



A Study on Performance of IPOs in Indian Stock Market

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Abstract

One of the biggest investment opportunity which is considered by investors is Initial Public Offer (IPO) for which many investors wait to invest in. This paper attempts to study the performance of IPO over short and long term (one year) that how IPOs generate return over a period of time. And whether investors should invest in IPOs just for speculation that is to take listing gains or they should hold the shares over a period of time to earn fair enough amount of return. Raw Returns, Market Adjusted Excess Returns(MAER) are calculated and Result revealed that nine IPOs studied performed well not only at the time of listing but also investment in the IPOs for long term generated around double digit profits for the investors.

Keyword: -IPO, investors, Raw Returns, MAER.

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INTRODUCTION

An initial public offering (IPO) is a key in signpost in a company's growth. A strong IPO market is essential for many reasons. IPOs provide the emerging companies liquidity for their funds. An IPO brings in new investors for a company, which facilitates the company's access to future development capital. And once public also reduces the costs of raising future capital by stimulating the supply of information from the investment population. The cost of external equity capital for companies going public depends not only upon the transaction costs incurred in going public but also upon the returns that investors receive in the aftermarket(Ritter 1991).

IPO's are time and again looked upon as a speculative outlook to earn abnormal profits on the listing day. Companies which decide to go public had to face the extra pressure of the market



which demands to focus more on short term profits rather than long-term growth. The actions of the company's management also become gradually more scrutinized as investors constantly eye for rising profits.

There are numerous reasons why the long-run performance of initial public offerings is of importance. But from an investor's point of view the presence of price patterns may provide opportunities for trading to generate superior returns. Also the returns of IPOs were predicted with the number of times the issue got the subscription (Shah 1995). For long-run underperformance for Indian IPOs, factors like under pricing (listing day return), offer size, timing of issue, age of IPO Company, and rate of subscription, promoter retention, and price-to-book value are considered (Sahoo & Rajib 2010).

The performance of IPO can be measured in two ways the short-run and long-run performance. The short-run performance is usually measured over a period of a few days to a month upto a year after an IPO, while the long-run performance is investigated looking at periods longer than a year. This paper attempts to evaluate performance of IPOs up to a period of 12 months including the listing day.

REVIEW OF LITERATURE

Ritter (1984) examined over 5000 IPOs from 1960 to 1982 and reports initial return of 18.8% higher than the offering price shortly after listing. In addition, during the 15-month period, the mean return of common stocks purchased at the offer price and sold at the closing bid price on the first day of public trading was 48.4%. This is in distinction to a mean return of 16.3% during the remainder of the 6-year period 1977 through 1982.

Shah (1995) in the study of 2056 IPOs from the period of January 1991 to May 1995 recognized an exceptionally 105.6% higher return over the offer price of the IPOs. Nevertheless, this study provided confirmation on the short run performance only.

Rajan & Servaes (1997) developed a simple model in their work in which two market conditions change over time investor sentiment and feedback trader risk. The model shows that these



conditions partially explain the three anomalies associated with the IPO market under pricing, windows opportunity for new issues and long-term underperformance. The model is tested using a sample of company's IPOs over the period of 1975-1987.

Banu Durukan (2002) studied IPO from 1990 to 1997 listed on Istanbul Stock Exchange found that the initial abnormal returns of IPOs is due to overvaluation of share done by the investors on listing.

Ritter & Welch (2002) confirmed, with some concern, the initial evidence of long-term IPO underperformance and examined IPO underperformance using 6249 IPOs in the United States over the period from 1980 to 2001 and found that the number of IPOs varies from year to year, and that their shares were underpriced by an average of 18.8%.

Sahoo & Rajib (2010) evaluated the price performance of IPOs for short-run under pricing and long-run underperformance for 92 Indian IPOs for the period 2002-2006 up to a period of 3 years including the listing day. The result revealed that on an average the Indian IPOs are underpriced to the tune of 46.55% on the listing day compared to the index performance in the same duration.

Kumar (2010) studied the performance of IPOs issued through the book building process on NSE in India during the year 1999 to 2006. The sample comprises of 156 company IPOs and found that the IPOs in Indian market were underpriced as they offered positive returns on listing day and this continued upto two year period but later they underperform the market.

Poornima & Haji & Deepha (2016) in their study said that IPOs perform well when they are hold for a considerable duration of time of a year.

OBJECTIVE OF STUDY

- To measure IPOs Listing day Performance in Indian Stock Market.
- To study the long term performance of IPOs in Indian Stock Market.



RESEARCH METHODOLOGY

The Sample

To analyze the performance of IPO the sample of 9 companies whose IPO's got listed on the National Stock Exchange (NSE) along with issue size more than 1000 crore has been selected during the time period of July 2015-Dec 2016.

Tools for data collection

Secondary data of opening and closing prices of shares was collected from National Stock Exchange website along with the offer documents of companies studied were consulted for dates and prices of shares offered.

Tools for data analysis

Various statistical techniques have been applied to analyze the secondary data. Data was analyzed using MS Excel to find out Initial return, Quarterly gains, Average return, Annualizing return, Market adjusted excess return.

