

Investor's preference on IPOs in India

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Abstract

The investors are always looking for various investment options to land their hard earned money. There is multiple opportunities are available for them one safe investment is IPOs. There is a flourishing market for public issues in India. Public issues are made by both private and public sector companies. An initial public offer (IPO) is the selling of securities to the public in the primary market by the unlisted companies either a fresh issue of securities or an offer for sale of existing securities are both for the first time to the public. The Indian IPO market is one of the promising markets for the investors. During the period 1993-94 to 2007-08 4,538 companies had been raised Rs.1,49,671 crore from the primary market through IPOs. Resources rose through public issues declined by 91.5 per cent to Rs. 2,031 crore during April-June 2008 over those in the corresponding period of last year. The number of issues declined from 24 in April-June 2007 to 15 in April-June 2008. The average size of public issues also declined to Rs.135 crore during April-June 2008 from Rs.994 crore during April-June 2007. All public issues during April-June 2008 were in the form of equity. Out of 15 issues during April-June 2008, 13 issues were initial public offerings (IPOs), accounting for 78.4 per cent of total resource mobilization.

The study “**Investor's preference on IPOs in India**” has aimed to find out the fundamental risk and returns 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 researcher assumes that the investments in IPOs are very safe, risk free, and make good returns. The performance of IPOs has been evaluated on the basis of returns on the day of listing and the next day, three months, six months 12 months, 24months, 36months,48 months and 60 months.

It was found from the research that returns out of IPOs during the short period is very promising. In the recent past several large equity offerings including those from reputable business houses has failed to reach their price targets. Out of the 285 companies that raised Rs.99, 218 crore money from Investors in India through IPO, many are quoting below their issue price.

Keywords

Initial Public Offer (IPO), Short term returns, Long term returns, and performance review, Investors preference.

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1. Introduction

There is a flourishing market for public issues in India. The instruments commonly offered in the primary market are equity, debentures, and a variety of convertibles including debentures bundled with warrants. Public issues are made by both private and public sector companies. Unlike many other countries, where issues are privately placed, public issues in India are directly marketed to retail investors all over the country.

Investment returns of the Indian primary market have been condensed to a great extent during 2007-08 and 2008-09. Associated Chambers of Commerce and Industry of India (ASSOCHAM) found that retail investors and financial institutions including foreign institutions (FIIs), are gradually withdrawing from the capital market particularly from initial public offerings (IPOs).

Since the current market sentiments are not positive many investors are exploring other options such as bond, mutual funds and security markets as demand for raising IPOs has been subsiding a great deal," the ASSOCHAM analysis said. "FIIs are pulling out of IPOs because of high inflation, and alongside, the debt and bond markets are growing phenomenally," ASSOCHAM president Sajjan Jindal said. "The price band of IPO is also no longer attractive for retail investors. Under such circumstances, being optimistic about IPO market would not be realistic as the fear factor against the primary market is becoming more visible and pronounced," Jindal added. At least 74 companies which were close to going for IPOs and collectively raise Rs 440 billion (Rs 44,000 crore) are now awaiting better times.

1.1 Indian Financial Market

Development of an economy is based on sound financial system. It's a well-known fact that finance is the lifeline for any business enterprise. The efficient functioning and success of business operations depend upon the availability of adequate fund at the right time and required amount of funds as and when required. Financial Market is the place where the investors and fund seekers meet for mutual benefits. Indian stock market has about 6,000 listed companies in 22 stock exchanges. The number of listed companies in India is similar to that of United States.

.Financial Market is divided into Money market and Capital market. *Money market* refers to open market operations in highly marketable short-term debt instruments and the capital market deals in long-term debt issues and stocks. *Capital market* deals in financial assets excluding coin and currency - is essentially a market for securities, which have either long-term or infinite maturities consists of two segments:

- ✚ Primary market

- ✚ Secondary market.

New issue of shares and debt securities are made in the primary market and the existing securities are traded in the secondary market. Thus, whenever a company has to raise funds, it approaches the primary market with one of the three options:

- ✚Public Issue

- ✚Rights Issue

- ✚Private Placement

An initial public offer (IPO) is the selling of securities to the public in the primary market by the unlisted companies either a fresh issue of securities or an offer for sale of existing securities are both for the first time to the public. The Indian IPO market is one of the promising markets for the investors. During the period 1993-94 to 2007-08 4,538 companies had been raised Rs.1,49,671 crore from the primary market through IPOs. Resources rose through public issues declined by 91.5 per cent to Rs. 2,031 crore during April-June 2008 over those in the corresponding period of last year. The number of issues declined from 24 in April-June 2007 to 15 in April-June 2008. The average size of public issues also declined to Rs.135 crore during April-June 2008 from Rs.994 crore during April-June 2007. All public issues during April-June 2008 were in the form of equity. Out of 15 issues during April-June 2008, 13 issues were initial public offerings (IPOs), accounting for 78.4 per cent of total resource mobilization. Rich and Gumpert (1992) offer the following assessment: "Because risk and reward are closely related, investors believe companies with fully developed products and proven management teams should yield between 35 percent and 40 percent on their investment, while those with incomplete products and management teams are expected to bring in 60 percent annual compounded returns."

