Valuation of Indian IPO'S Direction and Trends in Short -run performance

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Abstract

The main objective of this research paper is to examine the direction and trends short run performance of IPOs by taking one-month performance. There exists a notion that the performance of IPO stocks has improved in the short run after going public. In this study, the data for short run analysis are taken for 30 days. We try to test the empirically the short run performance for a sample of 89 IPO firms that approached the market during the period 2009-18. We have calculated listing gain, short run gain, short run excess gain and Index growth. We have used a logistic regression model to test the basic hypothesis, with the help of data on 89 IPOs, from the Indian stock market. The study uses prelisting information on which IPO pricing is based. In this paper we have seen that many of the IPOs have significant returns on the day of listing but thereafter they do not give much return in the short-run, it shows that market overreacts to the initial public offers.

Keywords: Listing Gain, Short Run Gain, Determinants of Short Run Gain Bear Market, Bull Market, Under Pricing, Overpricing, Offer Price, Bid Price

INTRODUCTION

Initial public offering (IPO) or stock market launch is a type of public offering in which shares of a company are usually sold to institutional investors that in turn, sell to the general public, on a securities exchange, for the first time. Through this process, a privately held company transforms into a public company. Initial public offerings are mostly used by companies to raise the expansion of capital, possibly to monetize the investments of early private investors, and to become publicly traded enterprises. A company selling shares is never required to repay the capital to its public investors. After the IPO, when shares trade freely in the open market, money passes between public investors. Indian capital market began its transformation path since 1991 after the introduction of new economic reforms. India, due to its improved economic fundamentals, skilled labor force, enhanced technology and greater integration with the world economy has resulted in major investment and financial hub by the global investors. Indian capital market still has to undergo a paradigm shift, implying that further reforms are needed to make India a world class financial market. We all know the stock market is highly unpredictable. Whenever the market is in bullish phase, large number of investors line up to invest in Initial public offerings. Initial public offering is the selling of securities to the public in the primary stock market. It is a process many business owners go through in the hope of becoming extremely wealthy. IPO marks the beginning of a process, not the end.

Rationale of the Paper

The present paper evaluates the short run performance of IPOs by taking one-month performance. There exists a notion that the performance of IPO stocks have improved in the short run after going public.

H0: The IPO market has not performed well in short run.

Types of Public Issues

1. Book Building Issues
2. Fixed Price Issues

1. Book Building:-

Book building is the process of selling the shares to the public at an acceptable price through merchant bankers. A company can use the book building process to fine tune its prices. Under this, floor price of the offer is mentioned and the merchant banker record the number of offers that he has received and the offer price along with the name of the investor who makes the offer. The allotment is made on the basis of the best bids received up to the requested number of shares. It is essentially a process of price discovery.

2. Fixed Price Issue:-

Under fixed price, the company going public determiners a fixed price at which its shares are offered to investors. The investors know the share price before the company goes public. Demand from the markets is only known once the issue is closed. To partake on this IPO, the investors must pay the full share price when making the application.

REVIEW OF LITERATURE

Reviewing the existing literature provides, the researcher with exhaustive information on the previous studies, which helps in finding the research gap and forms the basis for the further studies. It is in this context, the research papers of the various authors have been reviewed for the better understanding of the topic.

Himanshu Puri (2012): studied the short-run performance of Indian IPOs, as on the First, Seventh, and thirteenth trading day and he states that IPOs offered positive returns on First and 7th trading day but subsequently they underperform the market at the end of 30th trading day. He also opines that, investors can make significant positive returns if they go for IPOs and sell them within a period of less than one month

Ranjitha.R Dr.Nirmala Joseph (2016): Studied the performance of the IPOs during the period 2009 to 2013, The study shows conclusive evidence of initial abnormal returns of a majority of IPOs considered for study. This finding is indicative of the presence of under pricing of IPOs.

