A Study on Factors Influencing the Initial Public Offerings (IPO) in the Bombay Stock Exchange (BSE), India: During 2007-2013

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ABSTRACT

This study has examined the IPO performance in India from 2007 to 2013. Results show that under-pricing exists in the first day of trading during the particular period, but results show that the degree of under-pricing is dramatically decreased in comparison with what is shown in previous studies. The study finds that the IPOs are influenced by its issue variables. The face value of the shares and oversubscription subscription of the share are highly affected factor for underpriced in initial day of listing. After 36 months of listing the IPOs are underperformed by 29.06 percent and market capitalisation of the firm, issue premium of the share, face value of the share, issue price, and oversubscription of IPOs are highly influencing IPOs performance in long run. The study has considered 146 companies for identifying the factors influencing the Initial Public Offerings (IPO) in the Bombay Stock Exchange (BSE), India.

KEYWORDS:
Face Value, India, Initial Public Offering, Issue Size, Oversubscription, Stock Market, Under-Pricing

1. INTRODUCTION

Capital market is one of the most important segments of the Indian financial system. It is the market available to the companies for meeting their requirements of the long-term funds. It refers to all the facilities and the institutional arrangements for borrowing and lending funds. In other words, it is concerned with the raising of money capital for purposes of making long-term investments. The market consists of a number of individuals and institutions (including the Government) that channelize the supply and demand for long-term capital and claims on it. The demand for long term capital comes predominantly from private sector manufacturing industries, agriculture sector, trade and the Government agencies.

One of the prime functions of a capital market is to channelise resources towards productive purposes. The ability to market securities offered to the public depends on fixing a correct price closer to the intrinsic value of a given asset successfully. Initial Public Offerings (IPOs) have become an important segment of the capital market in recent years. The unprecedented growth in this segment of the capital market has attracted the attention of many towards its sustainability which essentially calls for evaluating the efficiency of the Indian IPO market, particularly in ‘liberalised’ environment.

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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.

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.

The Indian stock market has been particularly volatile in the past few years. The present scenario points to a dangerously shrinking investor population that has rendered the IPO market almost inactive. It has become extremely difficult for the corporate sector to raise equity capital. In financial year 2010-11, 72 firms cancelled their IPO plans, and 58 Indian companies let their regulatory approval for their IPOs lapse in the 2011-12. In the same period, 34 firms issued their IPOs but raised only Rs 58 billion, which was the second lowest since the financial year 2005, when 23 companies raised a much larger amount of Rs 146 billion. Impacted by the dull market and uncertain investment climate, 22 firms have called off their IPOs targeted to raise an aggregate Rs 83 billion this year despite approval. The companies failed to launch their IPOs within the validity period. All these companies had Securities and Exchange Board of India (SEBI) approval for their IPOs.

The number of IPOs has reached the peak in the years of 2007 and 2010 where in the amount raised went up to Rs. 33,946.22 and Rs. 36,362.18 crores, respectively. The policy initiatives taken by the Government of India to liberalise the economy and encourage privatisation and to move towards globalisation are the major reasons for the spurt in the primary market. However, in 2011 onwards, the number of new issues have fallen dramatically, but the amount collected from the market was marginally higher when compared to the previous year. The main reasons, among others, for low primary market activities in recent years are mainly the economic slowdown, political uncertainty, depressed secondary market conditions and lack of investors’ interest. The global economic downturn that followed did hit the markets hard - the BSE Sensex touched 8000 levels in March 2009. Table 1 shows the year wise IPOs and capital mobilisation during the study period. During the year 2007, total 108 companies are issued IPOs out of that 4 companies failed to attract the investors and 104 companies succeeded to mobilise the capital from primary market. The numbers of IPOs have decreased from 108 in the year 2007 to 29 in 2014.

1.1. Evaluation of Indian IPOs

Table 2 shows the total performance of IPO from 2007 to October 2014. Out of the 349 issues that hit the market since 2007, nearly two-thirds (258 to be precise) are trading below their issue price. While 2007 was a boom year, 2008 and the early part of 2009 saw massive falls in equity valuations. The recovery since then doesn’t seem to have done enough to help the valuations of these IPOs. Even conservative investors would have got higher returns. Investing in a fixed deposit at 8% would have given returns of 25.97% before taxes over three years. Only 91 of the 349 issues have given positive
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