CHAPTER 6
CONCLUSION AND POLICY IMPLICATIONS

The major findings of this study are as follows:

(1) Researcher’s first objective was to find out the factors determining going public decision of Indian firms. According to probit model size, age, profitability, growth, disclosure, asset risk, market risk and cost of credit emerged as the significant determinants of going public decision. It was found that bigger size firms are more likely to go public. Bigger size helped firms in reducing adverse selection cost and floatation cost. Risk was found to be one of the important determinants of going public decision. Researcher has captured three types of risk by three different variables. Risk in terms of information available for a firm is captured by age of the firm. Younger firms was found to be more likely to go public. Asset risk of a firm is captured by ratio of intangible assets to total assets. Firm with high assets risk was found to be to be more likely to go public. However industry controlled results showed that the probability of going public for high asset risk firms is industry specific. Market risk of the firms is captured by accounting beta. Firm with high beta was found to be more likely to go public.

Adverse selection cost appeared to be a major deterrent for going public decision. Profitability was found to positively related to the probability of going public. As discussed a smaller size firm faces high adverse selection cost. Similarly firm with low profitability or no profitability will also have to face a high adverse selection cost. On the contrary firm with high profitability can easily signal their financial position to outside investors.
Researcher find firms with high disclosure level to be more likely to go public. Disclosure was captured by ratio of corporate tax to sales. It was expected that firm would like to pay a lesser amount of tax and hence would like to remain private. Researcher further found that IPO enables firm to bargain for a lower cost of credit. Probit result showed that firms with high cost of credit are more likely to go public. Firms do IPO when their cost of capital is high. Cost of capital was captured by beta and it was found that increase in beta increases the probability for going public.

(2) The post IPO analysis confirmed that IPOs were done to finance future investments and growth of the firms. Even though the leverage was not among the significant variable affecting the probability of going public, post IPO analysis of leverage proved that the debt to equity ratio decreased significantly after IPO. It can be said that probability of going public increases with leverage but company definitely restructure their capital structure through IPO. The significant decrease in insider’s ownership confirmed that IPO is one of the ways for the owners to diversify their risk. Even though the decrease in cost of credit was not significant for first two time windows, the significant decrease in two year after IPO indicates that IPOs enabled the firms to bargain for lower cost of credit.

(3) Researcher’s second objective was to investigate the change in performance of Indian public firms post to their Initial Public Offerings (IPOs). It was found that overall performance of firms deteriorated significantly in post IPO period. As compared to PBDIT/TA the decrease was sharper for CF/TA. Industry adjusted performance measures
recorded the same result and hence negate the reason of this decrease to be an industry effect. One can argue that decrease in post IPO performance could be because of lack of sales and investment opportunities in Post IPO period. Therefore the study examined the trend in Sales and Capital expenditure around IPO. The results suggested that the Sales and Capital expenditure increased considerably in Post IPO period. Hence it can be argued that the decrease in Post IPO performance doesn’t seems to be because of lack of Sales and investment opportunities or cutback in capital expenditure in post IPO period.

(4) Researcher’s third objective was to examine whether change in insider’s ownership around IPO has any relationship with post IPO performance deterioration or not. Analysis based on panel data showed that there is a curvilinear relationship between ownership and performance. These results suggests that firms with “low” and “high” levels of managerial ownership experience negative relationships between managerial ownership and changes in firm performance (entrenchment hypothesis), while firms with ‘intermediate’ levels of managerial ownership exhibit a positive relationship between managerial ownership and changes in firm performance (alignment-of-interest hypothesis). Our findings (entrenchment-alignment-entrenchment) is in support of Christina (2005).

(5) Researcher’s fourth objective was to examine the relation between underpricing as a signaling mechanism and post IPO performance of Indian firms. Our results concluded that underpricing could not be held responsible for the deterioration in post IPO performance. The difference in the change in performance for both the group was investigated through wilcoxon sign rank test, which rejected the alternate hypothesis that the difference in
deterioration in performance could be attributed to underpricing. The result supports Jain and Kini (1994). Jain and Kini (1994) however argued that the results do not prove that signalling is not responsible for deterioration of performance. But the proxy for signalling appeared to be wrong. Firms might not have used underpricing as signalling mechanism. They might have used some other measures to signal their high value in the market. This gives scope to future studies to explore other proxies for signalling. Based on the results it can be concluded that firms do not underprice to signal their value and there is no relationship between underpricing and post IPO performance.

(6) Researcher’s fifth objective was to investigate the impact of market timing on deterioration in post IPO performance. Results obtained by examining, the earning potentials like P/E and M/B and earnings like EPS, from IPO year to two year after IPO suggest that investors expectation that earnings growth will continue after IPO were not even sustained. The constant decline in P/E and M/B suggest that firms took advantage of over-optimism of investors. The decline in earnings in post IPO period is in support of Jain and Kini (1994).