M. Muthu Gopalakrishnan and Paluri Hareesh (2016):studied the performance of IPOs in Indian market, The study examines the performance of the Indian IPOs listed in National Stock Exchange (NSE) during January 2010 to December 2015. Short run price performance of 126 IPOs that entered into Indian capital market in the study period has been examined on listing day and for a time gap of three days, one week, fifteen days, one month, two months and 3 months .The findings reveal that, there exists under-pricing in the Indian Market in the short run. So it is recommended that the investors can participate in IPOs to get returns in the short run.

Ranjan and Madhusoodanan (2004) studied the pricing of IPOs in the Indian context. He examined whether the introduction of book building has an impact on IPO pricing. For the purpose of analysis, the dataset consist of 92 IPOs listed on the NSE and BSE in the period January 1999-November 2003. BSE and NSE along cowl a minimum of ninety three of the IPOs in worth terms listed throughout the amount. The dataset contains offer opening date, method of pricing the IPO and daily closing prices for first 60 days of trading for these companies as well as the market capital-weighted index NIFTY (a 50-stock index) closing value for the study period.

S.S.S. Kumar (2007) investigated the short run furthermore as end of the day under pricing of Initial Public Offerings within the national capital markets by gazing the various factors moving them. As the underwriters don't have discretionary power in Indian IPOs, some of the theoretical models like Rock’s (1986) and costly information acquisition hypothesis (1989), which involves the extent of enlightened furthermore as unacquainted with investors may be tested a lot of robustly in national capital markets. Therefore a model is projected taking these oversubscription variables in conjunction with age and issue size to elucidate the under pricing. Since completely different completely different} sectors have different level of personal and public data, it is interesting to perform industry wise analysis and has been taken up here. The period for study was twenty two months (Jan 2006- October 2007) considering 116 IPOs.

Sasi, Kumar & Vikkraman (2008) aimed to find out the fundamental risk and return involved in investment of IPOs and the performance of initial public offers for the last five years. The performance of the IPOs during the last five years has been studied with the help of secondary data collected from NSE, BSE and other relevant data sources. The researchers assume that the investments in IPOs are very safe, risk free, and make good returns. The performance of IPOs has been evaluated by taking a dataset of IPOs issued in India between 2004-2008. During the period there were 275 IPO issues. The study includes sample of 71 new equity issues offered during the study period. The study examined the performance of the IPOs.

THEORETICAL FRAMEWORK

Primary Market:-

Primary market is the market where the companies issue their securities (shares debentures etc.) for the first time. Primary market is popularly known as New issue Market (NIM). It does not have a physical structure or form. It extends to all the places where the securities of the company are subscribed for the first time.

Secondary Market:-

Secondary market is the market where securities are traded after being initially offered to the public in the primary market and/or listed on stock exchange. In other words it is a market where the existing securities of the companies are traded; it provides liquidity and marketability to the securities which are issued in the primary market.

Offer Price:

Associate in Nursing giving value is that the value at that in public issued securities are created accessible for purchase by the investment bank underwriting the problem. A security's offering price includes the underwriter's fee and any management fee applicable to the issue

Bid Price:-

A bid value price terms damage is that the price a emptor is willing to get a security. This is one part of the bid with the other being the bid size, which details the amount of shares the investors, is willing to purchase at the bid price.

Bull Market:-

A market may be a monetary market of a bunch of securities during which costs are rising or are expected to rise. The term "bull market" is most often used to refer to the stock market, but can be applied to anything to anything that is a traded, such as bonds, currencies and commodities. Bull markets are characterized by optimism, investor confidence and expectations that strong results will continue.

Bear Market:-

A market condition during which the costs of securities ar falling, and widespread pessimism causes the negative sentiment to be self-sustaining.

Under pricing:-

IPO under-pricing is the increase in stock value from the initial offering price to the first-day closing price. Investors state that under-pricing signals high interest to the market that will increase the demand.

