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Indian IPO Performance

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Abstract: *The first equity issue of any private company is called as Initial Public Offering, popularly known as IPO. The IPO are issued by smaller and new start companies which needs capital to expand their business. This study has been conducted to know the performance of initial public offering by Indian companies. The data have been collected from NSE website from the companies which have trading history of three years and in the study period. The offer price, listing date and if the listing is delayed for specific reasons has also been collected for the purpose of analysis. Nifty-50 is considered for calculating the market returns. The IPO's have been considered for a period of 10 years from January 2007 to December 2016. Market returns and stock returns were calculated to evaluate the performance with wealth relative. The study shows that market has underperformed from 2007 to 2011 due to recession in the global market and outperformed from 2012 to 2016.*
Keywords: *Equity issue, IPO, Indian companies, NSE, Nifty-50, Returns*

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I. Introduction

An initial public offering (IPO) is that the 1st time that the stock of a personal company is obtainable to the general public. IPOs are usually issued by smaller, younger corporations seeking capital to expand, however they'll even be done by giant in private owned corporations wanting to become publically listed. In an IPO, the institution obtains the help of Associate in nursing underwriting firm, that helps verify what sort of security to issue, the simplest providing value, the quantity of shares to be issued and therefore the time to bring it to plug. Before 1992, the govt of India controlled the rating of equity problems. A government appointed official, the Controller of Capital problems (CCI), priced the difficulty of equity capital employing a pre-determined formula. Since then the govt has abolished value controls and corporations are liberal to value the equity problems. Currently, the Securities Exchange Board of India (SEBI) regulates the new issue process. All corporations reaching to create equity offerings to the general public submit a proposal document for approval by SEBI.

The advantages of IPO's are;

- Bolstering and diversifying equity base
- Enabling cheaper access to capital
- Exposure, status and public image
- Attracting and retentive higher management and staff through liquid equity participation
- Facilitating acquisitions
- Creating multiple finance opportunities: equity, convertible debt, cheaper bank loans, etc.
- Increased liquidity for equity holder

Pricing of an issue (IPO)

Indian primary market ushered in Associate in era of free rating in 1992. SEBI doesn't play any role in value fixation. The institution in consultation with the bourgeois banker on the premise of market demand decides the worth. The provided document contains full disclosures of the parameters that are taken in to account by bourgeois Banker and therefore the institution for deciding the worth. The parameters embody EPS, letter multiple, market value and comparison of those parameters with generation of corporations. On the premise of rating, a problem may be additional classified into fastened value issue or book building issue just in case of a set value issue the difficulty at the offset decides the issue value and mentions it within the provide Document, whereas just in case on a book designed issue of a problem is discovered on the premise of demand received from the possible investors at numerous price levels.

The book building technique has lot of economical issues because it solves the "leakage" valuable usually seen with fastened priced IPOs. Here the institution sets a value vary inside that the capitalist is allowed to bid for

shares. The change is predicated on wherever comparable corporations are commerce Associate in establishing an estimate of the worth of the corporate that the market can bear. The investors then bid to buy variety of shares for a value that they feel reflects truthful worth. By collecting a book of investors, the institution will ascertain what value vary the shares ought to be valued at, supported the demand of those which are progressing to obtain them by the investors by providing and matching the demand.

Globally, the book building technique is favoured for its multiple natures; investors get the shares at a good value that generally has potential top side, and therefore the issuance company receives truthful compensation, but regionally it's possible to require time to adapt to the present technique. Issuers clearly have unconditional interest in moving the approach that has lot of possibility to steer to a stronger value for his or her corporations. This upsets some investors within the short term, World Health Organization is accustomed creating plenty of cash from these fastened value IPOs within the longer-term, however, economical rating ought to be seen as a symbol of the growing maturity of the capital markets within the region.

Book Building Process

Book building is a method of worth discovery. The institution discloses a worth band or floor worth before gap of the difficulty of the securities offered. On the premise of the strain received at varied worth levels at intervals the worth band nominative by the institution, Book Running Lead Manager (BRLM) in shut consultation with the institution arrives at a worth at that the safety offered by the institution, are often issued. The band may be of price at intervals that investors will bid. The unfold between the ground and therefore the cap of the worth band cannot be quite twenty p.c. the worth band are often revised. If revised, the bidding amount is extended for an extra amount of 3 days, subject to the overall bidding amount not exceptional 13 days.