The result based on multivariate regression suggest that Market timers, identified as firms that go public when the market is hot, tried to maximize the total proceeds at the time of IPO. The hot-market effect is remarkably robust; it is significant for both firm and industry-level characteristics.
Pre IPO profit margin serves as the basis for the investors’ expectations about firms’ future earnings. Our result supported the argument given by Jain and Kini (1994) that firms came with their IPO when their profitability level was high. The post IPO decrease in performance suggests that the issuers of these firms were sure at the time of IPO that they would not able to maintain the current level of profitability in the future. Study has found that overall performance of firms deteriorates significantly in post IPO period. As compared to PBDIT/TA the decrease was sharper for CF/TA. Industry adjusted performance measures recorded the same result and hence negate the reason of this decrease to be an industry effect. Overall it was found that Indian market do reflect the market timing behaviour by the issuers.

**SIGNIFICANT CONTRIBUTION FROM THE STUDY**

The significant contribution from this thesis are as follows.

This study:

(1) provides an understanding of the IPO motives of the firms from emerging market of India. Similar motives may also be applicable for the foreign firms from the other emerging markets. A clear understanding of the IPO motives will help the security market regulators and stock exchanges’ authorities in designing appropriate regulations and strategies to attract maximum public issues of equity by the firms of emerging markets.

(2) serves as a useful guide to the managers of the Indian firms contemplating IPO of their firm. Results of the study provide insights to the firms’ managers about the possible merits and impacts of their IPO decisions.
(3) has implications for the Indian capital market structure, given growing interest of investors into the Indian primary market. While the success of the Indian primary market is a positive signal, efforts need to be done to sustain the positive trends in the future also. The volatility in the volume of new issues can affect the liquidity, size and depth of the capital market which can ultimately affect the investment opportunities for the investors. Hence it is very important for investors, policy makers, stock exchange authorities, and finance researchers to understand the determinants and impacts of going public decision.

(4) suggests that policy makers in India should prescribe a higher transparency level and more stringent accounting norms for the listed firms. This will enable the Indian firms to improve their credibility by listing their stocks on the Indian stock exchanges. Besides, high transparency and stringent norms will also help in attracting the foreign Institutional investors to invest in the Indian markets.

(5) records that the post IPO financial performance deteriorates for Indian firms. Similar decline in performance has also been recorded by other studies done with the samples of other emerging markets as well. Such deterioration in performance is of concern to the domestic investors, foreign institutional investors, security market regulator and the stock exchanges’ authorities. Therefore, market regulators and stock exchanges’ authorities in the emerging markets have to work out strategies so as to increase the post IPO performance.
(6) reports that Promoters of Indian firms significantly reduce their stake through IPO, which have negative impact on the post IPO performance of firms. Although SEBI keep a check on the level of ownership concentration in post IPO period but more stringent and transparent rules are required to strengthen the corporate governance activities of the firms.

(7) the curvilinear relationship between ownership and performance illustrated by the analysis has implications for the investors and policy makers. The policy makers have to closely monitor the firms where the promoter’s ownership is either very low or very high in post IPO period. Because at both the levels managers/owners interests do not seem to be aligned with common shareholders.

(8) has implications for the fund managers, domestic investors and foreign investors for efficiently managing their portfolios, given the impact of IPO on the performance, ownership, liquidity and cost of capital etc.

LIMITATIONS OF THE STUDY

1. The study used several proxies whose selection may be a matter of subjective decision.

2. The time window taken in the study includes two years post IPO. It could be enhanced from one year before IPO to three year before IPO to as long as 10 years after IPO.

3. The study is based on secondary data. Future studies can capture qualitative factors through survey.
4. Though we have used only underpricing as a signaling variable, the other variables can also be used to proxy signaling. Study on market timing behavior could be further enhanced by elongating the study period so that it can capture more number of hot and cold market cycles.

5. Dealing with missing information for the variables was one of the challenges in the study. Though we have used one of the popular academic database CMIE Prowess, in future more sophisticated databases can be explored.

6. The study focusses on companies of India only. In future multi country comparison can also be done.

**RECOMMENDATIONS FOR FUTURE RESEARCH**

The process of research is continuous and never ending. The more questions are answered in new research, the more questions are developed from the new findings. This section lists possible areas/topics for future research. They may be helpful in increasing the understanding of the future IPOs.

1. Studies with similar methods could be conducted in other international markets. Such studies could start with other Asia countries and then be extended to other continents. Comparison could be drawn if different patterns are found among countries.
2. The differences in the nature of IPO may result in differences of effects on firm performance. The differences in nature may include the firm’s original formation (e.g., partnership, family business, joint venture, etc.) concentration of ownership, stability of insiders (e.g. insider turnover ratio), wealth of insiders, average age of insiders, and so forth. Future studies could investigate how some of these factors affect relationship between IPO and firm performance.

3. Future studies could investigate whether the relationship between IPO and performance are linear or nonlinear? Based on some previous research and some evidence from this research, it is possible that the effects of IPO on firm performance are not linear.

4. This study investigate the effects of IPO on firm performance in only 3 years. Using a longitudinal method, future studies could investigate whether the effects of IPO changed (increase/decrease) over time.