Advances in Economics and Business Management (AEBM)
p-ISSN: 2394-1545; e-ISSN: 2394-1553; Volume 3, Issue 9; October-December, 2016, pp. 922-926

http://www.krishisanskriti.org/Publication.html

The Scenario of Initial Public Offerings (IPOs) Market in Indian Capital Market

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Preamble— (This paper starts with introduction and covers origination, evolution and background of IPOs in Indian capital market, pricing methods of IPO and IPO market in India. Moreover it covers the anomalies and particular objectives of study. In particular, IPO capital market, issues and problems is an off shoot of this paper. Which consider certain important anomalies such as positive first day return on listing day (called underpricing), short run underpricing, long run performance and determinants influencing underpricing and long run performance). It ends with summary.

1.1 Prologue

India has been undertaking a series of economic reforms since first reforms in 1991, gradually moving toward market economic development by introducing more foreign investments (FDIs and FIIs) recently which is one of the key development in Indian economy. Besides Government allow firms to raise the fund by issuing various kinds of securities like bonds, debentures and equity stocks to the public. The government established a regulatory body by the name of SEBI in 1992, which take care of interest of investors by producing certain guidelines, rules and regulations. India provides an interesting case study of IPOs because of its importance in the transition from mixed economy to modern market economy. So an understanding of the performance and the characteristics of the Indian IPO markets becomes the focus of attention for investors at home and abroad.

Post liberalization of capital markets in the year 1993, the Indian market has encouraged closer to the world economy. As such, the policy changes and regulations of the Indian capital market have vigorously advanced as per the requirements of the economy.

1.2 Initial public offering (IPO)

For the new company can raise fund or capital for its operations from the general public through issuing equity or debt. And when a company decides to sell its shares for the first time ever to public, it is called an Initial Public Offer (hereinafter as 'IPO'). Fund raising via IPO, give an opportunity to unlisted firm to get listed on recognized stock exchange and becomes a public entity.

An IPO, or Initial Public Offering, is the sale of shares by a company to the public for the first time. (source - http://www.chittorgarh.com). Initial public offering (IPO) is the most favoured tool adopted by corporate to raise money from public. Technically, it is said that a company is 'going public'. An IPO is the first sale of stock by, formerly a private company. The revolutionary reform which took place in Indian stock market was fair price discovery of IPO through book building mechanism (Trivedi and Soni, 2012).

1.3 Why firms go to public: "Going public" view

IPOs (Initial Public Offerings have been a great source of tapping finance (Sahoo, 2012), thus, enabling a firm to growth in terms of expansion and diversification of business. Rock (1986) quotes that for the two reasons a company enters the new issue market. 1. To refinance the firm, 2. to finance the new investments. If a company needs additional equity capital at some point in time, then it is desirable to 'go public' by selling its shares to a large number of diversified investors. A company usually goes public via an initial public offering (IPO) of their shares to investors. However, "going public" is not easy as there are many costs and rules/regulations attached to it. The various costs include transaction costs, underwriting and legal fees. Factors such as issue size (capital raised), age, operating performance, market condition all influence this decision of "going public".

According to historical research the acquition is the most primary and important motivational factor to go public (Brav and Fawcett, 2004).

"Going public" adds value to a firm due to increased liquidity, heightened visibility, more monitoring, and better avenues for raising capital (Chadha, 2003, pg. 3).

(Ritter, 1991) and (Loughran and Ritter, 1995) put forward that companies go to IPOs to take advantage of favorable windows (timing) that allow them to get the most attractive offering prices. Market timing is driven by the attractiveness of the IPO market. The first-day security price performance of firms going public signals other firms to decide to go public (Lowery and Schwert, 2002). Choe, Masulis, and Nanda (1999) poster that firms prefer to go public when other good firms are currently issuing. (Lowery, 2002) argue that firms go public when they reach a certain point in the business growth cycle and need more external equity capital to continue to grow and expand the business.

1.4 The public offerings: Indian capital market

The primary market in India has been formed uniquely by a remarkable history of regulation (SEBI) coupled with the institutional details of how IPOs take place. The total capital INR 400, 123 Cr, raised by 6,154 equity offerings from 1989 to July 2015 which includes IPOs, FPOs and offer for sale (OFS). (Refer table 1; enclosed in Annexures 1)

Table 1: Capital called through equity offerings (IPOs, FPOs and OFS)

