

Pricing of IPO: Inefficiency of Indian Capital Market Effecting Sources of Business Finance

Abstract

This paper attempts to give a brief overview of detailed investigation carried out by researcher on how inefficiency of Indian capital market is affecting the companies in getting equity financing. The research is based on IPO's that were listed at NSE from January 2001 to December 2015. With effect from 1999, SEBI has allowed investment banks to use Book-building process of IPO for better price discovery. However the objective was not achieved. It was found that there were certain factors which affected IPO pricing like underwriter's goodwill, firm's characteristics, industry classification, delay in listing, and at times intentional under pricing which resulted into under pricing of IPO.

Keywords: IPO, Book-Building, Inefficiency, under pricing.

Introduction

Indian IPO market has witnessed a phenomenal change after new industrial policy and introduction of SEBI as a regulator in securities market. The decision of using IPO for financing or making public offering of equity is very important decision in business cycle. It's a milestone decision. Due to its presumed importance, it has become one of the most widely researched topics in the finance literature. Companies are using this source of finance for many reasons like

1. To raise capital at lower cost,
2. Offering liquidity to existing holders,
3. To increase company goodwill in the market,
4. To increase chances of potential mergers & acquisitions,
5. To finance its growth & expansion strategies etc.

Pricing of IPO is a very crucial problem in the complete issuing process. It is fundamentally related to interest of all parties and will eventually be affecting the interest of firm in long run. A review of literature has shown that in Indian capital market the major lacuna is regarding pricing of IPO's. Most of the IPO's that were issued in our country are overpriced and thus on the day of listing their prices tumble down.

The IPO Market in India is on the boom as more and more companies are issuing equity shares in the capital market. With the introduction of the open market economy, in the 1990s, the IPO Market went through its share of policy changes, reforms and restructuring. The important development was the introduction of the free pricing mechanism. This step helped one in developing the IPO Market in India, as the companies were permitted to freely price the issues. This mechanism permitted the companies to raise funds from the primary market at competitive price.

An IPO may be priced either on Fixed Price Method or Book Building method or a combination of both. Book-built pricing gives investors a better opportunity to take a call on the price they are willing to pay. The companies only specifies the 'floor price' & 'cap price' and the investors are making a bid in between these prices. The most popular price is selected as the cut-off price & share are issued on cut-off price to those who bids above cut-off price.

The world financial markets (USA & UK) have come a long way. In the US markets, the IPO market has grown anifold in number and volume. The NYSE and the AMEX did not allow for transactions in equity securities of small companies

Review of Literature

Studies probing IPO cardinal activity are diverse. The researches done in the field are related to post-issue stock performance, valuation, ownership and structuring issues. The review is given as under:



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SP Ferris, Q Hao, My Lio (2013) in their article "The Effect of Issuer Conservation on IPO Pricing and Performance" studies that conservatism is inversely related to the firm's operating performance for 3 years following the IPO.

Ansari V. Ahmed (2006) studied the IPO underpricing in India during the period of 2005 and found that the average first-day return (underpricing) was 40.9 percent which is quite substantial

E Bajao, C Raimondo (2017) studied that media coverage play a great role for conveying IPO information to investors, which helps a company to effectively place its IPO.

Seshadev Sahoo and Prabina Rajib (2010) evaluated the price performance of IPOs with respect to short-run underpricing and long-run underperformance for 92 Indian IPOs.

Objective of Study

The study is aimed at analyzing the IPO market in India and the initial returns on IPO.

Result and Discussion

IPO investment is done by three types of investors with different objectives.

1. The first types of investors are called as 'Fly by investor' who invests for listing gain.
2. The second type of investor may be called the short term investor who invests for Short term capital gain.
3. The third type of investors may be called as long term investor who wishes to stay for long term gain.

The investment decision of first category investor is based on three points of information i.e. 1) Red herring prospectus; 2) Lowest price in the price band & Highest price in the price band and 3) Listing price

The second type of investor i.e. short-term investor would be driven by various factors such as a price trend of the share, a trend of the index and volatility in the market. The third type of investor i.e. long term investor wants to be assured of the true price.

As far as first category of investors is concerned the listing price is of at most importance. While for the

other two post IPO performance is a major issue. We further investigate the post-IPO performance of firms to gain some insight into the long term survival and stock market performance of the firms that issued an IPO. The table below gives an insight of the various IPO's during research period.

