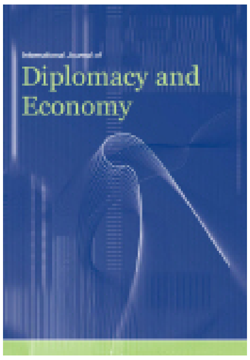

International Journal of Diplomacy and Economy

ISSN online: 2049-0895 - ISSN print: 2049-0887
https://www.inderscience.com/ijdipe

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DOI: 10.1504/IJDIPE.2024.10059317

Article History:

Received:	30 May 2023
Last revised:	10 July 2023
Accepted:	31 July 2023
Published online:	01 March 2024

India's largest fintech IPO: a case study of Paytm

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Abstract: India's momentous Initial Public Offering (IPO) year has been 2021. This case talks about the star of the show, Paytm IPO. One of the largest fintech IPOs in the Asia-Pacific region failed horribly on the stock market. Even though the company successfully raised the desired amount, investor enthusiasm for Paytm's offer was relatively low compared to other tech firms. The present study discusses the reasons for the debacle of the Paytm IPO, including excessively inflated pricing, Fear of Missing Out (FOMO), etc. The case discusses in depth the emergence of fintech and Paytm. The learnings from the case study follow this. It also highlights the modifications that the Securities and Exchange Board of India (SEBI) brought to tighten the IPO process. The regulator wants new-age IT businesses to tell precisely how they valued their stocks for IPOs, compare it to pre-IPO share sales and upload all pre-IPO investor briefings to enable investors to make educated decisions.

Keywords: fintech; Paytm; IPO; book building; case study.

Reference to this paper should be made as follows: Dhingra, B., Saini, M., Yadav, M. and Saini, M. (2024) 'India's largest fintech IPO: a case study of Paytm', *Int. J. Diplomacy and Economy*, Vol. 10, No. 1, pp.57–77.

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1 Introduction

India's momentous Initial Public Offering (IPO) year has been 2021. Nykaa, Lenskart, Zomato, Paytm and many other tech firms have risen with the stock market. Nykaa had a big debut and dominated the listing event, while others drowned in the process. One such instance is Paytm, one of the biggest e-commerce IPOs in Indian history that utterly flopped on the stock market. Paytm turned out to be a lame duck and has drastically decreased investor value since its highs. In November 2021, One 97 Communications Ltd. issued its first public offering, fully subscribed on the third day and raised 183 billion (Rs. 18,300 crore) (see Table 1). This is the largest fintech IPO in the Asia-pacific region. Even though the company successfully raised the desired amount, investor enthusiasm for Paytm's offer was relatively low compared to other tech firms, as it got just 1.89 times oversubscribed.

One 97 Communications Ltd. (parent company of Paytm) founded in 2000, is the nation's leading digital platform for businesses and consumers. After a full subscription, Paytm made its market debut on 18 November 2021, on India's main bourses, the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). Paytm's disappointing debut wasn't entirely unexpected, given the sluggish demand for the country's largest stock exchange listing – although the magnitude of the dip surprised many. The stock was listed on bourses at a discount of 9% (approx.). In afternoon trade, shares were traded at Rs. 1614 per share, down from the offer price of Rs. 2150. It closed at Rs. 1560, 27.40% below the offer price. As a result, its market valuation came down to Rs. 1.01 lakh crore compared to Rs. 1.39 lakh crore valuation. On its first day on the market, the stock hit the lower circuit. Four hundred billion rupees of the company's market capitalisation and billions of investor money were lost. It has failed to touch its issue price since listing.

The stardom of Paytm, as mentioned above, calls for the research question of what made the failure of India's largest e-commerce IPOs – Paytm. Hence, this study adopted the case study approach to answer the research question since the subject to study is a single unit, not multiple units.

The study finds that Paytm is a loss-making company that funded its losses with 70% of its stock. Although lending is considered one of the most profitable areas of the fintech industry, Paytm lacks a banking licence. The IPO's high price is also a factor in Paytm's collapse. Analysts think it is overpriced when compared to major international fintech competitors. Moreover, there is a lot of competition for Paytm from apps like Google Pay, Phonepe, etc. The research claims that Paytm's many business lines prevent it from being the market leader in any industry other than wallets, and these wallets are losing importance as UPI payments soar in popularity. One of the main reasons why investors have submitted applications for this IPO was Fear of Missing Out (FOMO). Indian investors view IPOs as a means of making quick money. Investors have shown interest in Paytm's IPO due to the price rise of other IPOs, including Nykaa and Zomato. Concerns are also raised regarding corporate governance procedures and structure. There is no separation between the chairman and the CEO, a small board with more foreign members and regular attrition among senior executives.

This case study is structured as follows: The history of fintech is included in Section 2. The emergence of Paytm is discussed in Section 3, followed by case study insights in Section 4. In Section 5, the conclusion follows.

2 History of Fintech

Fintech, more than a catchphrase, refers to rising technical advances based on IT in the financial world. According to Financial Stability Board (FSB), Fintech refers to 'technology-enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on the provision of financial services'. The origins of the fintech sector can be traced back to the nineteenth century, when technology began to make its imprint on history, causing the fintech industry to grow. In their research article, Arneris, Barberis & Ross have differentiated the evolution of fintech into various phases (see Figure 1).

