A Study on Performance Evaluation of Initial Public Offerings (IPOs) in India during 2007-13

Srinivasa Rao Dokku, Department of Business Administration, P.V.P. Siddhartha Institute of Technology, Vijayawada, India

Rajesh Choudary Jampala, Department of Commerce and Business Administration, P.B. Siddhartha College of Arts and Science, Vijayawada, India

P. Adi Lakshmi, Department of Business Administration, P.V.P. Siddhartha Institute of Technology, Vijayawada, India

ABSTRACT

The authors analyze 146 Indian Initial Public Offerings (IPOs) that were listed in Bombay Stock Exchange (BSE) between January 2007 and December 2009. The units of the sample are selected on the basis of companies available in the Indian stock market for three years for calculating short-term and long-term returns. The evidence suggests that the IPOs are initial day underpriced by 4.25 per cent and underperformed by 29.06 per cent after 36 months of listing. The study also finds that issue variables are highly influencing the IPOs performance in short run and long run but age of the company doesn’t have any influence on its performance during the study period. The JEL classifications are G12, G14, G24, and G32.

Keywords: India, IPOs, Long-Run, Returns, Short-Run

1. INTRODUCTION

Capital market plays an extremely important role in promoting and sustaining the growth of an economy. It is an important and efficient conduit to channel and mobilize funds to enterprises, and provide an effective source of investment in the economy. It plays a critical role in mobilizing savings for investment in productive assets, with a view to enhancing a country’s long-term growth prospects, and thus acts as a major catalyst in transforming the economy into a more efficient, innovative and competitive marketplace within the global arena.

The Indian capital market has undergone tremendous changes since the initiation of the
liberalisation programme by government and has evolved as a vibrant system of investment flows. A dynamic capital market is an important segment of the financial system as it plays an important role in mobilising savings and channelising them for productive purposes.

During the last decade, the Indian capital market has grown dramatically in respect of number of stock exchanges, listed companies, new issues, market capitalisation, trading volumes and the number of shareholders. Efficient functioning of such an expanding market naturally calls for constant evaluation of its operations so as to enable the policy makers to correct deficiencies, if any, and provide direction for its growth. The present study is an attempt in this direction.

The Indian capital market has evolved dramatically over the past two decades. However, India still has a long way to go. The total market capitalization of all listed companies in India is nearly 65 percent of the GDP at present as compared to the US at nearly 90 percent, Thailand and Korea at about 100 percent and Malaysia and the UK at about 150 percent. Even starker, the value of total Debt Capital Market (DCM) in India is only 34 percent of GDP as compared to China at 49 percent, Brazil at 68 percent and the US at 177 percent. And corporate debt market is even smaller accounting for only 20 percent of all debt in the case of India. Corporate debt in India is nearly 8 percent of GDP as compared to 16 percent in China, 19 percent Brazil and 130 percent in the US. India has a very high household savings rate. In fact, along with China, India has the highest savings rate in the world. If one was to segment the savings, nearly 50 percent of all savings is in physical assets like real estate and gold, while the remaining 50 percent in financial assets, of which equity (both direct and through mutual funds) is a small percentage, just less than 4 percent of total household savings.

1.1. Review and Need for the Study

An evaluation on Indian IPOs is timely in the light of the many developments in primary market in consequence to the SEBI’s permission for free fixation premia for public issues. Indian corporate sector started raising equity substantially to finance either their expansion or diversification plans in addition to venturing into newer lines of business.

The free pricing policy has motivated many hitherto closely held companies to offer shares to public thus making the primary market to witness hectic activity, synchronising with the series of reforms brought in Indian Economy. Unprecedented rise in small issues promoted by first generation promoters, sometimes ‘fly by night’ operators has called for suitable policy changes for efficient regulatory mechanism, prompting the Government and SEBI to increase their surveillance and enforcement activities. As a result at present only those companies with considerable track record are only issuing IPOs.

In free-pricing era, pricing of equity has become very important in a company’s capitalisation effort. Merchant Bankers are expected to play a significant role in price fixation decision which will have a greater bearing on the success of an issue. Presently public issues are routed through book building process which considers to be efficient mechanism when compared to fixed price method followed earlier. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process. This exploratory study focuses at identifying the rationality and justification associated with fixing premia in select IPOs. An evaluation on IPO underpricing, goes a long way in redesigning the strategies for sustaining growth in IPO market in Indian context.

1.2. Studies on Performance of IPOs

Various studies have been conducted by researchers to understand the short-run behaviour
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