Over pricing:-

Overpricing is measured as the difference between the offer or opening price for the IPOs stock and its closing price after the first day of trading scaled by the offer price. When the gap value exceeds the price, the commerce is claimed to be expensive.

OBJECTIVES OF THE STUDY

Keeping in view the background and the rationale of the research as summarized above, the study has the following objectives:

To study the pattern of IPOs under pricing across time, issue size and market segment.

To identify the factors affecting short-run under pricing of IPOs in India.

To suggest a model this could explain the possible level of underpricing for Indian IPOs.

RESEARCH METHODOLOGY

The paper makes an attempt to evaluate the performance of IPOs in the Indian capital market during the period 2010-2018. In view of this the data regarding number companies went for IPO (Initial Public Offer) during the study period has been collected. The issue price and listing price i.e., closing price on the Listing day of IPO issue has been taken to calculate the proportion of companies with Gain/Loss and attempt has been made to study the number of IPO issues underpriced/ overpriced during the Study period. Further attempt has been done to study the post-issue IPO performance by evaluating the listing day, 30th day,90 day performance of the IPOs during the study period. i. Sample Size The sample size for the study includes IPOs listed on NSE (National Stock Exchange) during the study period has been collected for the study. Total number of IPO offered during the study period is 89, due to withdrawal of IPO issues and non-availability financial information of IPO Issues only 67 IPO issues are eligible for the study.

ii.SAMPLE SIZE

89 samples taken from the IPOs quoted in National Stock Exchange

iii. Data Collection

The information collected for the study is secondary data. The Secondary data have been collected from two sources. The data regarding number of companies went for IPO during the period 2010 to 2018, their issue price and listing price have been sourced from the website of NSE (National Stock Exchange) ,BSE,SEBI,RBI money control.

iv. Analysis Tools

The paper has been framed using Statistical and Mathematical tools such as, Percentage, Mean, and SPSS version 16 has been used for processing the data.

DATA ANALYSIS

1.1 SHORT-RUN UNDERPRICING OF IPOs

A comparison of short-run initial return of 24.93% as estimated in the present study with estimates documented in various studies at different point of time and provided in Table 1.1 of this chapter indicates that short initial come back has come back down considerably over time. According to S S S Kumar (2007), this decline is maybe thanks to the introduction of book-building method, an important change that the public issue process has witnessed from the early nineties to the present day. According to Pandey & Vaidyanathan (2007), the reduction in under pricing might even be attributed partially to the modification in regulation whereby the allocation to help institutional investors was allowed. However the under pricing still seems to be high as compared to some of the developed international markets as shown in Table 1.2 of this chapter especially in view of the fact that the average under pricing given in this Table is for the period between 2011-2014 and the downward trend in short-run initial return over time as observed in case of Asian country may need additionally followed in different countries with progressive relief of world economy and integration of the worldwide market. The year-wise pattern of short-run Initial Return on Indian IPOs at different point of time is provided in Table 1.3 of this chapter. While the primary return ticket is with relation to the asking price, return for subsequent periods have been estimated with respect to the first day closing price of the IPO. An analysis of the trend in initial come across short term and long-run time horizon (up to three years amount) throughout the reference period indicates that the primary day initial return of 24.9% becomes negative in the subsequent period up to 6 month (7 day, 30 day, 90 days and 180 days return) before going up to 2.3% at the end of the first year from the date of listing. However, the returns thereafter again becomes negative at the end of second year (-9.9%) and this trend continues even up to 3 years (-11.6%). The trend in future returns on Indian IPOs confirms to the international findings that within the long haul the positive abnormal initial returns become negative overtime. Overall, Indian commerce market is found to be for the most part a speculative market wherever the investors square measure searching for terribly really a awfully} higher come on the investment on the very initial day of the listing. In the different words, the investors aren't taking a protracted term read on the market whereas subscribing to IPOs within the national capital Market