Fintech 1.0 (1866 to 1967): From the late 1800s until World War I, 'Finance' and 'Technology' came together to create the first phase of financial globalisation. Fintech traces can be traced back to 1866, according to historians. This year saw a noteworthy development that involved the installation of transatlantic cables, entering a new age of globalisation. In the USA, the Federal Reserve Bank devised the first electronic fund transfer mechanism through a wired network using telegraph and morse code in 1918 by Fedwire. The financial industry has embraced various technologies in this era, including the telegraph, canals etc., to facilitate cross-border financial interconnections, rapid data transfer, payments and so on worldwide.

Rapid technological advancements accelerated as World War II progressed. This period also marks one significant event, namely the introduction of the Diner's Card in 1950, revolutionising the landscape of payment activities.

During this era in India, many British Raj banks were nationalised post-independence, when the country's economic growth started to shoot up, and many citizens availed of banking services.

Fintech 2.0 (1967–2008): In 1966 telex replaced the telegraph for transporting information around the globe, bringing an era of affiliated financial transactions and communication. The arrival of ATMs by Barclay's and financial calculators in 1967 heralds a new phase (transition from analogue to digital) in fintech's history. In the early 1970s, the significant event that shaped Fintech 2.0 was establishing the first electronic stock market, NASDAQ. It allowed people to exchange stocks over a computer network and revolutionised the IPO process. Another key event was the introduction of Society for Worldwide Interbank Financial Telecommunications (SWIFT) in 1973. It's an interconnection system financial institutions use to facilitate large-scale cross-border payments. The 1980s and 1990s saw the popularity of electronic trades and online banking systems.

The first bank to start internet banking in India was ICICI, but with restricted services. Fintech 2.0 provided the fintech business with a more modern appearance, and the events listed below sparked the emergence of fintech in India:

- *1980*: The country's first credit card by the Central Bank of India.
- *1987*: The first ATM by HSBC in Mumbai.
- *1994*: Stanford Federal Credit Union became the first financial institution to allow consumers to access banking functions via the World-Wide-Web.
- *1998*: Introduction of PayPal.
- *2008*: The Global Financial Crisis.

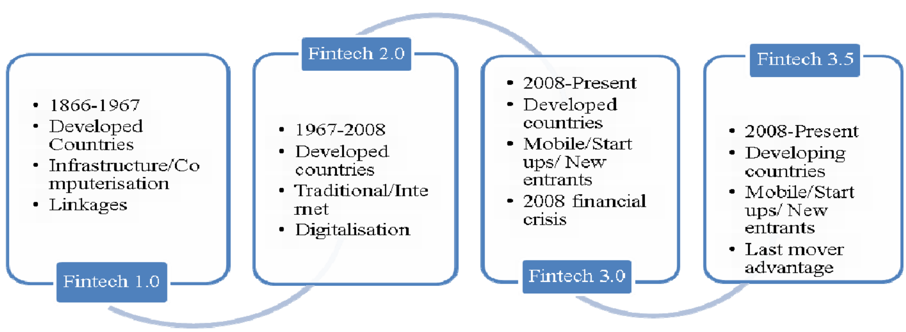
Fintech 3.0 and 3.5 (2008 to Present): The defining feature of Fintech 3.0 is the move away from established banking systems. The 2008 crisis led to a lack of trust and stricter compulsions for traditional banks, which paved the way for new service providers to enter the market. This resulted in a new era of financial services, with enthusiasm for new products and services among investors and consumers. The Global Financial Crisis of 2008 heralded the fintech business to acquire traction and spread worldwide. Two significant breakthroughs in this era include the invention of Bitcoin (the very first cryptocurrency) establishment of P2P payment networks in 2009 and 2011, respectively. So far, numerous advancements and hundreds of new unicorns exist in developed countries.

Fintech 3.5 signifies a departure from the Western-dominated financial sector and embraces global digital banking advancements. Someone threw a cable through the Atlantic in the Fintech 1.0 era in 1886, kicking off new approaches to doing banking business. Fintech 3.5 defines internet availability and changes in consumer behaviour in developing countries. From 2014 onwards, two of the world's most populous countries, China and India, have seen a non-linear rise in fintech. This, combined with fintech advances in Africa, is seen as the growth engine for this era. Financial software developed by Indian IT businesses, m-Pesa in Africa, payment banks in India (e.g., Fino PayTech) and Alipay in China, to mention a few, are driving this trend.

India had emerged as one of the active players in this era with a plethora of smart innovations and entrants. India has grown in fintech recently due to its concentration on customer-centric financial products and services. The 2016 demonetisation push drew a lot of attention from the finance community. The Indian government's push for digital India, which aims to transform the country into a cashless economy, also supports fintech firms significantly. Many Indian companies, such as Paytm, Phonepe, Mobikwik and Freecharge, emerged due to the increasing adoption of fintech.

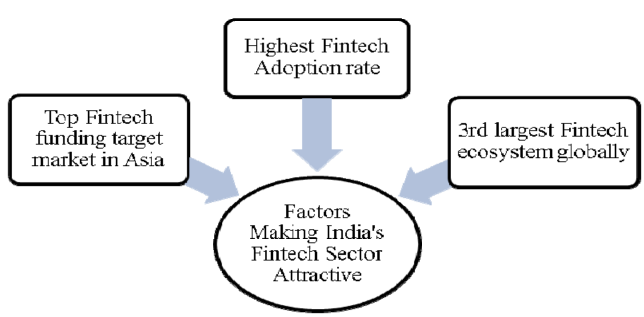
After the USA and China, India's fintech market is currently the world's third-largest fintech ecosystem. However, due to limited financial service penetration, India is currently an attractive destination. Fintechs in India have room to develop because of these untapped opportunities and a favourable ecosystem (see Figure 2). As per a report by BLinc Insights, there are 6386 fintechs in India. Figure 3 depicts the segment-wise distribution of fintech. Payments, lending and investment tech make up 70% of the fintech industry in India. According to BLinc Insights report, the fintech adoption rate is highest in India, at 87%, exceeding the global average of 64%. The report also provides that the fintech sector will expand at a CAGR of 22% over the next five years.

