G.J.C.M.P.,Vol.5(3):23-27 *(May-June, 2016)* ISSN: 2319 – 7285

GLOBAL JOURNAL OF COMMERCE & MANAGEMENT PERSPECTIVE

(Published By: Global Institute for Research & Education)

www.gifre.org

Study on Issue Price Performance of IPO's In India: 2010-2014

Dr. Vikas Gupta*& Mr. Nitin Saxena**

Professor *

Gitarattan Intenational Business School, PSP 2 A & 2 B Complex – II, Madhuban Chowk, Rohini, Delhi – 110 085

Research Scholar**

Abstract

Stock market is most promising sector in an Indian economy for raising the level of Indian financial system. After liberalization phase stock market has proven as a weapon of fighting with the foreign economies. After its inception in 1875 stock market has been played a challenging role for savers as well as for investors. Directions of an economy can be measured by movement of volatility index .Stock Index has been a barometer for measuring the performance of Indian economy with its development. Micro and macro economic factors have continuously affected the industrial growth. Our financial industry has been affected by financial crisis frequently that has proven the stock market full of risk and uncertainty. That was already an unsolved problem for the investors. But CAPM, APT, Portfolio diversification has proven a very effective risk management tools. Nifty and Sensex always have been in the mind of active investors which have changed the life as miracle. Indian stock market has gained new milestones and its volatility has surprised our economy with the expansion in equity, debentures, bonds, real estate, Options, Futures, and Derivatives. Our Indian economy will be the third largest economy after 2035 according to a survey. After getting freedom from Britishers, Indian economy has survived with rebuilding their stand through monetary policies, fiscal policies, five year plans etc. Efficient and effective stock market is that place where prices of the security are showing all related information about that with its true worth. Working on Indian stock market has become interesting job for various researchers. Already appreciable studies have been conducted in this area. This paper is an attempt to analyze stock market conditions with all related measure to check on risk management tools with their respective return. With the help of Secondary sources like current research studies, Reports of BSE, NSE this study has been taken further to exploring some new highlights.

Key Words: *Adjusted Returns, Initial Public Offers (IPO), Issue Price, Issue Size, Issue Oversubscription, Underpricing*

Introduction

An initial public offering (IPO) is the first sale of stock by a private company to the public. IPOs are often issued by smaller, younger companies seeking the capital to expand, but can also be done by large privately owned companies looking to become publicly traded.

In an IPO, the issuer obtains the assistance of an underwriting firm, which helps it deterMtne what type of security to issue (common or preferred), the best offering price and the time to bring it to market.

Also referred to as a "public offering."

An initial public offering is a transformational event for an organization. The preparation for "being public" is just as important as the preparation for "going public." A company will need to meet additional requirements and continuing obligations as a public company that may require new skill sets, additional resources and changes to the business.

Going public is a monumental decision for any company. It forever changes how a company goes about doing business. A public company has access to more, and often deeper, sources of capital than a private company. The actual process of going public can be time-consuMtng and presents certain unique challenges that a company should be prepared to undertake.

Broadly speaking literature regarding IPOs study reveal that 1) IPOs are listed with significant preMtum to issue price and due to this investors are able to earn significant return on the listing day. 2) The overpricing or in other words, underperformance of IPOs persists for a long period. Effect of underpricing varies from company to company. In this process of underpricing investors gains and loss for the issuing companies at times. Studies reveals that IPO's are generating positive returns on the day of listing but negative or stagnant return over long time period.

Review of Literature

The underpricing of initial public offerings (IPOs) is referred to in the literature as one of the anomalies observed in primary markets all over the world. The extent of it, however, varies from country to country. Underpricing refers to the positive initial returns over the offer to listing dates of the new issues. It is defined as the percentage difference between the closing price on the listing date from the offer price of the issue. It is a cost to the issuers and has drawn considerable attention in the acadeMtc literature over the last three decades.

S S S Kumar (2010) this study exaMtnes the performance of IPOs issued through the book building process in India over the period 1999 2006. The sample comprises 156 firms that offered their shares through the book building route on the NSE. Upon listing the IPOs on an average offered positive returns (after adjusting for market movements)to investors and a large part of the closing day returns on the listing day were accounted for by the opening returns. In the long run the IPOs offered positive returns up till twenty four months but subsequently they underperform the market.

