Mutual Funds Investing in IPOs

IPOs have become the buzz-word for anyone tracking the stock markets these days. With many known and several unknown firms getting listed, there is hardly anyone who is not talking about making money by investing in IPOs. But do you really know what IPOs or how you can make money by investing in IPOs?

What are IPOs?

Initial Public Offering or IPO, as its commonly known, is the first time when any privately-held company offers its shares to the general public to be traded on any of the stock exchanges. In a nutshell, an IPO is the route through which a private company goes “public”, to raise funds for various purposes. The IPO process involves an issuer (the entity whose shares are being listed), the subscribers (individuals / institutions who wish to purchase the shares of the issuer) and the banker (one or more investment banks who manage the entire process on behalf of the issuer).

There are two overarching reasons why you must consider investing in IPOs. One, they offer you a chance to invest in a new company which was previously not traded and two, IPOs generally offer you a one-time opportunity to make big gains by buying low and selling high. Despite these very obvious advantages, most people don't usually have a great experience with IPOs. Some of the key challenges include:

- As an individual investor, you will be given the least priority in an IPO. Generally, investment banks give preference to institutional investors while retail investors might or might not get the share for which they applied.
- IPOs are typically riskier than publicly listed blue chips and can often be overpriced. As a result, they might list with a loss and destroy investor wealth.
- Since they are unlisted, researching companies opting for an IPO becomes difficult.

And this is where mutual funds investing in IPOs can be a great option for you.

Do mutual funds invest in IPOs?

Yes, mutual funds invest in IPOs and can offer you a great opportunity to reap the advantages of investing in IPOs. As a professional medium for pooled investments, a mutual fund is in a good position to do the relevant research, identify the best IPOs, and then make the necessary investments. Further, owing to the large quantity of shares that mutual funds purchase, they also benefit from buying and selling at the right price.

Are mutual funds a better way to invest in IPOs?

Given the challenges that you would normally face in realising the true gains of investing in an IPO, you might be better off investing in a mutual fund that invests in IPOs. Some of the key benefits of this approach include:

- No need to do in depth research and identify the IPOs that can potentially perform well over the long-term
- Avoid the temptation of cashing out on listing day when you see huge gains and stay in the game longer based on the company's potential.
- Ability to get a bigger share of the pie by being invested via the fund rather than receive a small amount of shares as a retail investor.

What are the risks of investing in IPOs through mutual funds?

All investment products carry risk and IPO investments are not immune to the same. Often, IPOs list at a lower price relative to the issue price which can erode your wealth. Further, in the short-term, stocks listed via IPOs can witness higher price fluctuations as the market is yet to identify their true fundamental value.

Thus, you should keep in mind that while mutual funds investing in IPOs are a viable option, you must have a high risk appetite and should be willing to stay invested for the longer term, if you want to benefit from the growth potential of IPOs.

An investor education initiative by Edelweiss Mutual Fund
All Mutual Fund Investors have to go through a onetime KYC process. Investor should deal only with Registered Mutual Fund (RMF).
For more info on KYC, RMF and procedure to lodge/redress any complaints, visit - https://www.edelweissmf.com/kyc-norms

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.