Figure 1 Overview of Fintech evolution



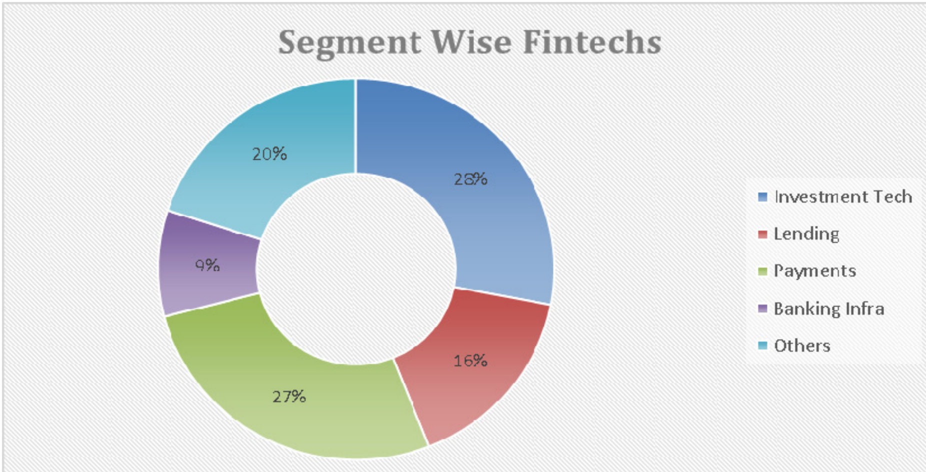
Source: Douglas W. Arner, 'Fintech: Evolution and Regulation'.

Figure 2 Fascinating factors of India's Fintech sector



Source: INVEST INDIA.

Figure 3 Segment-wise distribution of fintechs (see online version for colours)



Source: BLinC insights.

The Indian financial services sector is expected to be worth $500 billion in 2021, with the fintech market accounting for $31 billion.

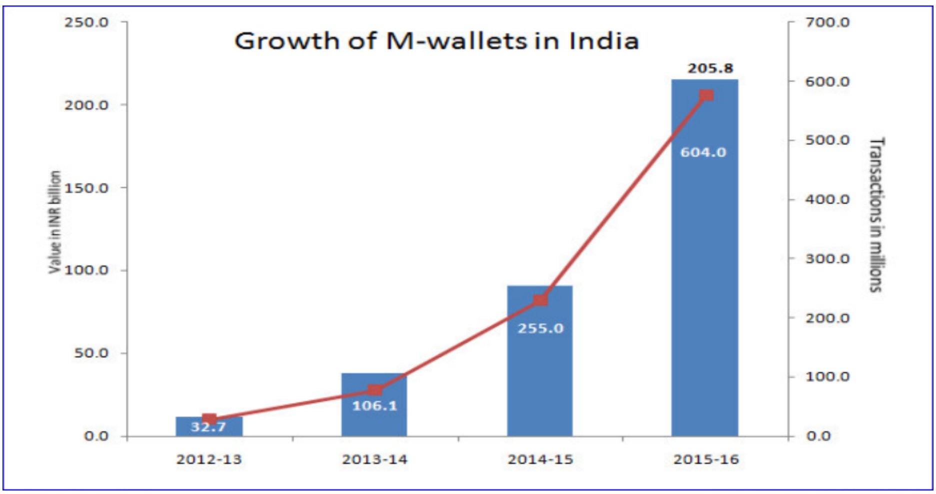
3 Paytm emergence

Incorporated in 2000, 'One97 Communication Ltd.' is India's premier digital platform for sellers and buyers. The corporation had a 333 million-plus customer base in FY21, with over 21 million registered merchants using its various services. Paytm subsidiary of One97 Communications was the dream of Vijay Shekhar Sharma. Paytm, 'Pay Through Mobile', began operations in Noida in 2009 with a $2 million investment. It is a corporation that specialises in financial technology and e-commerce payments. Paytm was formerly a prepaid mobile recharge platform, unlike today when an individual can use it for almost anything.

One of the company's ambitious objectives is to improve the payment network in India. Many of India's people lacked access to traditional financial services at the time of the company's creation. Those who had their accounts with banks found it difficult to use them at times. The most common payment methods were cash and cheques at that time. Paytm's founders found this problem needed to be solved, so the company launched its wallet in 2014.

It gradually expanded its business portfolio with an easy and user-friendly interface to embrace practically every type of digital transaction. As a payments platform, it facilitated the payment of utility bills, insurance, loans and education fees and gave investment options like mutual funds and gold. It offered more services in e-commerce, e-wallets and launched an online mall. It became a go-to place for booking hotels, movie tickets, trains, aeroplanes and bus tickets. It took a lot of work for Paytm to persuade its customers to believe in online transactions in a country where 95% of monetary transactions were performed in cash before demonetisation. Still, Paytm persevered and enabled individuals to adopt cashless transactions. Paytm's significant growth occurred in 2016. This year is known for two things: Demonetisation and Jio. When Prime Minister Shri Narendra Damodardas Modi announced demonetisation in 2016, the entire country was stunned. Even at this stage, a small percentage of the public preferred internet payments to cash payments (see Figure 4). Paytm, on the other hand, recognised an opening and seized it. Advertisements promoting Paytm as an alternative to cash 'Paytm Karo' and a solution to the country's cash shortage appeared immediately. Another aspect that worked in Paytm's favour was the technological advancements in the smartphone industry. In addition, Jio's entry opened the internet to everyone, gradually increasing users' readiness to adjust to online payments.