Investment decision in IPOs is appeared to be very attractive and encouraging to many of the retail investors. Before investing in an IPO, investors need to have an understanding of

the company, including various aspects of its business, its track record in executing projects, future earning potential, future orders, adaptability with the changing micro and macro economic and political environment, credentials of promoters and the valuation compared with its peers.

Table 1.2 Fund Generated Through IPO

Year	No. IPOs	Amount(crore)
1993-94	692	7864
1994-95	1239	16572
1995-96	1357	10924
1996-97	717	5959
1997-98	52	1048
1998-99	18	404
1999-2000	51	2719
2000-01	114	2722
2001-02	7	1202
2002-03	6	1039
2003-04	21	3434
2004-05	23	13749
2005-06	79	10936
2006-07	77	28504
2007-08	85	42595

Source: Handbook of statistics on the Indian securities market 2008

The above table reveals the number of IPOs during period 2005-2008 has been steadily increasing and found generated from the IPO market also considerably high during 2007-08. The share market operations are fine during the period. The economic crises and international market trend has been forcing thread both secondary market and primary market. The statistics reveals that the new IPOs issues has been reduced considerable amount during 2008-09. During the year 2009 IPOs in India dried up all of a sudden. In recent weeks, several large equity offerings, including those from reputable business houses, have struggled

to hit their targets. India's stock markets have been volatile, reacting to fears of a widening global credit crunch and fears of a U.S. recession.

Table 1.3 FOREIGN INVESTMENT INFLOWS

Year	Direct investment	Portfolio investment	Total (Rs. crore)
1990-91	174	11	185
1991-92	316	10	326
1992-93	965	748	1713
1993-94	1838	11188	13026
1994-95	4126	12007	16133
1995-96	7172	9192	16364
1996-97	10015	11758	21773
1997-98	13220	6696	19916
1998-99	10358	-257	10101
1999-2000	9338	13112	22450
2000-01	18406	12609	31015
2001-02	29235	9639	38874
2002-03	24367	4738	29105
2003-04	19860	52279	72139
2004-05	27188	41854	69042
2005-06	34188	55306	89494
2006-07	88446	31713	120159

Source: Handbook of statistics on the Indian securities market 2008

The above table reveals that even though the foreign direct investment increased considerably over a period of time the investment in portfolio i.e. in stock market has been reduced considerably during 2006 onwards. This indicates the economic recession has affected considerably the flow of foreign investment in the stock market.

2. Review of related studies

Performance of IPO has been well researched over a long period of time through the world. Reilly and Hatfield (1969) reported under pricing to the extent of 11% from their study of the IPOs in US during the period 1963-65. Subsequently Ibbotson (1975), Reilly (1977), Aggarwal and Rivoli (1989), Ritter (1991), Loughran and Ritter (1995), Ritter and Welch (2002), Ljungqvist and Wilhelm (2003) all document under pricing in the U.S. market. Jog and Riding (1987) report the same for the Canadian market; Ljungqvist (1997) for the German market; Gong and Sekhar (2001) for the Australian market also report under pricing. Wong and Chiang (1986) for the Singapore market; Chen et al (2004) for the Chinese market and Yong and Isa (2003) provide evidence on under pricing of IPOs in the Asian markets. It is clear that most studies agree that IPOs leave some money on the table where the money left on the table is the difference between the listing day's close price and the offer price multiplied by the number of shares outstanding.

In the Indian context **Shah** (1995) documents a phenomenal 105.6% excess return over the offer price in a study of 2056 new listings over the period January 1991 to May 1995. However, this study provides evidence on the short run performance only while Madhusoodanan and Thiripalraju (1997) from a study on IPOs offered on BSE during the period 1992 to 1995 shows that under pricing was higher than the international experiences in the short run and in the long run too they yield higher returns compared to the negative returns recorded from the international markets. Krishnamurti and Kumar (2002) working on a sample of IPOs that hit the market between 1992 and 1994 demonstrate that the under pricing is to the extent of 72.34% (market adjusted returns). Kakati (1999) analyzed the performance of a sample of 500 IPOs that came to the market during January 1993 to March 1996 and documents that the short run under pricing is to the tune of 36.6% and in the long-run the overpricing is 40.8%.