The return on the listing day (R) short term return is calculated by using the formula:

$$R = (P1 - P0) / P0 * 100 \dots\dots\dots \text{Eq. (i)}$$

Where, P1 = Price of share on the listing day

P0 = Issue price

To measure the raw return of IPOs, whether an investor gained or lost by buying the share during the IPO on offer date and selling at the prevailing price on the opening day the following formula was used

$$R_i = (P2 - P0) / P0 * 100 \dots\dots\dots \text{Eq. (ii)}$$

Where,

R_i = subscribers initial return

P₂ = closing price on the first day of trading

P₀ = offer price



Market adjusted excess returns (MAER)

The initial returns would be valid in a perfect market, where there is no time gap between the application closing date and first day of trading. On the other hand in India there was time gap between this and a major macro and micro changes could occur in market. Due to this the prices observed in the market on the listing day may be different from the offer price therefore there is need to compute market adjusted returns of the IPOs for the same period. Therefore, the initial return is adjusted for market return as under:

$$\text{MAER} = \left[\frac{(P1 - P0)}{P0} - \frac{(M1 - M0)}{M0} \right] * 100 \dots\dots\dots \text{Eq. (iii)}$$

Where,

P1 = closing price on the first day of trading

P0 = offer price

M1 = market index on the first day of trading

M0 = market index on the offer date

MAER = market adjusted excess return

Annualizing factor

Since for different companies, the time taken to list the shares varies, so as to normalize, annualized returns are calculated by multiplying Raw Return and MAER by the following factor

$$\text{Annualizing factor} = 365 / \text{aftermarket trading lead time}$$

To evaluate long-term performance of Indian IPOs, long-term returns (including initial returns) has been measured. These figures were compared with the market index (nifty50) in order to calculate long term MAERs. The following formula has been applied for this purpose.

$$\text{Rit} = \left[\left\{ \frac{\text{Pit}}{\text{Pio}} \right\} - 1 \right] * 100$$

$$\text{Rmt} = \left[\left\{ \frac{\text{Nmt}}{\text{Nmo}} \right\} - 1 \right] * 100$$

$$\text{MAER} = \text{Rit} - \text{Rmt}$$

Where, Pit = price of the share of firm i at time t

Pio = offer price of share of the ith firm

Nmt = nifty at time t

Nmo = nifty on the offer day

Rit = raw return of firm i at time t

Rmt = return on market index during period t

MAER = market adjusted excess returns

As mentioned earlier, annualized long run returns (including initial returns) have been calculated by taking into consideration annualizing factor.

Annualized Raw Return = Rit*Annualized Factor

Annualized MAER = MAER*Annualized Factor

RESULTS AND FINDINGS

Table I IPO performance calculations using Ri, Rit , MAER Annualized MAER ,Averages, Listing Gains along with mean and standard deviation.

Company	Rit = Raw return of firm	MAE R	Annualized Raw Return	Annualized MAER	Listing opening gains	Listing closing gains Ri=(p1-p0/p0)*100
Equitas Holdings Ltd.	26.81	11.55	38.34	4.43	33.11	24.03
Mahanagar Gas Ltd.	90.74	75.29	180.57	135.95	42.10	36.92
L&T Infotech Ltd.	10.13	-6.38	22.60	-1.44	-5.39	-1.04
RBL Bank Ltd.	81.90	69.02	244.87	169.00	22.41	33.66
ICICI Prudential Life Insurance Company Ltd.	30.67	16.73	120.22	20.11	10	-0.81

Endurance Technologies Ltd.	69.59	52.41	347.93	182.34	22.48	38.52
PNB Housing Finance Ltd.	57.16	35.35	385.81	136.37	14.66	18.82
Varun Beverages Ltd.	9.72	-10.88	66.85	-7.27	-2.27	4.43
Laurus Labs Ltd.	10.41	-18.70	316.51	-59.18	15	12.76
Mean	43.01	24.93	191.52	64.47	16.9	18.58
Standard Deviation	32.33	34.92	138.48	90.45	15.32	15.75

Findings of the research showed highest 33.11% of listing gains in Equitas Holdings Ltd. against lowest of -5.39% in L&T Infotech. Seven out of nine IPOs studied showed double digit short term positive return on listing which reflect investor's interest in IPOs may be to tap this gain as all IPOs provided positive raw return and with more than 22% of annualized raw return in all IPOs.

Also listed IPOs continued to provide double digit return on their listing day closing with loss in only one IPO of less than a percent which strengthens investors trust over the performance of IPOs and denied the general market thought that IPOs were merely speculative opportunities.

Mahanagar gas Ltd provided 75.29% of MAER followed by RBL bank Ltd 69.02%. Three IPOs Laurus Labs Ltd., Varun Beverages Ltd., L&T Infotech Ltd. fail to beat the index as they showed negative MAER and Annualized MAER provides the Endurance Technologies Ltd. with 182.34 % became the highest performing IPO followed by RBL bank ltd with 169%. Along with the following results IPOs performance is concluded that the returns are the high when the shares are bought in the primary market and sold in the secondary market and this performance continued till a year.

CONCLUSION



The study done is broadly in thought of line that near the peak of the market they are trending in. When analyzing long-run performance using MAER; IPOs do not underperform over one year, in fact the IPOs showed over performance. Upon Listing IPOs on an average offered positive short and long term (one year) return but findings are not conclusive over a one year period of time as above one year IPOs performance is not analyzed. These results suggest that one must be careful in concluding whether IPOs underperform or over perform over Long term.

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