Year	Amount (in crores)	No. of Issues
2001-02	1,082	6
2002-03	1,039	6
2003-04	17,807	28
2004-05	21,432	29
2005-06	23,676	102
2006-07	24,993	85
2007-08	52,219	90
2008-09	2,034	21
2009-10	46,941	44
2010-11	46,182	57
2011-12	23,982	36
2012-13	34,313	44
2013-14	15,234	83
2014-15	29,716	39
2015-16	34,322	42

Table 1: IPO Activity in India during 2001-2015 Analysis

Among the above IPO's nearly 70% of IPO's are traded below listing price and the investors are losing their hard earned money. Only around 30% of these IPO's are making money in the market. But some companies among these are able to grab very high rates like Majestic Research services & Solutions Ltd. (3092.94%), Suyog Telematics Ltd. (1283.4 %), Umiya Tubes Ltd. (1100.00%). Among the top losers Anshus Clothing Ltd (93.37%), Bronze Infra-Tech Ltd (93.33%), Tara Jewels Ltd (88.98 %) etc.

Best Performing IPO's

Scheme Name	Issue Price	List Price	LTP	CHG(%)
Majestic Research Services & Solutions Ltd	12.75	140	407.1	3092.94
Suyog Telematics Ltd	25	25.2	345.85	1283.40
Umiya Tubes Ltd	10	10.5	120	1100.00
Dhabriya Polywood Ltd	15	16.5	164.85	999.00
Ashapura Intimates Fashion Ltd	40	48.05	412.8	932.00
SRG Housing Finance Ltd	20	20.3	192.75	863.75
Atishay Ltd	16	17.75	138	762.50
V-Mart Retail Ltd	210	216	1145.55	445.50
Kushal Tradelink Ltd	35	35	176.8	405.14
Oceanaa Biotek industries Ltd	10	9.75	49.95	399.50

Worst Performing IPO

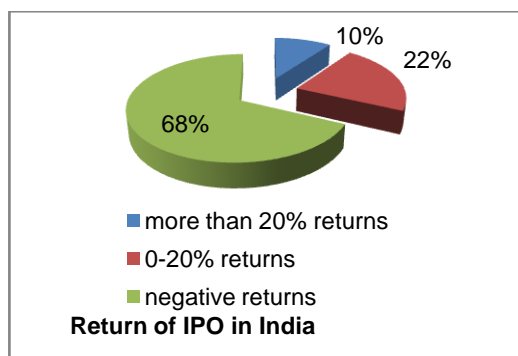
Scheme Name	Issue Price	List Price	LTP	CHG(%)
Anshus Clothing Ltd	27	26.85	1.79	-93.37
Bronze Infra-Tech Ltd	15	16.7	1	-93.33
Tara Jewels Ltd	230	242	25.35	-88.98
GCM Capital Advisors Ltd	20	33.55	2.66	-86.70

eDynamics Solutions Ltd	25	25.4	6.05	-75.80
Radhika Jeweltech Ltd	75	73.95	19.2	-74.40
Amrapali Capital and Finance Services Ltd	100	100.6	25.77	-74.23
VKJ Infradevelopers Ltd	25	23.8	7.21	-71.16
Satkar Finlease Ltd	18	19.9	6	-66.67
Ortel Communications Ltd	181	181	65.15	-64.01

One can see in above data that neither the top gainers nor the top losers are big brands. One major reason for that was found was the role of underwriters in the complete issue process. They do not incorporate public information while deciding prices and when these IPO's are traded in secondary market these are driven by market sentiments more than logics. Institutional investors as well as retail investors just make their decisions mainly on the basis of market sentiments. if market is in good condition and company is also showing a promising position then IPO becomes successful otherwise it fails.

For issuing of IPO there are strict norms laid down a company need to fulfill SEBI eligibility criteria, Provisions of Companies Act, Promoters contribution & lock-in requirement, Post issue Stock Exchange requirement etc. In spite of these steps IPO are still not able to earn required finance for the company. Also many companies do not resort to IPO as a means of financing their issue due to the complications involved in it. An attempt was made for improving this condition by changing grading norms of IPO; still it has been observed that a highly graded IPO is going to falsely cheat the investors. If we analyze returns on IPO the picture will be clearer

Returns	% of IPO
Negative returns	68%
0-20% returns	22%
More than 20% returns	10%



A research was conducted for around 300 investors who invest in IPO located at various places in Rajasthan and it was analyzed that most of the time when they are not able to generate good returns on their investment.

Conclusion

The proposal for this study is targeted towards understanding whether the IPO issues in recent times is efficient or not. From the above analysis it is very much clear that in the last one and half decade IPO's has faced the problems which researcher has stated and due to that only these failed to gain their actual price. SEBI should take measures to assure investors about the price band so that their hard earned money is not wasted. Investor education is also very much required.

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