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DEPARTMENT OF COMMERCE

Topic

A study on initial and post issue performance of initial public offerings (IPO's) at NSE

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"In the short run, the market is a voting machine but in the long run, it is a weighing

machine. - **Benjamin Graham**

I. **Introduction**:

A financial system is a system that allows the exchange of funds between lenders, investors and borrowers. It promotes savings and investment in the economy and enlarges the resources flowing into the financial assets which are more productive than the physical assets. A financial market is a market in which people trade financial securities, commodities and other fungible items of value at low transaction costs and at prices that reflective supply and demand. Financial market has significant role to play in this context because it is a part of the financial system. It provides the financial resources needed for the long term and sustainable development of different sectors of the economy.

Investors have access to a large number of financial markets and exchanges representing a vast array of financial products. Some of these markets have always been open to private investors; others remind the exclusive domain of major international banks and financial professional until the very end of the twentieth century. Financial market is divided into money market and capital market.

Primary market facilitate securities to the investors and assist the corporate sector in arranging funds in the form of public issue, offer for sale, private placement and right issue. Public issue can be further classified into Initial Public Offer (IPOs) and Further Public Offer (FPO). An initial public offering is a company’s first offering of equity to the public. IPO is a major source of capital for firms.

IPO’s are important milestone in any company’s growth as it progresses from being a start-up/private limited company to public limited. Successful IPO can generate tremendous amount of wealth for company promoters as well as pre IPO investors. Historically a majority of the IPO’s were under-priced with an aim to issue abnormal profits on the listing thus attracting more investors to subscribe to their stocks. Empirical studies have established the above in efficient markets.

Numerous research papers have studied the anomaly of under pricing and abnormal returns yet they are insufficient to demystify the above. Hence this study will analyze the short term and the long term performance of the Initial Public Offerings and help the investors take an informed decision while investing for the same.

II. Relevance of the topic:

IPO’s are often looked upon as a speculative opportunity to earn abnormal profits on the listing day. Companies which decide to go public face the added pressure of the market which may cause them to focus more on short-term results rather than long-term growth. The actions of the company's management also become increasingly scrutinized as investors constantly look for rising profits. This may lead management to perform somewhat questionable practices in order to boost earnings.

Before deciding whether or not to go public, companies must evaluate all of the potential advantages and disadvantages that will arise and fix prices that are in the best interest of the company and investors. This study helps the investor to decide the suitable investment strategy to get maximized returns.

III. Objectives of the study:

The present study has been initiated with the following objectives:

- To find out the performance of Indian IPOs for short period, i.e. from the date of offer to the public to the date of their first day of trading after listing on stock exchange.

- To measure the long term performance of Indian IPOs including and excluding initial returns.

- To analyze whether the returns are more in short term or long term for better conclusion

- To compare & analyze Initial Public Offerings (IPO’s) returns with Index returns.

IV. Review of related literature:

Sudesh Kumar Sharma, Sanjiv Mittal & N. K. Gupta, "Post-issue Performance of IPOs in India" (2013), indicate inverse relationship of market price appreciation to time period meaning that the stock appreciation tends to decrease with time. Maximum appreciation of stocks is witnessed on listing day across all sectors. Appreciation is observed ranging from 12 percent to 42 percent with average being 25 percent across all sectors. Finance and IT/ITES sectors outperform the average level of appreciation. Petrochemical and Infrastructure sector stocks gain poorly on listing day.

Dr. P. Roopa "A study on initial performance of IPO's in India", during 2015-16, was revealed that average return on the listing day in case of fixed price issue is 7.04% and in case of book building mechanism is 6.4%. In case of market adjusted initial returns, the average return in fixed price offer is 7.3% and book building mechanism is 9.8%.

Dr.S.Poornima, Aalaa J.Haji & Deepha.B "A study on the performance of initial public offering of companies listed in NSE, India & Gulf Base GCC Index" (2016), show that there are five companies that offered higher returns in the primary market and sold in the secondary market, whereas there is only one company which gives higher returns in the primary market and one company which gives higher returns in the secondary market.

V. Research Methodology:

The short-term returns are calculated for the listing day using the traditional method of calculating returns, i.e. The difference between the closing price on the first day of trading and offer price and divided by the offer price. The result figure was multiple by 100 to set the figure in percentage.

To measure the raw return of IPOs, whether an investor gained or lost by buying the share during the IPO on offer date and selling at the prevailing price on the opening day the following formula has been used

$Ri = p1\text{-}p0/ p0 * 100$ …………. (1)

Where

Ri = subscribers initial return (hereafter raw return)

P1 = closing price on the first day of trading

P0 = offer price

If Ri is more than zero, one can interpret that short term returns were positive and the issues were under- priced, if Ri is less than zero, one can interpret that short term returns were negative and the issues were overpriced, and if Ri was zero, it means there were no returns

Market Adjusted Excess Returns (MAERs):

The returns measured by eq. (i) would be valid in a perfect market, where there is no time gap between the application closing date and first day of trading but in India this time gap is quite long. During this period, a major change could occur in market conditions. As there was a lag between offer dates and listing date, the price observed in the market on the listing day may be different from the offer price as a result of the overall market movements, the researcher also compute market adjusted returns of the IPOs for the same period. Therefore, the initial return estimated by eq. (i) will be adjusted for market return as under;

MAER= (p1-p0 /p0) – (m1- m0/m0) * 100

Where

P1 = closing price on the first day of trading

P0 = offer price

M1 = market index on the first day of trading

M0 = market index on the offer date

MAER = market adjusted excess return

VI. Data and sampling:

Data has been collected from NSE, CMIE PROWESS, and CAPITAL LINE. The present study was mainly confined to secondary data. The sample of the study was based on the following criteria

The research will be done through observation method by taking 7 years data starting from 2013. Further the researcher will take the details of the IPO's price at the time of listing and the performance of the public issues after one year. Based on this the researcher concludes and gives the quantitative & qualitative interpretation which will be useful to the investors.

NSE- Nifty was selected as the Market Index for the study because National Stock Exchange of India is the oldest stock exchange and most of IPOs were listed in the stock exchange.

IPO's - Year Wise (IPO's in India Share Market)

Year	No. of IPOs	Amount Raised (Rs In Cr)	Issues Succeeded	Issues Failed
2013	5	1,283.95	3	2
2014	7	1,200.94	5	2
2015	21	11,362.30	21	0
2016	27	26,372.48	26	1
2017	35	70,714.41	35	0
2018	25	31731.28	24	1

2019*	13	11027.64	13	0

Source: https://www.nseindia.com/products/content/equities/ipos/hist_ipo.htm

VII. Conclusion:

This study aimed at analyzing the performance of IPO both in primary market and secondary market. Investment tools like the Raw Returns; Market Adjusted Excess Returns is used to analyze both the short term and the long term performance. It is important for the investors to analyze the trend of IPO stocks to make informed decisions.

The sample size used in this study is small, and study period for the long term performance is also small since it may take more than 1 year for a company to improve their financials. The study implemented only Market Adjusted Excess Returns method to analyze the performance of the IPO due to time constraint whereas other tools like Buy and Hold Abnormal Returns and Wealth Relatives could be used to analyze the actual performance of IPO's. Companies listed in Bombay Stock exchange can also be taken for study to understand the overall performance of IPO stocks in India. Factors influencing under pricing which results in abnormal profits can also be studied to have a comprehensive view on the exact reason behind the anomaly.

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