Bansal &Khanna(2012) analysed thatthere is significant difference between the magnitudes of level of underpricing of IPOs that priced through the book build with those priced through the fixed price option and IPOs price through book build are more underpriced than fix price option IPOs.

The firms, which are going for IPOs, do not have a market for pricing their shares. The most common starting point for setting the price of these shares is by comparable firms approach. In this approach, the under writers take the Price to Earnings ratios (PE ratios) of comparable firms in the industry and then arrive at a mUltiple for the firm that is going public.

Now if the earnings of the firm going public can be inflated, the price at which the shares would be offered to the public would be higher. Since higher prices result in wealth increase for the issuers, they have a motivation for inflating the earnings during IPOs. Looking at the same issue from the side of the investors, it is observed that there is very little financial information about the firm that is going public prior to its IPO (Rao, 1993 as quoted in Teoh, Wong and Rao 1998).

Satyendra K. Singh (2008) The Under pricing phenomenon for the common stock for initial public offerings (IPOs). Book-building company was made compulsory for the companies during the year 2000-2001. In this case 60% of the offer should be allotted to Qualified Institutional Buyers. The main study is to understand the relationship between performance of index and the average returns on the IPO.

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 issuercompany knowingly underprice the IPOs to encourage a wider subscription. According to the behavioural argument it is observed thatover-enthusiastic investors bid the price of IPOs beyond its true fundamental value on the listing day.Shah (1995) analysed aremarkable 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.

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.

Problem Statement

How market reacts on price of IPO on initial day of listing and impact of Issue size, issue price, over subscription etc.

Objective

1. How much returns are generated by IPO on Listing day
2. Are Investors getting benebits of abnormal returns
3. Affects of different factors on performance of Listing day price.
4. Impact of Issue size, issue price and over subscription.

Time Duration

From Year 2010 to 2014.

Data Collection

Source of data is secondary and NSE official website is used to collect list of IPOs for analysis from the period of January, 2010 to December, 2014.

Sample Selection

All Indian companies which issue IPO on National Stock Exchange (NSE) from January 2010 to December 2014. Data is taken of 113 companies for the analysis.

Year	**Number of IPOs listed in NSE**
2010	63
2011	30
2012	12
2013	3
2014	5

Data Analysis

Measure of IPOs Performance:

Comparison of returns by IPO from the closing rate on the day it was offered till closing rated on the day of listing and similarly market index returns on the basis of closing point on the day it was offered and closing point on the day of listing.

(1) Rt = (Pl-Po)/Po

Where, Rt = return of single security on listing day, Pl = Closing Price of security on listing day, Po = offer price of security.

Secondly, to calculate index return on listing day,

(2) Mt = (Cl- Co)/Co

Where, Mt = market return on listing day,Cl = closing index at listing day, Co = closing index at offer day.

To analyze the underpricing of IPO initial day returns are adjusted with the market returns. This will show that whether a IPO is underpriced or generating higher returns for investors. For this Adjusted returns (Ar) are calculated :

Ar = {100* [(1+Rt)/ (1+Mt)-1]}

Explanation of Independent variables:

Issue Price: Issue price is the final offer price offered by the company deterMtned after book building process or fixed price process to the public for subscription of the Initial Public Offer (IPO).

Issue Size: Issue size is the total amount that the issuing company want to raise from Initial Public Offer (IPO). The total issue size is the total number of shares offered multiplied by the final offer price of the IPO decided by the merchant bank.

Oversubscription of IPO: Oversubscription is the number of times the IPO has been subscribed by the various investor categories during the issue offer period.

