CHAPTER 1. INTRODUCTION
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The first public offering of equity shares of a company, which is followed by a listing of its shares on the stock market, is called the initial public offering (IPO). According to Chandra (2001), “the decision to go public, is a very important but not well studied question in finance. It is a complex decision which calls for carefully weighing the benefits against the costs. The benefits include access to capital, respectability, investor recognition, availing of a (financing) opportunity, liquidity, and diversification and getting signals from the market. The costs include adverse selection, dilution, and loss of flexibility, disclosure, accountability, public pressure and costs of the issue". It can be seen that both in the case of benefits and the costs, the factors involved have a financial as well as a behavioral angle.

The benefits and costs stated so succinctly by Chandra need to be explained in some detail to underline their importance. The IPO’s assist the promoters to have an access to capital; the very purpose behind forming a public limited company. The company attempts to attain respectability by going public; business entities which are otherwise less known as partnership firms or private limited companies attract public attention. By so doing, the promoters also achieve investor recognition. The IPO’s often attempt to avail of favorable investment climate. Substantial funds raised through IPO’s, offer liquidity; these may also provide opportunities to diversify the business. Response received from IPO’s good or bad, provides a signal about what the market thinks about the company and the promoters can take bold or cautious steps, as the case may be to plan the business.

The ‘costs’ as the indicated by Chandra can be explained as follows. The decision for going public can be wrong (in terms of size, timing, associates)
and may therefore misfire. This is adverse selection. Entry of thousands of new shareholders automatically results in dilution of control. The public limited company needs to be governed through a structured mode, and Disclosure norms of Registrar of companies and Securities and Exchange Board of India (SEBI) result in loss of flexibility. The visibility of a Public limited company creates accountability and public pressure. The finances obtained also involve substantial costs of the issue – higher than other modes of raising funds.

In terms of sheer size of finance, the Initial Public Offering is an episodic event, taking place once in a lifetime of a public corporation As David Westenberg (2011) states “successful completion of an IPO requires substantive knowledge of securities law, corporate finance, corporate governance, accounting, employee benefits, intellectual property, and stock exchange listing requirements. To complicate matters, much of the knowledge necessary to navigate the many dimensions of an IPO has typically been unwritten gloss that could only be gleaned through years of practice.”

According to Madan (2003), the initiation of the process of reforms in India would not have possible without changes in the regulatory framework in the capital market. The new Economic policy (1991) led to a major change in the said regulatory framework. The Capital Issues (Control) Act 1947 was repealed and the Office of the Controller of Capital Issues (CCI) was abolished. The Securities and Exchange Board of India (SEBI), established in 1988 and armed with statutory powers in 1992, came to be established as the regulatory body with the necessary authority and powers to regulate and reform the capital market. The CCI has been the regulatory body for over fifty years, which had a strong control over the Indian Capital market. Guidelines for issue of capital and pricing of securities had been rigid. The abolition of the CCI, doing away with control on pricing of capital issues and
easy access to capital market has been the necessary imperatives for the
growth in the IPO’s.

An important development in Initial Public Offerings of shares is
introduction of Book Building System – also known as price discovery. The
book-building system was introduced by SEBI on recommendations of Mr.
Y.H. Malegam in October 1995. It is considered a practical, fast and efficient
method for management of Mega-Issues. Book Building involves sale of
securities to the public and the institutional bidders on the basis of
predetermined price range. It is an innovative method of marketing securities
involving price determination and quantum of securities on the basis of the
demand from the prospective shareholders. In this process the SEBI (Market
Regulator) has issued various guidelines for control and regulation of book-
building process. Since inception of book-building process in India, share of
Mega Issues in total capital mobilized has increased from 60.1 per cent in
1994-95 to 92.3 per cent in 2003-04 (Gangadhar and Reddy 2005).

An important aspect of Financial Theory in the recent past is **Behavioral
Finance**. The stock market, which provides the backdrop for the IPO’s is said
to be driven by ‘greed’ on one hand and ‘fear’ on the other. These are both
behavioral factors. Several factors that influence investor behavior, discussed
in the subsequent paragraph are behavioral.

For the reasons stated, Initial Public Offerings is a theme which attracts
considerable attention in financial literature and among practitioners. Some of
the important and recurring facets of IPO’s are as follows.

1. The aftermarket price of the shares related to the IPO offer price. –
   Higher, as normally expected or otherwise.
2. Impact of market conditions on underpricing of IPO’s – since IPO’s
   are more likely to be underpriced, researchers have an interest in
   exploring and measuring factors that lead to underpricing.
3. Features of the book building and auction mechanisms which account for their differential impact on underpricing in favorable/unfavorable market.

4. Role of institutional investors in participation in IPOs, especially compensation they receive for the role they play in the IPO process.

5. Variation in underpricing depending on type of the companies – especially the Technology companies.

6. Impact on pricing due to being affiliated with a private business group, domestic Indian or foreign.

7. Tradeoff between Equity and Debt finance, especially investigating whether the firms prefer large equity finance.

8. Study of ‘infant’ companies; those which decide to go public without substantial business background.

9. Influence of high-priced investment bankers, auditors, and advertising agencies on success of IPO’s and on issue price.

10. Use of high pre-IPO dividends by companies going public.

11. Incentive for underpricing of securities in spite of this resulting in reduction of the funds received.

12. Impact Venture Capitalists on IPO’s and on level of underpricing.

13. Factors to be considered while deciding to create one or more share classes.

14. The factors leading to wide fluctuations in IPO volumes from year to year

15. Study of entrepreneurial decision on whether to go public.

Needless to say, each one of the issues needs to be researched and well understood.

The research carried out as a part of this project concerns Initial Public Offerings in the Indian stock market during the 5-year period, 2002-2007. The main reason for the choice the period chosen is that it is the most
immediate five year period for the research project, which was initiated in 2008. On hindsight, however, the period holds a special significance. The first two years of this, 2002-2004, were during the National Democratic Alliance (NDA) regime, the first and the only 'rightist' government which India has had over its post-independence history. This was also the period which was widely publicized as 'India shining' years. The following 3 years, belong to the United Progressive Alliance (UPA) regime. The economic momentum gained however had to be sustained, since India's growth story by than had gained currency and India was being considered as one of fastest growing economies of the world. The IPO's during this period have thus been in a growing and maturing stock market, supposed to have benefited from and later survived the global trends. The largest Indian IPO to date has been that of Coal India, in 2010, amounting to Rs. 15000 Cr Comparatively, larger IPO's during the period 2002-2007, were Oil and Natural Gas Commission (Rs. 9500 Cr), DLF (Rs. 9188 Cr), Cairn India (Rs. 5788 Cr), Tata Consultancy Services (Rs. 5420 Cr) and National Thermal Power Corporation (Rs. 5388 Cr). In the year 2007 alone, 105 IPO's had been on offer adding to Rs. 39387 Crores. The period 2002-2007 has thus been an active phase as far as the IPO's are concerned.

In spite of research studies carried out in the past, the unique nature of the IPO’s during the period 2002-2007 therefore need to be studied.