CHAPTER I
INTRODUCTION AND DESIGN OF THE STUDY

1.1 Introduction

The capital market in India has witnessed spectacular growth during the nineties. The trend was overwhelmingly euphoric in consequence with the process of reforms and the gradual shift towards economic liberalization replacing controls by the free market forces. A sound capital market is an essential condition for a rapid economic growth of a country. It enables corporate sector to raise resources for gainful employment in industries, reducing dependence on the institutional financing agencies. With the number of Indian companies opting to get listed each year is increasing, equity market’s role in financing India’s economic growth has expanded greatly. The primary issue market, an important constituent of capital market provides the base for capital formation with direct participation of small investors investing their savings (resources) in the shares newly offered by corporate sector.

Public issues can be either initial public offering or follow on public offerings. When an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities for the first time to the public it is known as initial public offering (IPO). Shares issued by an already listed company on a stock exchange are called a further public offering (FPO). Till May 1992, the issue of capital by companies was controlled by the Government under the Capital Issues (Control) Act, 1947. The control was exercised through the Office of the Controller of Capital
Issues, which also regulated the pricing of such issues. The SEBI took hold of the primary market in 1992.

Buoyed by the bull phase and an unrelenting appreciation in stock prices in 2004-05, the initial public offering market was quite active in 2005-06. The bullishness in the secondary market always spills over to the primary market. Indian companies mobilized ₹51,459 crore through public offers, rights issues and private placements during this year. In contrast, through financial year 2005-06, the banks lent ₹42,976 crore to medium and large industries as a whole. With the four-fold rise in the prices of listed stocks since 2003 market capitalization of Indian stocks at about ₹23.57 lakh crore was substantially higher than the total outstanding bank credit of ₹13 lakh crore. A mere five percent expansion in equity can deliver resources to the tune of ₹1,18,000 crore for Indian companies, that is substantially higher than what industry borrows from banks each year. During this period as many as 18 companies in BSE 200 including public sector firms such as MTNL and National Aluminum were zero debt firms. One fourth of firms that were part of BSE 200 had outstanding loans of less than ₹50 crore.

Before the Sensex came tumbling down from its 12,671 peak in May 2006, the sentiments of the bourses got carried over into the IPO market and many companies tapped the capital market to ride the upbeat sentiments by pricing their shares aggressively. This list includes some high-profile companies such as Jet Airways, Shopper’s Stop, Suzlon Energy and Reliance Petroleum. It also featured the stock
market debuts by some unconventional companies in new business such as multiplexes, aviation and broadcasting hitherto unpresented on the stock market.\textsuperscript{4}

Initial public offering floated in the post April 2006 had, on an average, received subscription for 12 times their offer size.\textsuperscript{5} Secondary market conditions at the time of the offer and the sector to which the company belonged have also played a big role in deciding investor responses. Offers made during the market melts down in May-June 2006 (Unity Infra Projects, Deccan Aviation) and during the December reversal (Cairn Energy) elicited a lukewarm investor response. But investors were willing to make exceptions for companies from “hot” sectors or themes. Offerings from companies with the infrastructure or real-estate tag (Sobha Developers - subscribed 113 times, Parsvnath Developers – 50 times) and technology or dotcom companies (Info Edge – 55 times, Tech Mahindra – 70 times) have sailed through, even if they opened amidst uncertain market conditions.

The primary market for corporate securities witnessed a sudden dip in 2010–2011 due to the 30.55 percent drop in capital raised through private placements. The resources raised through public issues witnessed a dip of 2.55 percent from ₹254,790 million (US $ 5,644 million) in 2009–2010 to ₹248,300 million (US $ 5,561 million) in 2010–2011.

New reforms by the SEBI, in the primary market, included improved disclosure standards, introduction of prudential norms and simplification of issue procedures. Companies are now required to disclose all material facts and specific risk factors associated with their projects while making public issues. The SEBI has also
introduced a code or advertisements for public issues for ensuring fair and true picture. In order to reduce the cost of issue, the underwriting of issues has been made optional subject to the conditions that if the subscription is less than 90 per cent of the amount offered, the entire amount collected would be refunded to the investors.