Data Analysis and interpretation:

Market return of IPOs Listed in NSE during year 2010 to 2014

Year	**Variables**	**N**	**Mtnimum**	**Maximum**	**Mean**	**Standard Deviation**
2010	Issue price	63	11	1310	202.51	223.59
	Issue size		28.76	2486.35	395.64	505.46
	Oversubscription		0.96	93.6	15.21	19.41
	Market Return (Mt)		-0.09	0.08	0.0038	0.03
2011	Issue price	30	6	256	99.71	67.78
	Issue size		23.25	1245	237.64	329.05
	Oversubscription		1.11	35.21	5.04	8.55
	Market Return (Mt)		-0.07	0.09	0	0.056
2012	Issue price	12	50	1032	297.73	314.74
	Issue size		19	4155.8	612.2	1198.91
	Oversubscription		0	40.98	6.41	11.65
	Market Return (Mt)		-0.04	0.08	0.0096	0.033
2013	Issue price	3	172	530	304	196.64
	Issue size		94.42	950.11	438.31	451.88
	Oversubscription		1.2	11.63	4.83	5.9
	Market Return (Mt)		-0.029	-0.002	-0.02	0.015
2014	Issue price	5	47	645	228.6	237.6
	Issue size		120	351.86	240.19	105.33
	Oversubscription		7.39	59.97	34.6	26.2
	Market Return (Mt)		-0.037	0.019	-0.01	0.022

Above Table shows the in 2010 data the difference between the lowest price 11 and highest price 1310 is huge and average issue price was 202.5. Average issue size was 395.65 crores with Minimum issue size 28.76 crores. The average oversubscription was 15.2 times with maximum 93.6 times. The average market return S & P CNX nifty from issue close day to listing day was 0.38% with highest return of 8%.

In 2011 the average issue price was 99.71, the Minimum issue price was 6 and highest price 256. The average issue size was 237.64 with maximum issue size 1245 crores.

In 2012 in this year also Minimum and maximum range is high and average issue price was 297.73. Average issue size was 612.2 crores with Minimum issue size of 19 crores.

2013 three IPOs got listed on NSE and Minimum issue price was 172 and maximum was 530. Average issue size was 438.31 crores The average market return S & P CNX NIFTY from issue close day to listing day was negative 1.9 %.

In year 2014 total 5 companies' IPO got listed on NSE and maximum issue price was of Monte Carlo company issue. The average issue size was 240 crores for the year.

Returns of IPO companies during 2010 to 2014

S. no.	Year	Avg. Return
1	2010	8.30%
2	2011	2.90%
3	2012	3.95%
4	2013	2.14%
5	2014	26.11%

Above table shows year wise first day return of the all companies listed in NSE from 2010 to 2014.

Adjusted Return for period 2010 to 2014

Year	Number of firms	Minimum	Maximum	Mean	Std. Deviation
2010	57	-38.32	73.31	8.036	24.468
2011	21	-49.17	54.12	2.739	33.031
2012	11	-13.50	27.90	3.129	13.940
2013	3	-3.156	18.866	4.248	12.660
2014	5	-8.698	64.429	27.016	30.966

Above table shows the average adjusted returns of all the IPO companies issued during the given period of time were 8.03 %, 2.74%, 3.13%, 4.25% and 27.02% respectively from year 2010 to 2014. In year 2010 highest returnfrom57 IPOs was 73 % to the investors and standard deviation of that year was 24.4 %. This denotes that initial day adjusted returns were moderately deviated. In year 2011 the highest return from IPO was 54 % with standard deviation of 33 % but due to negative returns from many of IPOs the average returns were very low at 2. 74% as above mentioned. As year 2012, 2013 and 2014 had faced sluggish period for IPOs processes resulted in less number of IPOs in market. In 2014 out of 5 IPOs, Snowman Logistic and Sharda Corpchem had given more than 50% initial adjusted returns over market returns.

Findings

1. Overall primary issue market has faced downward sloping growth in terms of number of IPO due to global economic crisis.
2. The total number of public issues over 2010-2014 time period were 113. The total value of IPOs was 63633 crores.
3.The average year wise first day return of the all companies listed in NSE from 2010 to 2014 were 8.3 %, 2.9 %, 3.95 %, 2.14 % and 26.11 % respectively. Year 2014 has given exceptionally high returns in some of the IPOs whereas the average return from the all IPOs from 2010 to 2014 has given average 7 % return.

Conclusions

The research tried to find out the initial day returns and the factors affecting the degree of underpricing. The data for the research has been taken of total 113 IPOs listed on NSE between the periods 2010-2014. The average market adjusted return for above mention IPOs was 7.19%. It indicates that the Indian IPOs are underpricing and the explanatory variable like Issue oversubscription has impact on it. So investors should invest in IPOs for short term returns.

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