A floor worth or worth band at intervals that the bids will move is disclosed at minimum of 2 operating days before gap of the difficulty just in case of Associate in Nursing initial public offering and covers at least sooner or later before gap of the difficulty in case of an FPO. The candidates bid for the shares quoting the worth and therefore the amount that they'd wish to bid at the time when the bidding method is complete, the 'cut-off' worth is received supports the demand of securities. The basis of allotment is then finalized and allotment/refund is undertaken. The ultimate prospectus with all the small print as well as the ultimate issue worth and therefore the issue size is filed with Registrar of corporations (ROC), so finishing the difficulty method. Solely the retail investors have the choice of bidding at 'cut-off'. Cut-off" possibility is out there for less than retail individual investors. Such investors square measure needed to tick the cut-off possibility that indicates their temperament to buy shares at any worth discovered at intervals the worth band in contrast to worth bids (where a particular worth is indicated) which may be invalid, if worth indicated by someone is under the worth discovered, the cut-off bids forever stay valid for the aim of allotment. The capitalist will modify or revise the number or worth within the bid victimization for changing/revising the bid that's accessible at the side of the applying form. However, the complete method of adjusting or redaction the bids is to be completed at intervals the date of closure of the difficulty. The capitalist also can cancel the bid any time before the winding up of the premise of allotment by approaching/ writing/ creating an application to the registrar of the difficulty. The syndicate member returns the stub with the signature, date and stamp of the syndicate member. Capitalist will retain this as a ample proof that the bids are accepted by the commerce / syndicate member for uploading on the terminal.

II. Literature Review

Allen and Faulhaber's (1989) shows the empirical evidence for the existence of `hot issue' markets for initial public offerings: in certain periods and in certain industries, new issues are underpriced and rationing occurred. This research paper develops a model consistent with this observation, which assumes the firm itself best knows its prospects. In certain circumstances, firms with the most favourable prospects find it optimal to signal their type by under pricing their initial issue of shares, and investors know that only the best can recoup the cost of this signal from subsequent issues.

Reena Aggarwal et al. (1993) found the initial one-day returns to be 78.5 percent, 16.7 percent, and 2.8 percent for Brazil, Chile, and Mexico. The long-run mean market-adjusted returns were found to be -47.0 percent in Brazil after three years. The three-year mean excess return was -23.7 percent for Chile and the one-year mean excess return was -19.6 percent for Mexico. They indicated long-run underperformance. For Brazil, there seems to be a negative relationship between the initial returns and the long-run returns, suggesting the overpricing of IPOs on the first trading day. These findings for the Latin American markets were similar to the U.S. and UK pattern of long-run underperformance. Based on the international evidence, it appears that these long-run patterns were not just sample or country-specific. This phenomenon, in fact, existed in nearly all markets except the U.S. and UK.

Ritter (1991) found that the under pricing of initial public offerings (IPOs) that have been widely documented appeared to be a short-run phenomenon. Issuing firms during 1975-84 substantially underperformed a sample of matching firms from the closing price on the first day of public trading to their three- year anniversaries. There was a substantial variation in the underperformance year-to-year and across industries, with companies that went public in high-volume years faring the worst. The patterns were consistent with an IPO market in which investors are periodically overoptimistic about the earning potential of young growth companies, and firms take advantage of these "windows of opportunity."

Ritter (1984) analysed the hot issue market of 1980, the 15 month period starting from January 1980 and extending through March 1981 during which average initial return on unseasoned new issues of common stock was 48.4 percent. This average initial returns compares with an average of 16.3 percent during the cold issue market comprising the restof the 1977-82 periods. An equilibrium explanation for this difference in average initial returns is investigated but is found to be insufficient. Instead this hot issue market is found to be associated almost exclusively with natural resource issue. For firms in another industry, a hot issue market is barely perceptible. This research paper documented tremendous disparities between the initial returns from natural resource issues.

KasimAlli et al. (1994) analysed the under pricing of IPOs of financial institutions and found that in general, IPOs of financial institutions are significantly less underpriced than those of non- financial institutions. These results are consistent with previous empirical studies on the testing of information asymmetry hypothesis that the less ex ante uncertainty about the value of the new issues, the smaller the average under pricing. These results hold even after controlling for differences in underwriters' reputation, aftermarket volatility, and years since establishment. However, results also show that the difference in the under pricing between S&L conversion and nonfinancial firm IPOs disappears once the differences in underwriters' reputation, aftermarket volatility, and years since establishment have been controlled for. This suggested that the difference in the under pricing between the non- financial institutions and the financial institutions was primarily due to the under pricing of the non-S&L conversion IPOs. Furthermore, results generally indicated that the level of ex ante uncertainty was lower for financial institutions than for non- financial firms. Judging by the size of the average under pricing of the non-S&L conversion financial institution sample (3.84 percent), the ex-ante uncertainty associated with the financial institutions (represented by the non-S&L conversions) seemed to be bigger than those of equity carve-outs (1.7 percent) or leveraged buyouts (2.04 percent). The results from this study were more consistent with the information asymmetry hypothesis than the insurance-against- legal- liability hypothesis. The lower level of under pricing for non-S&L conversion financial institutions was also consistent with the regulation hypothesis that the regulations imposed on depository financial institutions helped reduce ex ante uncertainty.