3. Research Methodology

The research **Investor's preference on IPOs in India - A Review** has been carried out to find the performance of IPO 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 data has been collected from NSE web site (www.nseindia.com). The study examined the performance of the IPOs both in the short-run as well as in the long-run, where short-run means the behavior of initial returns up on listing. Short term performance has been studied by examining offer-to-open returns, offer to high ,offer to low and offer to average price, which will give us a clear idea of how much the IPO gained or lost up on opening trades and an intra day return on the listing day. The second day returns also examined in a similar manner with reference to the issue price. IPOs long run performance is measured by examining the returns beyond the second day of their listing at monthly intervals till 2008 subject to a maximum of 60 months.

4. Results and Discussion

Table 4.1 IPO Issue & Status

	2008	%	2007	%	2006	%	2005	%	2004	%
No. of issues	36	-	95	-	73	-	50	-	21	-
Withdrawn Issues	3	8	1		0	-	0	-	0	-
Not traded Issues	0		5		5	7	0	-	0	-
Not listed Issues	3	8	10	11	1	1	0	-	0	-
No. shares below Issue price	28	78	66	69	43	59	26	52	5	24
No. shares Above the Issue price	2	6	13	20	24	33	24	48	16	76

The above analysis reveals some of the very interesting facts, out of 36 issues during the year 2008 only two shares are selling above the issue price. This pretense so many questions like, is it because of recession, overpriced, over confidence of the investors, FII action and so on. During the year 2004 there is about 21 issues and even after 4 years only 5 issues are selling below the issue price. Franklin Allen, a finance professor at Wharton, says primary markets will continue to be "tricky" until the markets settle down. "When you have so much volatility [in the secondary market] - it's up 2% one day and coming down 2% the next day - it is very difficult to do these primary market operations; that is the underlying problem," he says. "This happens also in developed markets when there is volatility.

The research reveals even though the short term performance of the IPO market during the period 2008 it failed to sustain for long due to strong belief on economic recession. The performance of IPOs that hit the markets during the later stage of the bull market in 2006 and 2007 has been quite dismal. In all 43 out of the 73 IPOs that came in 2006 are trading below their issue prices, while 66 out of 95 IPOs that hit the market in 2007 are trading in the red. The stock market performance of majority of IPOs that came during the five-year-long bull-run (March 2003-January 2008) was disappointing. Out of the 275 IPOs between 2004 and June 2009, 193 are trading below their issue prices.

The public sector IPO s is doing better than private sector IPOs. Out of 13 public sector undertaking (PSU) IPOs that came between 2004 and June 2009, 12 are trading above their issue prices. On the other hand, out of 265 private sector IPOs during the same period, 189 are trading below their issue prices.

4.2. Short term Performance of IPO

Table 4.2 First days Performance

	Offer to Open (Earnings)	Offer to High (Earnings)	Offer to Low (Earnings)	Offer to Average Price (Earnings)
Average	24.41%	44.78%	13.24%	30.11%
SD	0.27	0.36	0.27	0.31
Median	16.8	36.8	8	23.50
Maximum	75%	163%	83%	123%
Minimum	-25%	-4%	-52%	-20%
p- Value(Chi ²)	0.18	0.004	0.24	0.017

skewness	0.49	0.98	0.510	0.87
kurtosis	2.41	3.52	3.16	3.24
N	71	71	71	71
N>0	63	71	54	64

The above analysis shows the first day performance of the IPO s. The study reveals the average earnings of the offer open IPO is 24.41% and it ranges to the maximum of 44.78% and the minimum of 13%and at an average of 30% return on the first day of listing. Standard deviation also calculated and presented in the above table. The maximum average return on the first day 163% and minimum average return on the first day is 75%. Out of 71 IPO studied only 8 are listed below the issue price and 17 issues went below the issue price during the trading day. It is interesting to note that all the 71 issues are gone above the issue price during the trading day (listing day).

Table 4.3 Second Day Performance

	Offer to Second day opening	Offer to Second day high	Offer to Second day low	Offer to Second day average
Average	32.67%	38.64%	26.96%	32.6%
SD	0.44	0.45	0.40	0.41
Median	22	26	17	21
Max	156%	192%	155%	183%
MIN	-42	-39	-100	-45
Skewness	1.17	1.24	0.57	1.25
Kurtosis	4.22	4.87	5.67	5.26
p-Value(Chi ²)	0	0	0	0
N	71	71	71	71
N>0	56	63	56	55

The second day's performance of the IPOs return analysis shows that all the IPO investors gain on the listing day's performance and also on the second day. The investors who weighted for the second day also gained considerably. The average return on the second day ranges from 38.67% to 26.96%. The maximum return on the second day is ranges from 192% to 155% and the minimum return on the second day ranges from -39% to 100%.On the second day trading out of 71 IPOs 56 stocks opened higher than the issue price and only 16 shares are opened below the issue price.