Table 1: Capital called through equity offerings (IPOs, FPOs and OFS)								
TOTAL AMOUNT OF GROSS PROCEEDS FROM 1990 TO 2015								
YEAR	**AMOUNT IN INR (CR.)**	**NO. OF ISSUES**	**YEAR**	**AMOUNT IN INR (CR.)**	**NO. OF ISSUES**	**YEAR**	**AMOUNT IN INR (CR.)**	**NO. OF ISSUES**
1989-90	2,522	186	1999-00	2,975	56	2009-10	46,941	44
1990-91	1,450	140	2000-01	2,380	110	2010-11	46,182	57
1991-92	1,400	195	2001-02	1,082	6	2011-12	23,982	36
1992-93	5,651	526	2002-03	1,039	6	2012-13	34,313	44
1993-94	10,824	765	2003-04	17,807	28	2013-14	15,234	82
1994-95	12,928	1336	2004-05	21,432	29	2014-15	29,705	36
1995-96	8,723	1402	2005-06	23,676	102	2015-16 (as on 31/07/15)	6,294	9
1996-97	4,372	684	2006-07	24,993	85			
1997-98	1,132	58	2007-08	52,219	90			
1998-99	504	22	2008-09	2,034	21			
Source: Prime data base- home page (access on 25-08-2015)								

1.4.a Capital Market: The Indian market is broadly dispersed into two parts namely: a. Primary capital market, b. Secondary capital market. The primary market facilitates the issuance of new securities while secondary market facilitates the trading of existing securities. A Primary market provides funds to the initial issuer of securities. Primary market operations include new issues by new and existing companies, and governments. The issues may be of equity shares, rights issue, offer for sale, Follow on shares, Debentures and bonds.

"The performance of the primary market depends on the health of the secondary market as Policy paralysis, rupee depreciation, volatile and sluggish markets, and foreign fund outflows affected the secondary markets in a big way". (Jagannadham Thunuguntla, research head, SMC Global). Source - http://archive.indianexpress.com/news/22-ipos-withdrawn-in-2012, Wed Jul 04 2012. The secondary market creates liquidity through trading of shares for investors. Some securities are more active and can therefore be traded or marketed more readily. This is an important feature of the secondary market.

The Equity segment of the Primary market in India has come a long way in terms of raising money. The Indian IPO market is big. The market capitalization of India is vast as a percent of the total GDP, with respect to other developed countries (such as US, UK, Japan, Australia) that have a higher ratio of the market capitalization of their stock exchanges respective to the size of their economy.

1.5 Fund mobilization on National Stock Exchange (NSE)

Since the year 2007-08, 74 companies were listed through IPO and the amount mobilized through issuance of IPOs was Rs.41, 899.13 crore (US $ 10,482.64 million). The biggest IPO was that of Reliance Power Limited from the Infrastructure sector whose issue size was Rs.11, 563.20 crore (US $ 2,893 million). DLF Limited was the second largest IPO during the year, issue size of which was Rs.9, 187.50 crore (US $ 2,299 million) followed by Power Grid Corporation of India Ltd. with issue size of Rs.2, 984.45 crore (US $ 746.67 million). In the year 201-11, 51 issues raised 33,391 crore. In the year 2009-10, 33 companies were listed through IPO mobilizing an amount of `23,684 crore (US $ 5,247 million). NHPC Limited was the largest IPO raised 6,038.55 crore (US $ 1,337.74 million) followed by Adani Power Limited raising 3,016.52 crore (US $ 668.26 million).

Table 3: Depicts the details of fund mobilization on NSE since 2006 to 2015.

Table No. 3: Fund Mobilisation			
Year	**No. of Issues**	**Amount in Rs. (cr.)**	**Amount in us $ (%)**
2007-08	74	41899	10.42
2008-09	19	3833	7.52
2009-10	33	23684	5.24
2010-11	51	33391	7.48
2011-12	26	4871	0.95
2012-13	12	6289	1.16
2013-14	5	1230	0.21
2014- 15	8	1462	0.23
http://www.nseindia.com/research/dynaContent/nse_factbook.htm			

1.6 IPO issuance method trend in India:

The book building method is more preferable by issuers than fixed price method. The following graph and table represents fact about trend of issuance method.

Table 5: Represents equity offerings in Indian capital market via methods from 2006 to 2015

Year	Book build	Fixed price	Total
2015	15	28	43
2014	6	40	46
2013	4	35	39
2012	11	14	25
2011	38	1	39
2010	71	2	73
2009	21	0	21
2008	33	5	38
2007	92	14	106
2006	69	22	91

***** this graph showing a decreasing trend of offerings sine 2006 to 2015, offerings via book build method is decreasing after 2010 and via fixed price is increasing. There is inverse relationship between both methods.

1.7 The prospects and problems associated with IPOs

Research in this direction has been conducted in various countries across the world. Numerous empirical evidences have been ploughed by researches on firm specific characteristics and issue specific characteristics at developed and emerging economy. In this present study the research focused on the under-pricing phenomenon in the Indian capital market prevalent here along with price performance of IPOs in long run. To analyse the short- and long-run performance of newly issued equities have been of significant interest to researchers and academics alike. This interest may be related to the importance of the IPO market for economic growth. More importantly, however, the specific return behavior or "market anomalies" of IPOs created, on the one hand, immense profit opportunities for investors but, on the other hand, tremendous risks as well. Consequently, a large number of theoretical explanations and empirical research have been developed to explain this phenomenon. In particular, empirical studies have investigated the underpricing, determinants causing underpricing, short run price performance and long-run price performance of Initial Public Offerings (IPOs) in the United States, UK, Germany, Canada, Australia and other countries.