Figure 4 Indian M-Wallet market growth



Source: RBI.

The company aims to 'bring half a billion Indians into the mainstream economy through payments, commerce, banking, investments, and financial services'. It believes that people's access to technology and financial services can help them make their lives better, help traders develop their businesses and positively influence our communities.

Payments have always been at the heart of Paytm's operation. The company is considered a 'problem solver'. Harinder Takhar (CEO of Paytm Labs Inc.) said, 'Our approach is to identify the pain points for customers and then solve them really, really well – better than anybody else can'.

Table 1 Issue details

	Issue Details
	One 97 communications limited
Issue Open	8 November 2021
Issue Close	10 November 2021
IPO Listing Date	18 November 2021
IPO Price Band	Rs. 2080 to Rs. 2150
Shares	85,116,278 total equity shares with a face value of Rs. 1

Table 1 Issue details (continued)

Issue Details	
One 97 communications limited	
Issue Size	Rs. 18,300 crores
	Offer for sale Rs. 10,000 crores and a new issue of Rs. 8,300 crores.
Advisors to the IPO	Collectively, Morgan Stanley, Goldman Sachs and Axis (together, the JGC-BRLMs) and I-Sec (ICICI), J.P. Morgan, Citi and HDFC (together, the BRLMs)
Oversubscription	Qualified Institutional buyers 2.79 times, Non-Institutional Investors 0.24 times, Retail Investors 1.66 times.
Type of issue	100% Book Building

Source: Red herring prospectus and internet.

Table 2 Income expenditure summary

Income & Expenditure Summary in Rs. Million			
One 97 Communications Ltd.			
Months	12	12	12
Date	3/31/2019	3/31/2020	3/31/2021
Total income	34,353.4	32,625.1	30,477.6
Sales	30,498.7	28,598.4	26,670.8
Income from financial services	3271.8	1251.4	3297.7
Other income	36.4	2630.8	184.3
Prior period and extra-ordinary income	546.5	144.5	324.8
Total expenses	73,949.8	60,956.9	46,079.6
Raw materials, stores & spares			
Packaging and packing expenses			
Purchase of finished goods			
Power, fuel & water charges	93.8		
Compensation to employees	6277.8	8251.2	8397
Indirect taxes	132.4	39.3	51.1
Royalties, technical know-how fees, etc.			
Rent & lease rent	178.9	58.8	9.5
Repairs & maintenance	717.1	272.6	220.3
Insurance premium paid	81.5	62.6	61.1
Outsourced manufacturing jobs		2482.1	1725.4
Outsourced professional jobs	3633.8	4727.3	5202.5
Non-executive directors' fees			
Selling & distribution expenses	34,224.3	13,655.7	5209.5
Travel expenses	342.7	274.9	38

Table 2 Income expenditure summary (continued)

Income & Expenditure Summary in Rs. Million			
One 97 Communications Ltd.			
Communications expenses	3111.3	37.4	21.2
Printing & stationery expenses	14.8		
Miscellaneous expenditure	115.5	185.2	217
Other operational expenses of industrial enterprises			
Other operational expenses of non-financial services enterprises		25,301.4	21,794.4
Financial services expenses	22,615.8	561.3	363.7
Fee-based financial services expenses	22,450.8	49.3	26.9
Fund-based financial services expenses	165	512	336.8
Other financial services expenses			
Provisions	249.6	358.4	474.7
Depreciation / Amortisation (net of transfer from revaluation reserves)	758.1	1431.8	1567.8
Amortisation			
Write-offs	0.6	34.6	74.2
Prior period and extra-ordinary expenses	1400.6	3221.8	650
Provision for direct tax	1.2	0.5	2.2
Profit after tax	–39,596.4	–28,331.8	–15,602
PBT	–39,595.2	–28,331.3	–15,599.8

Source: CMIE prowess database.

Table 3 Cash flow summary

Cash Flow Summary in Rs. Million			
One 97 Communications Ltd.			
Months	12	12	12
Date	3/31/2019	3/31/2020	3/31/2021
Net cash flow from operating activities	–43,550.4	–22,424.3	–20,022.2
Net profit before tax and extra ordinary items	–39,595.2	–28,331.3	–15,599.8
Adjustments for depreciation & amortisation in cash flow statement	758.1	1431.8	1567.8
Adjustments for impairment / (reversal of impairment) of PPE & intangible assets			
Adjustments for finance cost in cash flow statement	150	453.1	327.7
Adjustments due to provision for contingencies in cash flow statement (banks or FIS)			
Adjustments due to foreign exchange (gain) or loss in cash flow statement			

Table 3 Cash flow summary (continued)