Shah (1995) carried out a study on IPOs for the period January 1991 to April 1995 of 2056 IPOs and reported that under pricing on an average was 105.6 percent above the offer price on equally weighted basis and 113.75 percent if weighted by size of the issue. The commonest delay between issue date and listing date is 11 weeks, and it is highly variable. This delay is strongly associated with issue size, where bigger issues tend to have shorter delays. The listing delay had diminished over the years. Because the listing delay is variable, it is incorrect to use simple averages in expressing IPO under pricing; this would be clubbing together returns obtained over different lengths of time. Because this delay is long, it is necessary to measure returns on IPOs in excess of returns on the market index. Hence the focus is on the weekly returns on IPOs in excess of weekly returns on the market index. It is found that the average IPO under pricing comes to 3.8 percent per week by this metric. Very small as well as very large issues had higher initial returns than the issues of medium size.

Mohammed Omran (2005) noticed the under pricing for 53 share issue in Egypt between 1994 and 1998. Over several intervals (up to five years), share issue privatizations sustain the ir positive performance and provide investors with positive abnormal returns over a one-year period; however negative abnormal returns were noticed over three- and five-year horizons. The initial excess returns were determined by ex-ante uncertainty and oversubscription, whereas the aftermarket abnormal returns over a one- year period are driven by ex-ante uncertainty and the price-earnings ratio. However over three and five-year periods, abnormal returns are significantly affected by initial excess returns, the price-earnings ratio, and, to a lesser extent, oversubscription. These empirical findings were consistent with IPO markets in which investors are overoptimistic about the performance of these issues but grow more pessimistic over time.

Ghosh(2005) carried out a study to find out the factors explaining IPO under pricing using 1842 companies that got listed on Bombay Stock Exchange from 1993-2001. His study supported the signalling theory. Contrary to the international experience, he reported that under pricing was less during the high volume (hot) period as compared to the slump period in the Indian stock market.

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

analysed 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.

Jotwani and Singh (2011) say that subscription rate of the IPO plays major role only in short run. Investors may try to analyse 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.

Bharat.A.Jain The post-IPO investment and financing decisions of founders versus non founders CEOS studied and compare the post-IPO investment decisions and financial policy choices of founder-led versus non founder-led IPO firms after controlling for other factors that drive investment behaviour and financial policy choices of 258 firms.

Preeti Thakur A Research on the impact of regulatory framework on IPO under pricing. (1) To study whether under pricing exists in Indian IPO's. (2) To study the impact of regulatory framework on IPO under pricing.

Sanjay Dessai Post listing performance of Initial Public Offers in Indian capital market-A study (1) To study IPO market price appreciation post listing. (2) To study if there is any significance difference in IPO performance based on different industry sectors.

III. Research Objective

To evaluate the performance of Indian Initial Public Offerings

Research Methodology

Type of research: Quantitative research
Research method: Descriptive research method
Sampling technique: Probability sampling technique
Sampling method: Systematic sampling method
Type of data: Secondary data
Source of data: NSE website
Total number of samples: 218 Companies
Time period: January 2007 to December 2016.

Measures of ipo performance:

Consistent with the standard methodology, return of particular day is calculated as the percentage change from the issue price to the closing price on that day in the secondary market.

$$Stock\ Returns = \frac{P1 - P0}{P0}$$

Where P1 is current price and P0 is previous price. Secondly, to calculate return on market index,