For the Indian capital market there have been a number of empirical studies that analyze the underpricing, causing underpricing, short run price performance and long-run price performance of initial public offerings. These studies, however, produce some conflicting results (e.g., huge spreads in underpricing within analyzed periods, long-run underperformance (SSS, Kumar, 2008) versus neutral and positive performance (shah, 1995; Madhusoodan and Thripalraju, 1997) dependent on the benchmark used.)

1.8 Conclusion

For many years, the high listing day returns produced by IPOs is one of the greatest challenges to market efficiency. Recently In this context, Lao and Zhou (2012) advocates that underpricing adjust to market efficiency itself in a long run. Consequently, many studies have been done in order to explain this phenomenon. Ritter (1991) ploughed that higher listing day return leads to poor return in long run. Ibbotson & Jaffe (1975) have identified a significant correlation between the number of IPOs and the monthly average returns. Higher the number of IPO activities higher the expected underpricing as it signals to hot market (Beatty & Ritter, 1986). According to Wyatt (2013) explored the use of gross proceeds can be used as a meaningful source of information to investors as it is significant to predict future value of IPO firm.

In particular, IPO performance is an off shoot of this present study. Which consider certain important anomalies such as positive first day return on listing day (called underpricing), short run underpricing, long run performance and determinants influencing underpricing).

The study of Initial Public Offerings (IPOs) is a subject area of corporate finance, presenting a robust theoretical and empirical background in terms of various approaches like underpricing phenomenon, short term performance, long term performance and determinants influencing underpricing, short term performance and long term performance as well.

There has been comparatively few studies done on following anomalies: IPO under-pricing; factors causing underpricing, short run price performance and long-run price performance in India than developed countries. The empirical evidences on underpricing phenomenon and long run performance in US {(Ibbotson 1975), (Ibbotson and Jaffee 1975), (Ritter 1984), (Miller and Reilly 1987), (Carter and Manaster 1990), (Tinic 1988), (Sindelar and Ritter 1988), (Beatty and Ritter 1986), (Ritter 1991), (Loughran and Ritter 1995), Ljungqvist; Nanda and Singh (2001), (Ritter 2002), (Agarwal; Krigman and Womack 2002), Abhyankar and Ho (2003)}, in UK {(levis 1993), Khurshed; Goergen and Mudambi (1999)}, in brazil, Chile and Maxico {(Aggarwal; Leal and Hernandez 1993)}, in Australia { Perera, and Kulendran, (2012), Wyatt (2013)}, in Sweden {(Rydqvist 1993)}, in Switzerland {(Kunz and Agarwal 1994)} and in developing countries namely Hongkong {(Dowson 1987)}, Korean {(Kim; Krinsky and Lee 1991)}China { Su and Fleisher (1997), Zhongguang,Wei (2004), Tian and Megginson (2007) Abidin; Reddy and Zhu (2009), Zhou and Lao (2012), Song; Tan and Yi (2014), Malaysia {Zaluki; compbell and Goodacre (2006), Yonesi; Ardekani & Hashemijoo, (2012), Rashid and Rahim, (2012), Zarafat and Vejzagic (2014)}.

The underpricing of IPOs is one of the most studied anomalies at a global level since the first study was carried by Ibbotson, 1975, asserted a mean initial return 11.4%. Further Ibbotson and Jaffe, 1975 found 16.8% mean average return and than followed by Ritter, 1984 showed 18.8% mean initial return.

Than putting a forward analytical approach in context of the cause of higher listing day return (underpricing), the concept of information asymmetry introduced by Rock in a USA market as an explanatory theory. This is known as Rock's 1986 IPO theory.

There is an asymmetry of information between the investors and the company going public (Rock, 1986). While the company wants to maximize subscription levels, the investor wants to maximize returns. The company thus underprices its IPO. However, this information is not known to all. The extent and scenery of under-pricing is an unknown and some how unpredictable outcome. Investors can make use of this missing information (Purnanandam and Swaminathan, 2004). The time period for which this under-pricing can persist is also quite long from one year to up to five years (Ritter, 1991; Ritter and Welch, 2002).

For decades, researchers have been disagreed on the extent and predictability of abnormal stocks' price performance generated by initial public offerings (IPOs) (Smith, 2008). (Lao and Zhou, 2012) quote that abnormal returns exist only in a short-run time, while the long-run return is poor (Pg. no. 847).

Moreover, Underpricing and Underperformance has been an eminent feature of IPOs in all markets across different periods and are the most studied phenomena in the IPO literature.

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