Cash Flow Summary in Rs. Million			
One 97 Communications Ltd.			
Adjustments due to add back of amortisations & assets written off in cash flow statement	0.6	19.9	63.4
Adjustments due to add back of other provisions & impairments in cash flow statement	1581.8	3942.4	1191.7
Adjustments due to (profit) or loss on sale of investments in cash flow statements	–2161.8	–254.7	–890.9
Adjustments due to (profit) or loss on sale of assets	–430.2	–11	–18.5
Adjustments for interest income in cash flow statement	–1123.7	–891.7	–2388.2
Adjustments for dividend income in cash flow statement			
Expense on employee stock option scheme	860.6	1235.3	867.4
Adjustments due to provision or liabilities written back in cash flow statement	–157.6	–51.2	
Adjustments for other expenses or income in cash flow statement	3.1		–38.2
Adjustments for decrease/(reversal of decrease) in fair value of PPE			
Adjustments due to minority interest income			
Operating cash flow before working capital changes	–40,114.3	–22,457.4	–14,917.6
Cash inflow or (outflow) from operating activities of discontinued operations			
Cash flow generated from operations	–41,754	–22,169.9	–22,008.5
Cash (outflow) due to direct taxes paid	–1796.4	–254.4	1986.3
Cash flow before extra-ordinary items	–43,550.4	–22,424.3	–20,022.2
Cash (outflow) due to miscellaneous expenditure			
Cash inflow or (outflow) from extra-ordinary items			
Net cash inflow or (outflow) from investing activities	17,088.5	–21,808.7	17,179.8
Cash (outflow) due to purchase of fixed assets	–1580.4	–1721	–1778.9
Cash inflow due to sale of fixed assets	47.5	40.1	46.6
Cash inflow or (outflow) due to decrease or (increase) in capital WIP			
Cash inflow or (outflow) due to acquisition or merger or hiving off of companies or units			
Cash (outflow) due to purchase of investments	–35,688.8	–82,030.8	–70,917.3
Cash inflow from sale/maturity proceeds of investments	55,474.7	72,452	100,149.5
Cash inflow or (outflow) due to loans to subs or group companies	–2724.3		
Cash inflow or (outflow) due to loans to others		2376.1	–784.6
Cash inflow due to interest received	667.4	337.3	903.3
Cash inflow due to dividend received			
Cash inflow or (outflow) due to other investing activity	339.1		

Table 3 Cash flow summary (continued)

Cash Flow Summary in Rs. Million			
One 97 Communications Ltd.			
Cash inflow or (outflow) due to change in bank balance not considered as cash and cash equivalent/restricted cash	553.3	–13,262.4	–10,438.8
Cash inflow or (outflow) due to disbursements			
Net cash inflow or (outflow) from financing activities	21,655.7	51,691.8	–2074.8
Cash inflow due to proceeds from share issues	21,892.9	50,540.5	109.2
Cash inflow due to proceeds from issue of share warrants			
Cash (outflow) due to redemption or buyback of capital			
Cash (outflow) due to refund of application money(share/share warrant)			
Cash inflow / (outflow) due to cash subsidy			
Cash inflow due to proceeds from total borrowings (incl. Finance lease obligations)		2617	
Cash (outflow) due to repayment of total borrowings (incl. Finance lease obligations)	–72.4	–874.6	–1856.3
Cash (outflow) due to issue expenses	–23.9	–140.4	
Cash (outflow) due to interest paid	–140.9	–450.7	–327.7
Cash (outflow) due to dividend paid			
Cash (outflow) due to dividend tax paid			
Cash inflow or (outflow) due to other cash receipts or (payables) from financing activities			
Net cash inflow or (outflow) due to net increase or (decrease) in cash and cash equivalents	–4806.2	7458.8	–4917.2
Cash and cash equivalents as at the beginning of the year	203.4	–4602.8	2856
Effect of exchange differences			
Cash and cash equivalents as at the end of the year	–4602.8	2856	–2061.2
Net increase or (decrease) in cash and cash equivalents (closing-opening)	–4806.2	7458.8	–4917.2

Source: CMIE prowess database.

Table 4 Asset summary

Asset Summary in Rs. Million			
One 97 Communications Ltd.			
Months	12	12	12
Date	3/31/2019	3/31/2020	3/31/2021
Non-current assets	**21,907.9**	**42,697.2**	**24,618.2**
Net fixed assets	2861.4	5076.3	3904.3
Net pre-operative expenses pending allocation (Closing Balance)			

Table 4 Asset summary (continued)

Asset Summary in Rs. Million			
One 97 Communications Ltd.			
CWIP & Intangible assets under development (net of impairment)	508	118.9	227
Long term loans and advances by finance companies			
Long term investments	9677.3	10,562.9	11,520.9
Long term loans & advances	7042.6	7235	6867.6
Other long term assets	1368.1	19,704.1	2098.4
Current assets (incl. short term investments, loans & advances)	**66,407.4**	**63,764.9**	**72,044.1**
Short term investments	24,726.5	31,555.1	1471.8
Short term inventories			
Short term trade receivables & bills receivable	3142.8	4351.9	5001.4
Other short term receivables	17,971.3	10,462.6	23,761.6
Cash balance	0.3	33.7	0.6
Bank balance (short term)	3398.8	3659.9	25,724.9
Other short term balances (incl. deposit with post office, FIS etc.)			
Of which 1: foreign currency account (short term)			
Of which: cash and cash equivalents as reported	2352.2	2856	2947.6
Of which: bank balances other than cash and cash equivalents as reported	62.1	837.6	22,777.9
Short term loans and advances by finance companies			
Short term loans & advances	17,167.7	13,701.7	16,083.8
Assets held for sale and transfer (short term)			
Unamortised expenses (short term)			
Biological assets excluding bearer plants			
Total assets	**88,315.3**	**106,462.1**	**96,662.3**
Gross working capital (cost of sales method)	7152.39	7439.05	7804.79
Net working capital	35,642.2	42,124.1	44,027.3

Table 5 Liability summary

Liability Summary in Rs. Million			
One 97 Communications Ltd.			
Months	12	12	12
Date	3/31/2019	3/31/2020	3/31/2021
Shareholders funds	60,360.3	84,114.5	69,845.1
Net worth	60,360.3	84,114.5	69,845.1
Total capital	**575.3**	**604.3**	**604.8**

