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PENNY WISE

PARAG PARIKH

Greed is our strongest emotion when it comes to dealing with money in mkts

Our decisions are guided by certain behavioural anomalies like availability heuristics, representative thinking and overconfidence bias. Greed is our strongest emotion when it comes to dealing with money in the capital markets. Let us understand what happened to Reliance Power, the mother of all issues to be listed at a discount. Greed was the common factor: Reliance Power, a Rs 1.18-crore profit making company with a lot of dreams. Promoters were greedy. Their acquisition cost was around Rs 17 per share for their 90% stake. The remaining 10% stake offered to the public at Rs 430/450 per share. The strong bullish stock markets, hot power sector, brand "Reliance" and the name of "Dhirubhai" were the reasons for the overconfidence and overpricing. And it did work. The investment bankers' job is to advise the company to come out with a price that is a win-win for both. The best brains in the country were appointed. Did they not advise the company or the company did not listen to the advice? Greed and overconfidence were at the forefront.

RUSH HOUR

Investors were so greedy that they even borrowed to apply. They were blind to the expensiveness of the REPL offering

Why did this expensive issue become a mother of all issues to be overwhelmingly oversubscribed? Greed: investors were so greedy that they even borrowed to apply. They were blind to the expensiveness of the offering. Availability heuristic was at play: All the available information on Reliance Power was positive. The advertisement campaign talked about powering India.

Next is the turn of representative thinking. The brand 'Reliance' and Dhirubhai Ambani have been associated with wealth creation for the investors. Reliance Power was representative of the brand as well as the legacy of Dhirubhai Ambani. The grey market premium was representative of the profits to be made on listing.

Overconfidence bias: The investors also understood that the stock offering price of around Rs 430 to 450 was expensive but all were confident that they would sell their stock on listing and make a clean profit. The greater fool theory was at work. Surprisingly even the qualified institutional investors were also thinking on the same lines.

Why did the issue list at a discount? Due to herd mentality: All came to sell on the listing day and the stock tumbled. It was the herd at work. The same herd had made the issue a mother of all issues just a fortnight back. Same buyers turned sellers. The market sentiment had changed. It was all about the fear of losing. Investors turned loss averse.

Wisdom ignored: Just 10% had to be allotted to investors. A fair and a reasonable price would have earned immense investor goodwill. A win-win situation for everyone. This is what Dhirubhai would have done. He truly understood the value of investor goodwill, trust and faith.

Lesson: Everyone meant well but allowed their emotions to control them. Greed and envy were the culprits.

(Parag Parikh, chairman, Parag Parikh Financial Advisory Services, specialises in behavioural finance. His column will appear in the second week of every month)