The book-building process in the primary market has been introduced with a view to strengthen the price fixing process. Indian companies have been allowed to raise funds from abroad by issue of ADR/GDR/FCCB and the like. In a bid to protect investors amid a rush for public offers by corporate India, the Government has decided to scrutinize all the IPOs that garnered more than ₹50 crores to ascertain that funds were utilized for declared purposes. Regulations governing underwriters, registrars to an issue and share transfer agents and portfolio managers were notified bringing these institutions within a regulatory purview for the first time. These intermediaries require registration from the SEBI subject to certain authorization criteria and capital adequacy norms. Over the years the SEBI has taken several initiatives to improve the operational efficiency and transparency of the primary market, which provides investors with the issues of high quality.

As part of this drive, the Ministry of Company Affairs has directed the Registrar of Companies (ROC) to “keep under watch” the IPOs that hit the market since 2004, garnering an estimated ₹25000 crore. During this period, Indian market was inundated by a number of mega and medium-sized public offers including Reliance Petroleum, TCS, Patni Computers, Biocon, NDTV, Indiabulls, Jet Airways and Suzlon. The move coincides with market regulator SEBI’s stern action against
two depositories NSDL and CDSL and eight depository participants such as Karvy Stock Broking among other market players in the IPO scam. The Ministry of Company Affairs has launched a massive operation against vanishing companies, apart from strengthening efforts against serious corporate offenders through the Serious Fraud Investigation Office.

The growth of the primary issue market cannot be achieved without confidence and participation of the retail investors. According to Securities and Exchange Board of India (SEBI) “Retail individual investor means an investor who applies or bids for securities of or for a value of not more than 2,00,000. Retail investor is an individual who purchases small amounts of securities for him/herself, as opposed to an institutional investor. They are also called individual investors or small investors. Individual investor purchases securities for his/her own personal account rather than for an organization. Retail investors typically trade in much smaller amounts than institutional investors such as mutual funds, pensions, or university endowments. Though, their individual contribution may be small but, when it is summed it will become a huge amount.

Retail investors seem to have kept their faith intact in the stock market despite volatile market conditions. According to data from Central Depository Services Ltd and National Securities Depository Ltd, BSE sensex in a year saw a loss of around 24 per cent. The number of de-mat accounts grew by 5 per cent or 8 lakh between January 2011 and November 2011. De-mat accounts are those through which investors trade in the share market. Similarly, the number of such accounts rose by 17
per cent to 2 crore at the end of November 2011 from 1.7 crore at the end of January 2010. Low inflation-adjusted returns from debt options might have led individual investors to conclude that equities may be a better bet for the long term.

Yet, in 2012 retail investors' participation in the equity cash market is at a seven-year low. The savings found their way to properties, gold, risk-free avenues like bank deposits and high-yield debt instruments. The daily average volume of retail turnover is down to ₹6,690 crore in 2012 - the lowest since 2005 and a 51 percent drop from the peak of ₹13,709 crore in 2009. The daily average volume generated by retail investors was ₹10,882 crore in 2010 and ₹6,690 crore in 2011.