Table 5 Liability summary (continued)

Liability Summary in Rs. Million			
One 97 Communications Ltd.			
Paid up equity capital (net of forfeited equity capital)	575.3	604.3	604.8
Forfeited equity capital			
Paid up preference capital (net of forfeited preference capital)			
Equity contributions / securities in the nature of capital			
Money received against convertible share warrants			
Reserves and funds	**59,785**	**83,510.2**	**69,238.3**
Security premium reserves (net of deductions)	138,226.9	188,957.2	189,256.2
Capital, debt, investment & other reserves	–22.5	–25.9	–25.9
Revaluation reserves			
Employee stock option reserve	1984.6	3030.1	3822.2
General reserves			
Surplus/deficit as at the end of the year	–80,404	–108,451	–123,814
Revenue expenses directly charged to reserves			
Non-current liabilities	**808.5**	**5290.2**	**4586.6**
Long term borrowings excel current portion	269.6	1699	260.6
Deferred tax liability	450.5		
Other long term liabilities		3422.5	4119.1
Long term provisions	88.4	168.7	206.9
Current liabilities & provisions	**271,46.5**	**17,057.4**	**22,230.6**
Current liabilities	25,738.6	15,195.8	19,998.8
Provisions outstanding (short term)	1407.9	1861.6	2231.8
Of which current liabilities and provisions due to ssis and SMEs	112.4		
Total liabilities	**88,315.3**	**106,462.1**	**96,662.3**
Tangible net worth	60,186.1	83,996.3	69,755.6
Total outside liabilities	27,955	22,347.6	26,817.2
Total term liabilities	369.1	1699	260.6
Contingent liabilities / Net worth (%)	0.11	0.55	0.68

Source: CMIE prowess database.

4 Case study insights

4.1 Book building procedure

Corporations raise initial capital through IPO. IPOs are open to all investors, whether retail, high net-worth or institutional investors. There are two methods of pricing the IPO: the fixed price method and the other is the book-building process. The corporations and the investment bankers engage with each other to determine the price or the price band for the new issue, and the investment banker then oversees the book-building process. With the help of investment bankers, book building determines the price of a stock when it is put up for sale in an IPO. Most stock exchanges and regulators cite it as the most effective approach for pricing IPOs.

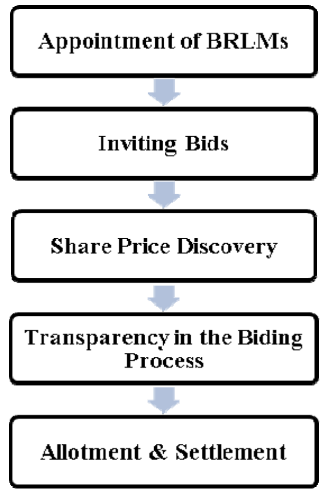
The book-building process is as follows (see Figure 5):

- *Appointment of BRLMs (Book Running Lead Managers):* The first phase is to hire an investment banker as a book runner. These bankers are chosen based on various characteristics, such as their market position, business experience, research quality and distribution networks. The investment banker undertakes due diligence. They decide on issue size, price and other details with the help of the firm's management. Investment banks are entitled to write the prospectus of the firm. The prospectus contains all pertinent information about the issuing company, such as financial information, issue size, the price range of IPO and future expectations of the firm, among other things. It gets approval from the SEBI (Securities and Exchange Board of India) upon submission by investment banker.
- *Inviting bids:* Investors are invited to submit bids on the number of shares they can obtain at different prices through investment banks. An issue may not be underwritten by a single investment bank but rather by a group of investment banks working together to attract a large number of bidders for the bidding process.
- *Share price discovery:* The investment bank evaluates the entire demand for the IPO after receiving all bids at various price levels. The final price of the issue's share is determined using the weighted-average method. The ultimate price is referred to as the 'cut-off price'. If investors have a favourable response to any issue, the ceiling price is often a 'cut-off price'.
- *Transparency in the bidding process:* For transparency and public interest, most authorities compel firms to disclose the details of their bidding procedure in the public domain. The investment banker is responsible for disclosing the details of the offers received to purchase the issue's shares.
- *Allotment and settlement:* Finally, the method for allocating shares begins with the confirmation of bidders and the transfer of shares. Those who bid higher than the cut-off price get their money returned at this point, but those who bid lower than the cut-off price must pay the difference. The proportional allotment is done in case of oversubscription.

4.2 Fixed price issue vs. book building issue

New issues were only permissible before the book-building process with the consent of the Controller of Capital Issue (CCI), with the corporation deciding on a single price to issue the shares after gaining CCI's approval. This system was named as fixed price system. In 1998, the SEBI established guidelines for raising funds under the book-building offer. Table 6 provides the differences between fixed price and book building issue.

Figure 5 Process of book building



Source: WallStreetMojo.

Table 6 Fixed price issue vs. book building issue

Basis	*Fixed price*	*Book building*
Pricing	Under this, the price is determined by the company. So, investors are well informed of the security prices.	Under this, prices are not pre-determined. A bidding process is used to determine the issue price. The issuer company provides a price band and invites investors to submit their bids. After collecting all bids, the final price is decided.
Demand for the securities	Market demand can be known only once the issue is closed.	Market demand can be determined daily based on the bids received during the bidding process.
Reservations	50% of the shares are allocated for applications with less than Rs. 2 lakh, while the remaining 50% is reserved for applications with a value greater than Rs. 2 lakh.	In profitable companies that meet specific conditions, QIBs receive 50% of the shares sold, retail investors receive 35% and NIIs receive 15%. The QIB quota is set higher in non-profitable businesses, at 75%, with 15% for NIIs and 10% for retail investors.
Effective	Investors have no control over the IPO price. It is also tricky for lead managers to determine the fair market-clearing price.	It is an effective price discovery technique that partially considers investor feedback regarding price. It has become a more common code of IPO.