TABLE 1.1 Short-run performance of Indian IPOs over time

Studies	Period	First day return
Madhusothanan and raju	2011-15	284.90% (annualized)
Kakati	2013-16	34.9% (Un annualized)
Krishnamuruti and Kumar	2012-14	72.34% (Un annualized)
SSS Kumar	2015-18	26.35% (Un annualized)
Jaitly and Sharma	2013-14	72% (Un-annualized)

Table.1.2 Degree of under pricing of IPOs in different countries

Country	Average under pricing	Period studied	Sample size
Malaysia	80	2010-2012	132
Spain	79	2011-2014	62
Mexico	78	2015-2016	347
Spain	58	2014-2017	32
Mexico	54	2014-2018	62
Japan	45	2014-2016	168
Italy	39	2013-2017	213
New Zealand	36	2015-2017	43
Singapore	45	2015-2018	72
Hong Kong	33	2010-2015	472
United states	33	2012-2014	37
United king Dom	29	2011-2015	149
Australia	27	2010-2012	75
Germany	18	2012-2016	66
Finland	12	2011-2016	10626
Canada	12	2013-2017	2133
France	11	2016-2019	170

Table. 1.3 Short run & long run return on IPOs :

Year	IR D1	IR 7D/DAY CLOSING	IR1 MONTH DAY1CLOSING	IR3MONTHS/ DAY1 CLOSING	IR 6 MONTHS/ DAY1 CLOSING	IR 12MONTHS DAY1 CLOSING	IR 24MONTHS/ DAY1 CLOSING	IR 36 MOPNTHS/ DAY1 CLOSING
2009-10	0.127	0.023	0.177	0.470	1.448	2.803	2.135	3.717
2010-11	0.527	0.045	0.016	-0.004	0.057	0.330	2.135	3.717
2011-12	0.458	0.008	0.029	0.172	0.420	0.871	2.135	3.717
2012-13	0.356	0.021	0.060	0.020	-0.005	0.094	0.243	-0.435
2013-14	0.170	0.012	-0.016	0.081	0.138	0.349	-0.380	-0.274
2014-15	0.390	-0.029	-0.055	-0.097	-0.124	-0.394	-0.521	-0.394
2015-16	0.122	-0.072	-0.192	-0.348	-0.357	-0.332	-0.291	0.582
2016-17	0.054	-0.017	-0.022	-0.09	-0.010	-0.079	-0.272	
2017-18	0.157	-0.039	-0.094	-0.082	-0.148	-0.352		
2018-19 (uptodec.18)	0.013	-0.093	-0.173	0.204	-0.215	-0.234		
Over all Return	**0.249**	**-0.014**	**-0.033**	**-0.037**	**-0.012**	**0.023**	**-0.099**	**-0.116**

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IRD1- First day initial return (calculated writ offer price)

IR7D- Seventh day return (calculated writ. first day closing price)

IR1 month –return at the end of 1 month (calculated writ. first day closing price)

IR3 months- return at the end of 3months (calculated writ first day closing price)

IR6 months- return at the end of 6months (calculated writ. first day closing price)

IR12 months-return at the end of 12 months (calculated writ. first day closing price)

IR24 months-return at the end of 24 months (calculated writ . first day closing price)

IR36 months –return at the end of 36 months (calculated writ. first day closing price)

1.2 TRENDS IN UNDERPRICING

A snap of the IPO activities throughout the reference amount i.e. April 2010 to December 2018 in India is provided in the Table 4.4 of this chapter. It is observed from the Table 4.4 (a) that the Indian market saw a steady rise in terms of IPO issues up to 2014-15. Thereafter, the market started declining on account of global economic crises. The effect of global economic prices was reflected in terms of decline in the number of IPO issues which came to the market during 2015-16 and 2016-17-Then, there was a recovery period of one year when the number of IPO issues went up to 52 in 2017-18. The subdued IPO market of 2018-19 thereafter could be regarded as the fall-out of impact of Euro Zone crises on the India growth story as reflected in terms of decline in IPO issues as shown the table.

