A STUDY OF INITIAL PUBLIC OFFERS IN INDIA DURING PERIOD 2002-2007

ABSTRACT

Introduction

The research carried out as a part of this project concerns Initial Public Offers in the Indian stock market during the 5-year period, 2002-2007. There have been 272 IPO’s during this period.

The main objective of the research is to understand factors that influence the IPO’s, globally as well as in India, benchmark these in the context of IPO’s during the period 2002-2007 and to draw specific, statistically relevant inferences. The factors that are considered important in the case of IPO’s, as judged by their recurrence in 600 plus papers and articles on the subject which have been studied are: IPO underpricing, Role played by underwriters and investment bankers, Pricing and marketing issues and impact of IPO’s on corporate structure. In addition, several minor issues and practices have been cited in the papers which have provided insights for the research.

The objectives formulated for the research are as follows:

i. To evaluate role played by IPO’s in corporate finance.
ii. To measure the variations in IPO’s from year to year.
iii. To evaluate factors leading to pricing of IPO’s.
iv. To evaluate marketing aspects of the IPO’s.
v. To evaluate role of investment banks and the intermediaries in the context of IPO’s.
vi. To evaluate financial factors related to cost of capital, dependent on IPO price and issue cost.

Research Design

1. A comprehensive literature review is carried out to understand various facets of the research theme.
2. Historical data related to 222 out of 272 (81%) IPO’s during the period 2002-2007, has been obtained and studied.

3. A questionnaire study was carried out to obtain information about the motivation and policies and managerial attitude related to the IPO. This was done as a mail survey keeping in view constraints of time and cost. 31 companies responded out 272 during the period (11%).

4. Data obtained through the two surveys has been independently as well as jointly analyzed. This has been linked with the literature survey and inferences drawn.

**Research Hypotheses**

The hypotheses formulated for the research are as follows:

1. The number of IPO’s every year depends on outlook for the economy as measured by the Sensex.

2. An IPO being overpriced is related to the size of the issue. (i.e. The chance of share losing value post IPO is related to size of the issue, classified as small, medium and large).

3. There is a significant difference between importance attributed to the factors that motivate an IPO.

4. There is a significant difference between importance attributed to the factors that determine timing of an IPO.

5. There is a significant difference between importance attributed to the factors that create concern in a decision to go for the IPO.

**Findings and Conclusions**

1. The 222 companies included in the sample (out of 272 during the period) raised total capital of Rs. 45098 Crores, at an average of Rs. 203.14 Cr for every issue and with a median size of Rs. 140 Crores.
2. Out of the total, 74.2% companies followed Book-building method, as compared to the remaining 25.2% which went for fixed price method.

3. Out of the 222 companies, 21% raised capital of less than Rs 50 Crores through the IPO, 35% up to 150 Crores and the rest, 44% higher than Rs 150 Crores.

4. The underpricing of the share i.e. the market price being higher than the offer price is highest on day 1 – the first day of the trading. The ‘underpricing’ reduces as shares approach 180 days.

5. In terms of increase in market capitalization, over 180 days, medium size shares have performed better than small and larger issues.

6. Some of the factors which appear as important motivators in theory do not necessarily appeal the companies in practice. IPO as a better option to Debt Finance and as an image building exercise has received the lowest rating. Raising capital from public for future expansion is the most important motive.

7. As far as timing of IPO’s is concerned, the companies are not guided by what other good firms do. Overall favorable conditions in the stock market, followed by industry conditions have received the best ranking.

8. While selecting an investment banker or underwriter, underwriter’s overall reputation and status followed by his industry experience are the factors which are valued most. Fee structure and non-equity related services such as advice on M & A are considered least important.

9. Underpricing of IPO is supposedly the most common phenomenon going by the extant literature. However, we found that most IPO managers from the sample survey do not consciously plan for underpricing. The need to create a wider investor base, and to compensate the investor for participating in IPO process are the two most important reasons.
10. World over, several other factors are considered; one of the factors being to avoid litigation. An overpriced share can lead to litigation elsewhere if the investor feels deceived. The managers participating in our survey have not considered this as important.

11. The perception of the IPO managers in the companies regarding factors investors also deviates from literature. Having a good earnings record and having a proper size of the issue is considered important. Venture capital backing is not important nor having a high profile investment bank associated with the issue.

12. We had asked the respondents to rank 10 different ‘concerns’ while taking a decision related to IPO. Bad Market conditions and SEBI’s reporting requirements are the two topmost concerns. The regulator’s role thus continues to be important though the office of the Controller of capital issues has been abolished since long. However, fees of the underwriter are not an issue. Resultant dilution in earnings per share and possible loss of control is also not considered important.

13. All hypotheses formulated for the research, stated earlier, have been tested and have been found statistically significant.

14. Our study of the secondary data makes us strongly believe that the SEBI’s role as a regulator will continue to be important; especially in view of the scams which the stock market is habituated to deal with not too infrequently. ‘Vanishing companies’ has been a phenomenon which Indian stock market has known for long. The ministry of Company Affairs has been vigilant against such entities. The role of the SEBI therefore is unlikely to diminish in near future.

**Contribution to knowledge**

The research has been useful in carrying out a thorough analysis of the IPO phenomenon, though the focus has been on the period 2002-2007. The difference in priorities of the Western and the Indian practitioners has been an
important research contribution. Many of the insights listed under findings and conclusions are unique since they are based on primary survey of IPO managers. Many of myths related to importance of the factors have been dispelled. The phenomenon of underpricing in Indian environment has been studied and well understood.

**Recommendations and scope for further research**

1. The IPO market is characterized by a phenomenon known as the Winner’s Curse. What it means is that the winner in a tussle to buy the shares may have to repent for having paid an excessive price. It is necessary to educate the investors about the possibility of a winner’s curse so that they can take an informed decision.

2. The marketing aspect of the IPO’s has not received adequate attention in academic circles in India; judging by the number of papers available on this subject. It is recommended that this form of marketing practice should be studied both through theory as well as through case studies. Hardly any studies exist at present on marketing of the securities.

3. Behavioral finance is an emerging field in the domain of corporate finance. The stock market, supposedly driven by ‘greed’ and ‘fear’ is a field of further study for a researcher in behavioral finance.

4. An emerging field in information technology is mobile computing. India already has a large mobile phone penetration. Subscribing for an IPO through a mobile hand set is well within the realm of possibility and may well offer the solution for ‘including’ a large semi urban and rural population in the IPO marketplace. This is a very promising area which we recommend for the attention of both technologists and marketers.

5. The IPO market in India is also expected to gain from the entry of foreign merchant/ investment bankers. They are expected to bring to the field their professional expertise in risk management and
operations management. An important area for future study is Global Depository Receipts (which are comparable to IPO of an Indian company in foreign markets), especially in view of growing institutional investment in Indian stock markets by foreign investors.

**Limitations**

The study carried out and has been severely handicapped by the availability of data, in spite of the fact that statistics related to the share market appears to be a part of large, well maintained data bases of investment firms. Information related to less known, obscure companies is almost unavailable.

**Key words:** Initial Public Offerings (IPOs), Investment Banks, Underwriter, Pricing Mechanisms (Auction, Fixed Price, and Book Building), Underpricing.

Parastoo Sedaghat
Research Student

Prof. Dr. Sharad L. Joshi
Research Guide