Source: NSE, BSE websites and other internet sources.

The company can use a fixed price, book-building or both for the IPOs. According to SEBI guidelines, a corporation can go for the public issue of securities in the following ways:

a) 100% book building offer,

b) 75% book building offer and 25% fixed price issue. The issue price determined under the book building offer is used for the latter.

4.3 Intermediaries involved in an IPO

When a firm plans to go public, it must follow certain SEBI regulations and guidelines. These guidelines require four intermediaries to be involved in an issue process. The intermediaries are the financial institutions registered with SEBI, and their names, registration numbers, addresses and contact information must be included in the offer document. These intermediaries perform different activities and include merchant bankers, registrars, bankers and underwriters.

1 *Merchant bankers:* Merchant Bankers are SEBI-registered independent financial institutions that initiate the IPO processing. They are also called 'Book-Running Lead Managers' (BRLMs) for an IPO through the book-building process. Lead managers confirm SEBI & other regulatory agencies' statutory requirements and fulfil the stock market listing criteria. The lead managers are responsible for obtaining the Draft Red Herring Prospectus (DRHP) approved by SEBI and stock exchanges. They examine the firm documents, including financial records, documents relating to litigation and other materials, to complete DRHP for the IPO.

   After the public issue, they are responsible for finalising the issue price, monitoring escrow accounts, refunding unsuccessful applicants, sharing allotments and issuing allotment letters. The merchant banker helps the company appoint other agencies required for public issue and supervises their adherence to the SEBI's IPO requirements. They handle all of the marketing for the stock.

2 *Registrar to the issue:* The company, which is going public for the first time, appoints another intermediary involved in the issue, i.e., the registrars to the issue. Registrars are responsible for processing IPO applications, determining the ground for allotment in a given issue, processing refunds, allotment of shares according to SEBI guidelines, etc. They ensure that the applicants' allotted shares are credited to their accounts. They create a final list of authentic and qualifying applications and remove those that aren't. Registrars also handle the investors' problems. Problems may relate to pre- or post-issue like non-receipt of allotment letters, refund of orders, etc. The registrar, in collaboration with the lead manager, ensures that the procedure is followed all the way through.

3 *Banker to the issue:* As the name indicates, these financial intermediaries are responsible for banking-related processes such as the movement of funds, including collecting the funds & transferring them to escrow accounts, acceptance of applications and their amount, dividend payments and refunds for rejected applications, etc. They assist the registrar in concluding the base for allotment by giving precise fund information.

4 *Underwriter:* Underwriters or syndicate members are investment banks or financial institutions who undertake to buy the company's shares if part of them aren't sold. They collaborate with the issuing entity to set the security prices, buy those securities and resell them through their network. They provide copies of Red Herring Prospectus (RHP) and bid cum application forms to investors for public issue. They accept potential investors' bids, payments and application forms and enter those details into an electronic bidding system. The syndicate members deposit all money received from investors into the issuer company's escrow account. The application form and any supporting documents are then forwarded to the issue's registrar for further processing. Underwriters make money by charging issuers underwriting fees and then profitably selling the underwritten shares. However, they risk losing money if the securities remain unsold at the stipulated price.

4.4 Learning points

The lesson from the failure of the Paytm IPO could be viewed from a variety of perspectives:

1 On 8 November 2021, One 97 Communications Ltd.'s financial technology platform Paytm launched 'the mother of all IPOs'. The three-day offer closed on 10 November 2021. India's largest-ever IPO attempted to raise Rs. 18,300 crore, including issuing new equity shares totalling Rs. 8300 crore and selling existing shareholders' shares for Rs. 10,000 crore. Paytm's shares were issued with a price band of Rs. 2080–2150 per share and valued the corporation at Rs. 1.39 lakh crore (trillion) at the upper end. Paytm's IPO was one of the worst opening showings by a major technology company since the late 1990s dot-com bubble. Despite India's most prominent fintech platform, Paytm established a record low on its first day of trading: the shares were listed at a 9% discount, hit the lower circuit in the afternoon and closed at more than 27% lower. Paytm debacle provides insights on how large IPOs can crash in the absence of market depth, such as in the Indian stock market, where a few major FIIs can significantly impact market pricing.

From this, the mentor may discuss the market's depth and breadth. The mentor should also discuss the role of depth and breadth in the price discovery process.

2 During a market boom, all IPOs readily rise because investors are eager to pay high prices, but investors get fearful and make meticulous selections during a market downturn. Even good companies' IPOs may suffer during the downturn. The instructor may point out the difficulties connected to the timing of the IPO.

3 The mentor may also discuss the importance of good corporate governance through this case. Corporate governance helps investors develop trust by knowing a company's direction and business integrity. Good corporate governance ensures a company's financial survival as it attracts market actors having investment goals for the long term.

4 Paytm's debacle could be attributed to the IPO's aggressive pricing. Analysts claimed it to be overvalued. Macquarie's research report pointed out that the company is valued at 26 times FY23E price-to-sales compared to 0.3–0.5-times price-to-sales trade valuation of global peer companies. Different methods for

valuing an IPO may be introduced. Experts propose various methods for valuing the IPO, including dividend discounting methods, competitor market pricing and the current market price of the group's existing companies. The mentor may touch upon the relative valuation models and multiples such as price-earnings ratios, EV/EBITDA, etc.