The details of year-wise total IPO issues and the market returns, expressed in terms of percentage change in NIFTY index is provided in Table 4.4 (b) of this chapter. The pattern indicates that during an upswing in the market, an issuer try to take advantage of the bullish trends and the issue may draw more investors leading to higher demand, especially if the demand is correctly gauged throughout the book building method. Accordingly, the ultimate value asking price selling price} is anticipated to be terribly getting ready to higher limit within the price band indicated within the prospectus filed by the establishment with SEBI/Rocs. As already mentioned by Welch and Ritter (2002), when investors are overoptimistic, firms respond by issuing equity in a window of opportunities.

In general, the lead and lag pattern with respect to market return is further confirmed when the initial return on the 432 issues covered in this study is plotted against the market return across time.

Table. 1.4 Snapshot of IPO activities:

a)Year-wise descriptive statistics

YEAR	AVG.ISSUE SIZE (IN MM)	MEAN	MEDIAN	MAXIMUM	MINIMUM	STD. DEV	SKEWNESS	KURTOSIS	OBS
2009-10	1731.140	0.128	0.022	0.404	-0.058	0.196	0.535	1.633	6
2010-11	1739.450	0.528	0.312	1.791	-0.023	0.574	1.082	3.058	18
2011-12	6524.550	0.458	0.322	2.097	-0.206	0.542	1.426	4.941	22
2012-13	1465.460	0.356	0.258	2.582	-0.881	0.537	1.886	8.588	82
2013-14	3052.070	0.170	0.013	2.303	-0.422	0.468	1.955	8.216	78
2014-15	4915.710	0.390	0.237	2.863	-0.240	0.596	1.978	7.371	84
2015-16	950.110	0.122s	-0.018	1.596	-0.672	0.557	1.276	4.025	22
2016-17	6364.960	0.055	0.019	0.636	-0.372	0.247	0.515	3.015	39
2017-18	62444.990	0.157	-0.091	1.144	-0.529	0.334	0.824	3.483	52
2018-19(up to Dec.2018)	1715.520	0.013	-0.137	1.535	-0.731	0.573	0.723	2.927	29
Over all	**3751.100**	**26.930**	**0.126**	**2.863**	**-0.881**	**0.516**	**1.747**	**7.780**	

1.5 Relationship between IPO issues and market return:

YEAR	NO.OF ISSUES	%CHANGE IN NIFFTY
2009-10	6	-13.39914
2010-11	18	81.13883
2011-12	22	14.88515
2012-13	82	67.14809
2013-14	78	12.31429
2014-15	84	23.88952
2015-16	22	-36.19284
2016-17	39	73.75660
2017-18	52	11.13810
2018-19	29	-20.73195

1.4 ISSUE SIZE AND LEVEL OF UNDERPRICING

Past studies on IPOs have shown that as the deal size of IPOs (dollar value of IPOs expressed in terms of IPO proceeds) goes up, the level of IR declines. Large offers are expected to own less initial under pricing as a result of they have an inclination to be higher priced and are less risky. The position is confirmed in Indian case terms of the relation between mean initial come and issue size. However, it's any determined that after the scale of a problem exceeds one thousand large integer the mean initial come goes up. The trend is normally explained in the finance industry hypothesis as “grandstanding an IPO. According to this hypothesis, a firm will intentionally underpriced their issued specifically for the attention gains by the first day run-up in the stock price. This gives the firm additional substance and media exposure whereas at the same time proving the companies price to the investors. This also leaves the investors in good taste so as to make future issues of the big company a big success.