5. Long term earnings

Table 5.1 Fifty two weak high and low

No of sample	Average 52 weak high	Average 52 weak low	Difference	%
71	385.70	95.14	290.56	305
Index	6287	1163	5124	440

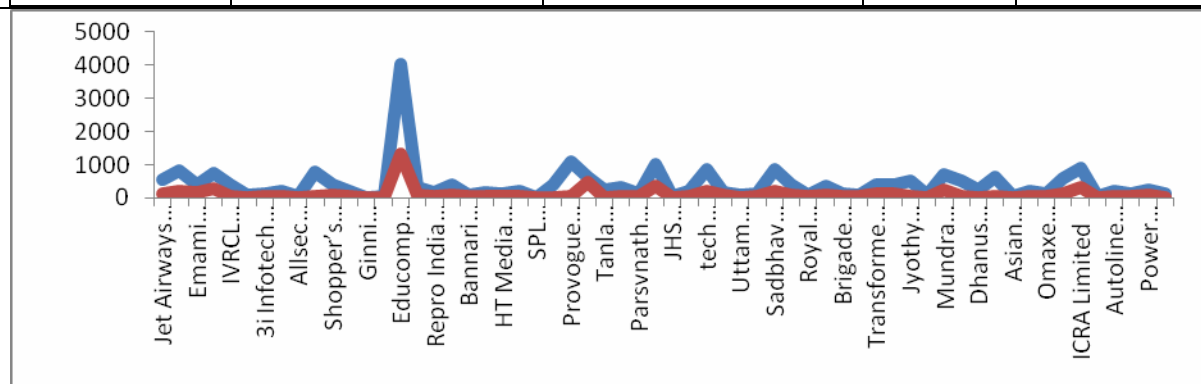


Table 5.2 Five years IPO Returns

Sample Size	From the issue price to:	Earnings (%)	Trimmed Mean (5%)	Index Return From issue price	Annualized index return
71	30 Days	55	56		
71	3 Months	52	33	-3	-3.27%
71	6Months	30	24	-8	-5.03%
71	12 Months	27	15	-8	0.29%
55	24 Months	36	20	5	14.52%
46	36 Months	35	23	29	22.17%
29	48 Months	30	24	56	21.35%
7	60 Months	2	29	70	8.97%

The study reveals that up to three months the average earning is more than 50%. During the period of last four years the average earnings were 30%. The long term return for 5 years has been reduced very much because of the fall in the stock market .The IPO investment has provided a healthy and reasonable return during the previous periods except five years. The researcher found that the economic recession has stroked the stock market to a greater extent that has an impact on IPO earnings also. The study reveals that the first 30 days performance of the IPO is appear very attractive because 55% return has been registered during the period. IPO performance in the long-run from earlier studies conducted in India is mixed.Kakati (1999) reports under-performance in the long run while Madhusoodhanan and Raju (1997) report that Indian IPOs have given higher returns compared to the negative returns reported from other countries. The present study reveals that IPOs generated positive returns even after four years of listing.

6. Conclusion

The study “Performance review of IPOs in India” examines the performance of IPOs issued during the period of 1004-2008. The sample comprises 71 firms that offered their shares to the public during the study period. The statistics revels that the new IPOs issues has been reduced considerable amount during 2008-09. The data has been collected from NSE web site (www.nseindia.com). The study examined the performance of the IPOs both in the short-run as well as in the long-run where short-run means the behavior of initial returns up on listing and the second day.

The stock market performance of majority of IPOs that came during the five-year-long bull-run (March 2003-January 2008) was disappointing. Out of the 275 IPOs between 2004 and June 2009, 193 are trading below their issue prices. The public sector IPO s is doing better than private sector IPOs. Out of 13 public sector undertaking (PSU) IPOs that came between 2004 and June 2009, 12 are trading above their issue prices. On the other hand, out of 265 private sector IPOs during the same period, 189 are trading below their issue prices. Out of 71 IPO studied only 8 are listed below the issue price and 17 issues went below the issue price during the trading day

The performance of IPOs has been cheering to the investors. Retail investors can go for the IPO market for safe and secured investment. Even though the recent economic

downtrend has slowed the process of IPO issues we could expect speedy recovery of both the economy and IPO activities.

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