4.5 Roles and responsibilities of market regulator

The abovementioned cases have dramatically increased the market regulator's roles and responsibilities. Earlier, under the fixed price mechanism, the issuing company determines the price of the issue once getting CCI's approval. On the other hand, market regulator plays a minor role in the book-building offer because corporations can freely set the prices for issuing securities without intervention from regulators. SEBI (ICDR) Regulations, 2009 regulates the initial issuance of securities.

Initially, for public offerings, SEBI issued 'Disclosures and Investor Protection' (DIP) guidelines, which were later (in 2009) translated into 'Issue of Capital and Disclosure Requirements' (ICDR) Regulations. These guidelines and regulations have undergone numerous modifications to keep them going with the market dynamics. A company has to fulfil all the requirements of SEBI (ICDR) Regulations to seek funds through the new issuance of securities.

Companies have raised a remarkable amount of capital through IPOs in stock markets worldwide. 2021 is setting itself up to be the year of the IPOs; almost $1 trillion in cash has been raised through IPOs in India alone this year. Many companies raised money through IPOs, including Zomato, Paytm, and others. Some of these companies are loss-making. This puts investors who have placed money into these IPOs at risk of losing money. Considering all this, SEBI has modified the regulations to tighten the IPO process and the criteria governing promoters' use of IPO funds applicable to the DRHP after the changes are notified in the gazette. These include:

- Suppose a firm states in its offer document an object for future inorganic growth but investment targets and acquisitions are not identified. In that case, it is allowed to use up to 35% of the entire issuance proceeds for such objects and General Corporate Purposes (GCP). In addition, if the acquisition and investment target is unknown, the company can use up to 25% of the equity-issuance proceeds. If the acquisition target has been identified and proper disclosures have been provided in the offer documents, these limits will not apply.

- Shareholders having more than 20% pre-issue shareholding can't offer more than 50% of their holdings for sale in an IPO. If shareholders have less than 10% pre-issue shareholding, the limit is 10%, i.e., they can only offer 10% of their holdings for sale in an IPO.

- Credit rating companies registered with the SEBI can now be appointed surveillance agencies. SEBI has also increased the frequency of audit committee inspections and now requires monitoring 100% of an issue's receipts. Furthermore, proceeds from the issue intended for general corporate purposes would have to be tracked and reported in the surveillance documentation.

- As per new SEBI rules, in the case of book-building issues, applying a minimum price range of at least 105 % is mandatory.

- The current 30 days lock-in period will stand for 50% of the part awarded to the anchor investors, while the remaining portion will be subject to a 90 days lock-in period starting on the day of allotment.
- Applicants investing over 2 lakhs but less than 10 lakhs will receive one-third of the non-institutional investors' part, while those spending more than 10 lakhs will receive the remaining two-thirds.

SEBI has also made numerous fresh proposals in its discussion paper. The regulator wants new-age IT businesses to tell precisely how they valued their stocks for IPOs, compare it to pre-IPO share sales and upload all pre-IPO investor briefings to enable investors to make educated decisions.

5 Conclusion

The failure of Paytm IPO is explained based on several factors: First, Paytm is a loss-making business (Tables 2 to 5) that has raised Rs. 190 billion in equity capital since its foundation. It concerns because 70% of it, or Rs. 132 billion, has been used to fund its losses. According to Macquarie, Paytm has 'too many fingers in too many pies'. They are regarded as 'cash guzzlers' and lack a targeted business approach. Lending is considered one of the most lucrative areas of the fintech industry, but Paytm does not have a banking licence. All of this casts questions about Paytm's growth and profitability in future also. Second, one of the critical causality is its excessively inflated pricing. The IPO was priced at Rs. 2150 a share (with a huge size of Rs. 18,300 crore), much higher than the actual value of the loss-making company. The IPO's grey market pricing was also at a significant discount. The aggressive pricing of the IPO contributed to Paytm's failure. When compared to global fintech players, analysts believe it to be overvalued. Macquarie's report pointed out that the company is valued at 26 times price-to-sales compared to 0.3–0.5-times price-to-sales trade valuation of global peer companies. Third, Paytm, once a success story, is now disrupted due to the introduction of the UPI payments system. Paytm faces intense competition from apps such as Google Pay, Phonepe, etc.

According to the report, Paytm's variety of business lines hinders it from being a category leader in any business except wallets. With the explosive growth of UPI payments, these wallets are becoming insignificant. Fourth, FOMO is one of the key motivators for investors to apply for this IPO. IPOs are seen as a way for Indian investors to make quick money. Investors have applied for Paytm's IPO after being enticed by the price surge of other IPOs such as Nykaa and Zomato. Fifth, corporate structure and governance practices also raise concerns. One 97 Communications Ltd. has a complex structure with 15 domestic and 17 international subsidiaries. Such multi-layer architecture can be a conduit for doing inter-party transactions. The alarming concerns are a small board with more foreign members, frequent senior executives attrition and no split between the chairperson and the CEO.

Like any other study, this study also faces some limitations. Such as the results of this study may not be generalised since the financial environment and the behaviour of investors may vary in developed nations than in emerging nations like India. The analysis is presented in the domestic currency of India; hence, it might get difficult to compare similar kinds of cases in another country. Future scholars can use another method, such as regression analysis, to ferret out the reasons and quantify the effects. Moreover, there is a need to develop such cases from a comparative lens between developed and developing nations.

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