A REVIEW OF INITIAL PUBLIC OFFERINGS (IPOs) 
IN INDIA – AN EMPIRICAL STUDY

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Abstract

Primary Market of a country plays vital role in the growth and development of capital market. Investors have lots of expectations from initial public offerings. IPOs are assumed as a high return avenue. Present study attempts to explore about trends and returns of Indian New Issue Market (NIM). The study is conducted with the help of secondary data from various published source. In this study an attempt has been made to understand the behavior of IPO during various time frames. Study shows that there is a significant variations in returns of IPOs in short run as well as long run. During the study it is observed that Indian Initial Public Offering has both underpricing and overpricing character.

Keywords: IPO, NIM, Underpricing, Overpricing

Introduction

Initial Public Offering is also known as "New Issue Market" (NIM), which facilitates companies, governments and other groups to obtain finance through debt or equity based securities. Initial Public Offerings plays very significant in raising capital for a company from primary market. A successful initial public offer results in brand building and better financial performance of the firm in the future. Better performance by IPO in primary market attracts customers very easily and creates a positive environment in the capital market of the country. Before and during the issue of IPO, the issuing company does rigorous publicity and marketing about its IPO and company which is very beneficial in terms of spreading awareness about capital market and investment. From an investor’s perspective, IPOs provide an opportunity to them to share the rewards of the growth of company. It is, therefore, important that the quality of the IPOs in terms of its efficiency, enhanced transparency, price discovery process, etc. is brought at par with the international standards so as to inculcate a fair degree of confidence among the investors in the market. The IPO method begins when the business lodges a registration declaration in accordance with SEC and as per the Securities Act of 1933. The SEC then studies the listing declaration and supports the entire revelation. The sponsor then proposes a prelude brochure and then an authorized catalog prior to the share offering. After the SEC endorsement, the value and time of the IPO are determined. As investing in an IPO is an uncertain and tentative endowment, only active merchants relying on their endowment motives and risk forbearance, should opt for such kind of endowment.
Objectives of the Study

1. The objectives of the study are the following –
2. To analyze the pattern of IPOs under pricing across time, issue size and market segment.
3. To identify factors that affects short-run under pricing of IPOs in India.
4. To examine the relationship between mispricing of IPOs managed /co-managed by investment banks vis-a-vis change in their market share during a given period.
5. To identify the factors that influences the performance of IPOs in long run.

Literature Review

Baron and Holmstrom (1980) noted that it is observed that investment bankers exploit their superior information regarding market conditions to underpriced new issues, thereby allowing companies to spend less effort on marketing the issue and gain the goodwill of potential clients.In 1980s and 1990s, there was an increasing realization on the part of the policy planners in India that an efficient and well developed IPO market is essential for sustained growth in an emerging economy like India. Accordingly, extensive reforms have since been taken for the IPO segment of Indian market, inter alia covering reforms in the legislative framework, trading mechanisms, institutional support, etc. As a result, IPOs have emerged as one of the major source of funds for Indian companies as well as an important avenue for common investors to channelize their savings for higher return. An analysis of the trends in the IPO market in India shown that although, there are fluctuating trends, this market will continue to remain an important source of funds in India.

Rock (1986) distinguishes between informed and uninformed investors. If the issues are underpriced, the IPOs will be oversubscribed by informed investors as limited number of shares would be available to uninformed investors. If the issues are overpriced, the IPOs will be sold exclusively to uninformed investors who will earn negative initial returns. Thus, uninformed investors will be winning the entire issue but at an unfavorable price, creating a situation termed as the winner’s curse. In order to keep uninformed investors in the IPO market, securities are offered at a discount from their expected listing price. According to the winner’s curse theory, the IPO under pricing will decrease if the information asymmetry gap between informed and uninformed investors is reduced.

Pandey, Ajay (2004) study based on a sample of 84 Indian IPOs from the period 1999 to 2002 concluded that the fixed price offerings are used by issuers offering large proportion of their capital by raising a small amount of money. The initial returns were found to be higher and more uncertain on fixed price offerings and all types of Indian IPOs in our sample under performed in the first two years subsequent to listing. The IPOs from issuers belonging to industries under the spell of "hot issue" market, showed a result of under-performance more than the rest.
Deb & Mishra (2009) studied the performance of the Indian IPOs from April 2001 to March 2009 for the long run. Results show that there exist positive returns on the listing day. It is found that the down-market is a major cause for the poor listing-day performance of the negative group, whereas a positive group does not gain anything from an up-market preceding the IPO. With respect to the average holding-period return, for the negative group (starting day-1, not day-0) becomes significant only after four years, while it is positive throughout for the positive group. The study concluded that IPOs in the long yield a return equal to the market, when initial return is ignored.

Sahoo & Rajib (2010) focused on the evaluation of price performance of 92 Indian IPOs issued during the period 2002-2006 up to a period of 36 months including the listing day and also examined the usefulness of IPO characteristics at the time of issue to seek an explanation for the post-issue price performance. It reported that on an average the Indian IPOs are underpriced to the tune of 46.55 per cent on the listing day compared to the market index. The empirical results suggest that the investors who are investing in IPOs through direct subscription are earning a positive market adjusted return throughout the period. Nevertheless, investors who have purchased shares on the IPO listing day are earning negative returns up to 12 months from the listing date and expect to earn positive market-adjusted return thereafter.