1.2 Statement of the Problem

Primary market provides a platform for the companies to raise funds to start a new venture or for expanding the existing one. It facilitates the flow of funds from the savers to the industrialists. This helps to promote the industrial development and the nation at large. Raising of funds in the primary market mostly depends on the secondary market and macro-economic factors. A robust economy encourages the companies to access the primary market for funds. At the same time during the period of recession companies shun away from the primary market. Reform measures that were undertaken in the stock markets had a profound effect in the primary market. Repeal of the Capital Controller Act and free pricing regulations in the primary market made many new companies approach the primary market.
Primary market gives opportunities to the retail investors to acquire a stake in blue chip companies of both public sector and private sector companies. The latest trend among the companies and merchant bankers is to price the issue aggressively. They wanted maximum premium from the investors. But the basic question remains, whether IPO’s are successful and what happens to them in the secondary market. Most of the stocks were quoted at a discounted price. If the scrip quotes below the subscription rate, the investor stands to lose. The historical data show that there is a perfect co-relationship between the Sensex and money mobilized through primary market. When the Sensex touched at all time at high 6000 plus region, the primary market raised an aggregate of ₹14,290 Crore through IPO route in 2001-02. The primary market was worst affected, as only six equity issues (2011-12) could tap the market raising ₹1013 crore, while plenty of them were deferred.

Sometimes there were astromical gains by subscribing to the new issues. The investors in 2005 gained a good quantum of money by subscribing to stocks such as Saksoft, FCS Software, Bartronics, Gateway Distriparks and Bharati Shipyard. With the recognition of this heightened interest among retail investors, Standard Chartered Mutual Funds has even come out with a fund that invests only in IPO’s. In 2011 though over 70 companies went to the market to raise funds (about 40 per cent more than in 2010), the number of issues that disappointed investors outstripped the good ones. The latter category were Educomp Solutions and Atlanta (both multi-baggers), Tech Mahindra, Parsvanth Developers, Info Edge and DCB, on the flip side, several issues, notably that of low cost pioneer Air Deccan and of a clutch of other mid- and
small-cap outfits, dashed investor expectations. Yet, some other companies have performed well in the market.

Widened use of the online trading and better access to financial information has increased the number of retail investors in recent years. To encourage the retail investors SEBI permitted them to apply for more shares in public offers, without breaching the Rs 2 lakh per application limit required for qualifying as a retail investor. This would enable them to target an extra 5 percent in such issues. SEBI has asked merchant bankers, who hand-hold companies during public offers, to allow retail investors to apply at the discounted price, rather than at the pre-discounted price, in all initial public offerings (IPOs) and follow-on public offerings (FPOs). Investor confidence is vital for the healthy growth and development of a capital market and the investors. In this context, it is essential to study the performance of primary market along with the investors’ investment motives, preferences and investments pattern, the motivating factors and disfavoring factors which determine their investment decision in the primary issue market.

1.3 Objectives of the study

The objectives of the study are given as follows.

- To document the growth and development of the new issue market in India
- To analyse the new equity issues in the stock market in 2011-12
- To estimate the post listing return and volatility in the return of the newly issued stocks after listing.
• To study the factors influencing the investment in primary market
• To analyse the investors’ investment pattern in new issues, risk and return in the primary market.
• To offer suggestions on the basis of findings of the study.

1.4 Scope of the study

The present study deals with the performance of the primary market during a select period inclusive of share price movements of IPOs in 2011-12 on Bombay Stock Exchange and National Stock Exchange after listing and investors’ investment pattern related factors in the new issues.

1.5 Data

Both primary and secondary data are used. The secondary data are collected from newspapers such as Business Line, The Hindu, books, stock exchange official directory, the RBI Annual Reports and Websites.

Primary data are collected from the investors with structured questionnaires. Before undertaking the survey, the pre-test was conducted and then the questionnaires were modified and restricted suitably.

1.6 Sample

Chennai and Coimbatore was selected for the purpose of collecting primary data; as the regional stock exchanges are situated in Tamilnadu only in these cities. Non probability sampling method has been adopted to select the sample.
The sample respondents are the investors in stock markets during 2011-12. Out of 300 samples 175 respondents are from Chennai and remaining from Coimbatore. The researcher visited these cities on different dates and collected data from the investors.