1.5 UNDERPRICING ANALYSIS BY SECTOR/MARKET SEGMENT

An attempt has been created to analysis the IPO under pricing level by sector/market phase. For this purpose, the IPOs issued throughout the reference amount are divided into ten segments, namely, IT& Its, communication and media, power, oil & gas, infrastructure, banks & financial services, reality, capital goods, including plant and machinery and engineering goods, consumer goods, including FMCG and consumer durables, chemicals, drugs and pharmacy and others. The market-segment wise descriptive statistics for under pricing by market phase is provided in Table four.5 of this chapter. Further, the market-segment wise (i) distribution of mean initial come of problems and (ii) share share within the total IPO problems is provided. It is observed from Table 4.5 that the market segment with highest level mean under prizing is IT & Its(45.3%) followed by Banks and financial services (31.6%), infrastructure (29.9%), capital goods together with plant and machinery and engineering merchandise (26.0%), communication and media (25.7%), power, oil and gas (24.21%), and consumer goods including FMCG and consumer durable (12.4%). A high level of initial come for market phase am passionate about it & Its is on account of difficulties in valuation of their assets that are for the most part intangible nature. This additionally indicates that industries with shorter and fewer data history are going to be a lot of under-priced as there's a lot of uncertainty regarding the supply firms

Table 1.6 Market segment –wise descriptive statistics:

SECTORS	AVG.ISSUE SIZE (IN CRORE)	MEAN IR	MEDIAN	MAX.	MIN.	STD.DEV	SKEWNESS	KURTOSIS	NO.OF ISSUES
Consumer goods incl.consumerdurables &FMCGS	126.480	0.124	0.008	1.786	-0.420	0.408	1.451	5.843	90
Capital goods including P&M&Engg.Goods	111.460	0.260	0.110	2.863	-0.582	0.606	2.236	9.592	54
IT&ITes	103.990	0.453	0.255	2.582	-0.628	0.702	1.543	5.163	53
Communication&Media	207.200	0.257	0.141	1.596	-0.422	0.418	1.059	4.016	47
Banks&Financial Services	444.690	0.316	0.160	1.820	-0.689	0.472	1.212	5.173	34
Reality	786.230	0.169	0.086	0.754	-0.301	0.280	0.615	2.445	34
Infrastructure	321.660	0.299	0.175	1.548	-0.881	0.475	0.353	3.585	33
Chemical,Drugs&Pharma	114.750	0.119	0.023	2.097	-0.731	0.583	1.245	5.751	29
Power Oil &Gas	2320.550	0.242	0.018	1.791	-0.206	0.500	1.750	5.497	27
Others	214.290	0.341	0.268	2.119	-0.356	0.538	1.733	6.392	25

Conclusion

The available evidence and some findings of this paper show that the price performance of IPO stocks and quality of issuers deteriorated in the years after going public. In this paper we have seen that many of the IPOs have significant returns on the day of listing but there after they do not give much return in the short-run, it shows that market overreacts to the initial public offers. Although the initial come back on Indian IPOs has return down considerably over time, the under pricing still seems to be high as compared to some of the developed international markets as shown in Table 4.2 of this chapter. Based on the past studies, the reduction in under pricing could be attributed to factors like introduction of book-building process, change in regulation whereby the allocation to informed institutional investors has been allowed, etc. The Indian IPOs market is basically speculative in nature wherever the investors area unit trying to find terribly a really a awfully} higher come back on the investment on the very initial day of the listing of IPOs. In the alternative words, the investors are not taking a long term view on the market while subscribing to IPOs in the Indian market. The amount of upper market come back is afterwards followed by period of high volume IPOs. The pattern indicates that during an upswing in the market, an issuer try to take advantage of the bullish trends and the issue may draw more investors leading to higher demand, especially if the demand is properly gauged during the book building process. Accordingly, the ultimate value asking worth selling price} are going to be terribly about to higher price limit within the price band indicated within the prospectus filed by the establishment with market regulator, i.e. SEBI. As so much as infrastructure, power, oil and gas segment is concerned, again valuation of these projects is based on their discounted cash flows and research and development. This makes the valuation relatively uncertain and hence higher level of initial return is demanded by the investors for the higher risk associated with the investment in such companies.

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