Most of the IPO valuation studies focus on the listing day return. Many empirical evidences (Omran, 2005; Reber and Fong, 2006; Khurshed, Pande and Singh, 2008) suggest that IPOs are underpriced on the listing day. Datar and Mao (2006) have suggested that the issuer company knowingly underpriced the IPOs to encourage a wider subscription. According to the behavioral argument it is observed that over-enthusiastic investors bid the price of IPOs beyond its true fundamental value on the listing day. Shah (1995) analyzed remarkable 105.6% excess return over the issue offer price in one of the study of 2056 IPOs over the time period of 1991 to 1995. In one more study Madhusoodanan and Thiripalraju (1997) studied IPOs offered on BSE exchange a period 1992-1995and inferred that under pricing in India was higher than the international IPO experiences in the short run and they yield higher returns in long term also compared to the negative returns recorded from the other country markets. Kakati (1999) studied the performance of IPOs that came in the market during January 1993 to March 1996 and concluded that the short run under pricing is of 36.6% and in the long-run overpricing is40.8%.It is analyzed that IPOs of January, 2001 to August, 2011, most of the stocks have generated listing profits whereas in long term most of the companies have underperformed compared to market returns. Bagga, Khurana & Singh (2012) advised three strategies for investors when investing in an IPO - a) Sell all the allotment on listing day itself, b) Partial profit booking on listing and rest holding for long term and c) holding for a period of more than 5 years. As per Jotwani and Singh (2011) subscription rate of the IPO plays major role only in short run. Investors may try to analyze the demand-supply situation of the IPO before investing, which has little significance in the long run. They also mentioned the objective of the IPO showed its significance only in the long run, i.e., five years after the IPO.
Research Methodology

Present study is based on secondary data. Data has been collected from the website of both national level stock exchange of India i.e. National Stock Exchange and Bombay Stock Exchange and data was also collected from the website of SEBI. The study analyzes the data between the years 2005 to August 2016.

No. of IPO listed in NSE during Study Period

Table 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of IPOs listed in NSE</th>
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<tbody>
<tr>
<td>2005</td>
<td>50</td>
</tr>
<tr>
<td>2006</td>
<td>73</td>
</tr>
<tr>
<td>2007</td>
<td>94</td>
</tr>
<tr>
<td>2008</td>
<td>36</td>
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<tr>
<td>2009</td>
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<td>2011</td>
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<td>2013</td>
<td>06</td>
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<tr>
<td>2014</td>
<td>08</td>
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<tr>
<td>2015</td>
<td>21</td>
</tr>
<tr>
<td>2016</td>
<td>20* (Till 21 September 2016)</td>
</tr>
</tbody>
</table>

Table 1 shows that in the year 2005 there was 50 initial public offerings in Indian primary market. In the next year i.e. 2006 the no. of IPOs increased up to 73 and it grows up to 94 in the year 2007 which was a period of recession. In the year 2008 there was the reflection of economic slump down worldwide and hence only 36 IPOs were there in 2008 and it was reduced to 21 in 2009. Again there was a great improvement in the year 2010 and 71 issues were offered to the public. But unfortunately 2010 onwards the performance of IPO market was not attractive and Indian capital market witnessed a decline in primary market. In 2016, till 21st September 2016 IPOs has been issued for the Public.

ICICI Prudential Life also has its IPO for the raising fund. It is India’s largest private sector life insurer. The 6057 Crore issue was oversubscribed 10.48 times.

Trend of Indian IPO Market during Study Period

Table 2
Year | No. of IPOs | Amount (Crores)
--- | --- | ---
2005-06 | 79 | 10936
2006-07 | 77 | 28504
2007-08 | 85 | 42595
2008-09 | 21 | 2082
2009-10 | 39 | 24696
2010-11 | 53 | 35559
2011-12 | 54 | 41515
2012-13 | 33 | 6528
2013-14 | 38 | 1236
2014-15 | 46 | 3,039
2015-16 | 74 | 14,815

**Short Run Returns on IPOs Listed in NSE during Study Period**

Table 3

<table>
<thead>
<tr>
<th>Time frame</th>
<th>R_Ret. (%)</th>
<th>MR_Ret. (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>On listing day</td>
<td>19.23</td>
<td>0.72</td>
</tr>
<tr>
<td>1 month after listing</td>
<td>-7.43</td>
<td>0.77</td>
</tr>
<tr>
<td>3 months after listing</td>
<td>-13.09</td>
<td>0.65</td>
</tr>
<tr>
<td>6 months after listing</td>
<td>-9.37</td>
<td>-0.43</td>
</tr>
</tbody>
</table>

In short there is approximately 19.23 percent return from IPO on the listing day. Table 3 shows there is negative raw return after the first month of listing that continues even after the 6 months. The market return is less than 1 percent up to the 3 months after from the listing date of IPO. There is negative market return after the six months from the date of issue of IPO.

**Long Run Returns on IPOs Listed at NSE during Study Period**

Table 4

<table>
<thead>
<tr>
<th>Time frame</th>
<th>R_Ret. (%)</th>
<th>MR_Ret. (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>On listing day</td>
<td>19.23</td>
<td>0.72</td>
</tr>
<tr>
<td>1 year after listing</td>
<td>-27.57</td>
<td>-8.77</td>
</tr>
<tr>
<td>2 years after listing</td>
<td>-29.24</td>
<td>9.21</td>
</tr>
</tbody>
</table>
From the Table 4 it can be said the raw return the IPOs give around 20 percent raw return on the listing day but thereafter the raw return is negative and it increases with the increase in time period. But, the market return on IPOs becomes positive in second year and it has increased in third year also and gave return around 22 percent which is deemed very fair return in Indian capital market.

Conclusion

The study shows that IPOs are very important corporate tool for raising fund from the primary market. With the help of Initial Public Offerings a company can raise huge amount of capital. On the basis of various evidences from past IPOs and studies it can be concluded that overpricing exist in IPOs listed in National Stock Exchange in short as well as long run. On the basis of results and finding of table 3 and table 4 it can be concluded that Indian IPOs gives negative or least return in short run but they gives higher return in long run.

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