1.7 Tools

*Kendall’s Co-efficient of Concordance*

Kendall’s co-efficient of concordance test is used to compare the rankings given by the investors’ on the basis of their personal factors and object of investment on various factors. The formula used is

\[ W = \frac{S}{\frac{1}{12} k^2 (n^3 - n)} \]

Where

\[ S = \sum (R_j - R_j)^2 \]

\[ R_j = \text{Sum of ranks}, \ R_j = \text{Average of ranks}; \]

\[ K = \text{Number of sets of rankings. (the number of judges)} \]

\[ N = \text{Number of objects ranked}, \]

To see whether the value of \( W \) is significant or not, table value of \( S \) is referred. If the calculated value of \( S \) is less than the table value, it is interpreted that the ranking by different categories do not differ significantly and the null hypothesis is accepted.

When there is a tie ranking, the formula used to calculate \( W \) is:

\[ W = \frac{S}{\frac{1}{12} k^2 (n^3 - n) - k \sum t} \]
Where \( \sum t = \frac{(r^2-t)}{12} \)

\( T = \) Number of observations in a group tied for a given rank.

**Chi-square Test**

The Chi-square test is applied to see whether the opinions of the investors are associated to other related factors. The formula for Chi-square is

\[
\chi^2 = \sum \frac{(O-E)^2}{E}
\]

with \((r - 1) (c - 1)\) degrees of freedom

Where

\( O = \) Observed frequency

\( E = \) Expected frequency

\( r = \) Number of rows in a contingency table.

\( c = \) Number of columns in a contingency table.

The computed \( \chi^2 \) value is compared with the table value at 5 per cent level of significance to draw inference. The null hypothesis is rejected if the computed \( \chi^2 \) value is higher than the table value for a given degree of freedom and vice versa.

**Inter day Volatility**

The inter day volatility is studied with the help of standard deviation \((\sigma)\)

\[
\sigma = \sqrt{\frac{\sum(x - \bar{x})^2}{n-1}}
\]

Where

\( x = \) variable

\( n = \) number of observation
**Parkinson’s Model (Intra-day Volatility)**

The high low volatility is computed by the Parkinson’s model. This model is used to denote high and low volatility of extreme movements and dispersion in the daily price during the trading time.

\[
\sigma = K \sqrt{\frac{1}{n} \sum \log \left( \frac{H_i}{L_i} \right)^2}
\]

Where \( k = 0.601; \) \( H_1 = \text{Intra-day high}; \) \( L_1 = \text{Intra-day low} \)

**Geographic Concentration Index**

To find out the degree of concentration of primary market issue to various regions, geographic concentration index is used. To find out the degree of concentration of region-wise issue of IPOs, geographic concentration index is used.

Geographic Concentration Index

\[
C = \sqrt{\frac{1}{n} \sum \frac{x_i}{x}}^2 \times 100
\]

\( x_i = \) refers to the issue mobilized to a particular region
\( x = \) refers to the total issues mobilized from primary market

Higher the value of the geographic concentration index, higher also is the flow of quantum of issue mobilized to the particular region.
1.9 Limitations of the Study

This study was limited to two cities i.e., Chennai and Coimbatore only and some of the particulars sought were furnished out of their memory. Hence the collected data were not free from recall bias to a certain extent. Moreover a general tendency towards an understatement of income (return) and assets and overstatement of expenditure and risk among the respondents were noticed. However, efforts were taken to minimize the bias by cross checking.

1.10 Scheme of the Reports

This report has been organized and presented in eight chapters.

The introduction, statement of problem, scope of the study, objectives of the study, scope of the study, data, sample, tools for analysis, limitations of the study and the chapter scheme are presented in the first chapter.

Second chapter presents the review of literature.

An overview of the new issue market is given in the third chapter.

An analysis of primary market is done in the fourth chapter.

Post-listing returns and volatilites of stocks are analysed in the fifth chapter.

The investors in primary issue market are studied in the sixth chapter.

An analysis of investors’ risk and return profile in the primary market is given in the seventh chapter.

The final chapter sums up the findings and conclusions of the study.
References:


3. ibid

4. ibid

5. ibid


