions. Retail investors who cannot afford the fees of financial advisors often rely on media articles for their investment decisions. It has been observed that retail investors tend to overreact, even in cases where old news is being churned out by the media. This emphasises the media's ability to create an impact on IPO subscriptions, even when no new information is available. A positive media tone can increase the demand for an IPO among retail investors, while a negative one creates the opposite effect. The tone of media coverage has been observed to increase underpricing. The reputation of the media, the

number of media outlets, and the circulation of news are factors that can exacerbate the impact of media on retail investors (Bajo & Raimondo, 2017).

Role of Notification

SEBI has already enacted multiple rules under Chapter IX of Issue of Capital and Disclosure Requirements, 2009. The rules outline requirements for issuing advertisements, which must be true and not misleading. Advertisements shouldn't contain false statements, promises, or forecasts and should provide all relevant facts. Financial data should include information about revenue, net profit, share capital, reserves, earnings per share, dividends, and book values. Technical, legal, or complex language should not distract investors. Statements promising rapid increases in revenue or profits should not be included. Advertisements should not display models, celebrities, fictional characters, landmarks, or caricatures. Television advertisements should not appear as crawlers and should advise viewers to read the prospectus for risk-related disclosures. Any key development between offer filing and allotment should be conveyed in a true and fair manner.

These existing rules can regulate the fairness of any information issued by the issuer and allied entities. Many finfluencers earn substantial incomes by creating video content on initial public offers, but concerns have been raised that these influencers promote the IPO instead of objectively informing investors about its merits and risks.

To protect investors' interests and limit the risk of falling prey to unsolicited advice online, SEBI has imposed restrictions on unregistered finfluencers from providing financial advice. In recent months, unregistered finfluencers have been banned, with a sole proprietor banned in

October 2023 and a YouTuber and options trader fined in May 2023 for allegedly violating investment advisor norms. Investors are advised to make well-informed investment decisions, especially when investing in IPOs, and not to be swayed by unsolicited advice on social media. The Advertising Standards Council of India (ASCI) has revised guidelines requiring SEBI registration for influencers in the banking, financial services, and insurance sectors. The move aims to protect investors from unverifiable financial advice and maintain India's financial market integrity.

This reduces reliance on unauthorised sources and ensures consistency, transparency, and clarity in communication, facilitating informed decision-making by issuers. Thus, with the rules already covering the readability of prospectuses and regulating media impact, the role of the AV rule warrants consideration. The rule is targeted at financial literacy; the regulated script for the video, along with a bilingual approach, can reach a wider audience. The video created will be able to tackle the noise created by finfluencers or media owing to its enhanced coverage. With the additional rule, SEBI has attempted to enhance the information flow by influencing the financial attitudes and literacy of retail investors.

Yet the rule may not yield the expected results. Despite the existing mandate for simple language in the prospectus, companies often use jargon, resulting in lower readability for retail investors. Poor readability will allow the media and finfluencers to act as a medium for conveying information. Thus, the ambiguity in defining simple language allows companies to deploy technical language. Even under the AV mandate, the language used cannot be completely regulated. Thus, the net impact of the mandate should be perceived with a sceptical view. Having a 10-minute time

frame restrains companies from overburdening investors with information. Companies may opt to focus on selective information, citing the time constraint. Biased reporting may become a common occurrence within AV disclosures.

In an economy where accounting policies and related choices are used for earnings manipulation, the choice of language and words can also facilitate biased disclosures, whether textual or visual.

SEBI can draw inspiration from SEC rules on “Plain English” and “Quiet Period” to improve IPO information flow. The SEC adopted the 1998 Plain English Mandate and provided a companion handbook entitled “A Plain English Handbook: How to create clear SEC disclosure documents”. The rule aims to enhance investors’ ability to make informed financial decisions and avoid being misled by complex jargon. The rule is not only restricted to prospectus filings, but SEC documents, speeches, and communications with shareholders. The AICPA launched the Centre for Plain English Accounting in 2013



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to help stakeholders better explain technical terms to their respective clients by providing the requisite interpretation. The rule requires that the prospectus adhere to plain English principles in every aspect of the disclosure. The direct and indirect effects of the SEC’s plain English improved readability in all samples after the regulation was enacted (Loughran & McDonald, 2014).

A firm cannot issue any communications for 25 days after an IPO due to securities regulations and underwriter agreements; this period is termed the “quiet period.” Requirements for prospectus distribution also prevent security analysts from publishing research reports. These guarantee equitable access for all investors and establish the statutory prospectus as the principal source of information (Bushee et al., 2020).

Thus, the AV disclosure mandate is moving in the right direction, but it may lack the requisite comprehensive framework to address the targeted concerns.

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