$$Market\ Returns = \frac{M1 - M0}{M0}$$

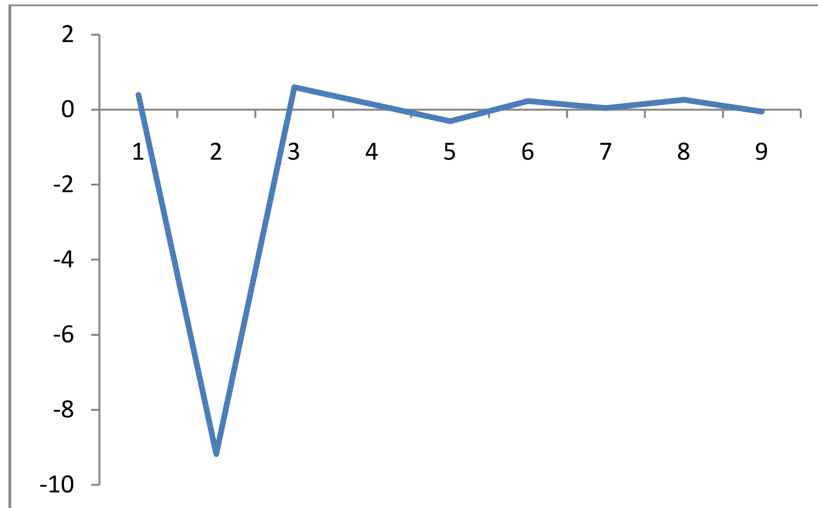
Where M0 is market price of previous day and M1 is current market price.

$$Wealth\ Relative = \frac{1 + 1/N \sum_{t=1}^{N} Ri}{1 + 1/N \sum_{t=1}^{N} Rm}$$

Where *Ri* is Stock Return and *Rm* is Market Return. The total number of IPOs in the sample is represented by *N*. A wealth relative above one implies that IPOs outperformed the market in that period. A Wealth relative below one indicates underperformance.

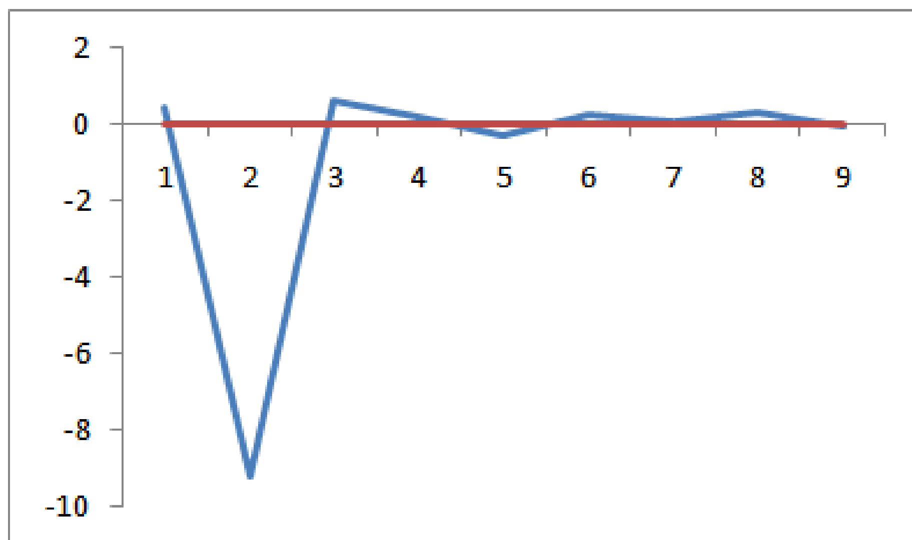
Data Analysis

Year	Market Returns
2007	0.394333872
2008	-9.184211205
2009	0.595817896
2010	0.145894072
2011	-0.307991011
2012	0.230859085
2013	0.041539898
2014	0.265487634
2015	-0.054652246



There is a negative return in the year 2008, 2011 and 2015.
A wealth relative above one implies that IPOs outperform the market and a wealth relative below one implies that IPOs underperform the market.

YEAR	Wealth Relative	PERFORMANCE
2007	-2.09789E-05	Underperform
2008	-9.67306E-06	Underperform
2009	-9.67306E-06	Underperform
2010	-1.18406E-05	Underperform
2011	-3.44783E-06	Underperform
2012	2.25703E-07	Outperform
2013	4.18455E-07	Outperform
2014	6.32515E-07	Outperform
2015	6.81584E-07	Outperform
2016	95.62782988	Outperform



IV. Conclusion

The data for the research has been taken of total 218 IPOs listed on NSE between the periods 2007-2016. Overall primary issue market has faced downward sloping growth in terms of number of IPO due to global economic crisis. 2007 have more percentage of negative stock returns. The shows a negative returns in 2008 due to subprime crisis. An average of 20% returns was recorded in the year 2016, 7% in 2015, 37% in 2014, 27% in 2013, 5% in 2012, 27% in 2011, 43% in 2010, 22% in 2009, 60% in 2008, 49% in 2007.
The wealth relative was underperform between the years 2007- 2011 and outperform between 2012-16.

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