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SHORT RUN & LONG RUN PERFORMANCE OF IPO & FPO – INDIAN STOCK MARKET

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Abstract

Now-a-days, Initial Public Offer (IPO) has become one of the preferred investments for the Investor. Performance of the IPO varies in accordance with the market i.e. bullish to bearish. This study examines listing day performance of IPOs, book-built and fixed-price IPOs, post-listing aftermarket performance of IPOs, book-built and fixed-price IPOs in the Indian stock market. For the individual investor, it is tough to predict about the performance of stock or shares on its initial day of trading and in the near future since there is often little historical data for the technical analysis of the stock. Also, most IPOs are of companies going through a transitory growth period, and they are therefore subject to additional uncertainty regarding their future value. We examine pricing as well as long run performance.

Keywords

IPO, FPO, Under-pricing, Over-pricing, Stock Returns, CAAR

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Introduction

There have been two major anomalies concerning IPO literature worldwide—listing day underpricing and post-listing underperformance in the medium to long run. Closing price on the listing day for IPOs has been much higher than the issue price which is termed as "underpricing" of IPOs. When the returns of these IPOs are calculated for one, three or five years (starting from the closing price on the listing day), the market-adjusted returns have been significantly negative.

Indian market need to be studied because of the strides it has made in the post-liberalisation period. Many reforms were introduced by the Securities and Exchange Board of India (SEBI) to ensure transparency in the Indian stock market. These reform measures include dematerialisation, demutualisation of stock exchanges, electronic trading system, shorter trading cycles, rolling settlement, circuit filters, derivatives trading, credit rating, IPO grading, lock-in period for promoter holding, price–volume tracking in the trading system, time bound application and allotment of securities, buy-back of shares, mandatory disclosure of securities pledged by promoters with banks for raising loan and book-building process for IPOs. These reforms have transformed Indian stock market and attracted the capital from foreign institutional investors (FIIs) by way of direct investment and portfolio investment. India has national as well as regional stock exchanges but the trading volume is restricted to two prominent exchanges, The Bombay Stock Exchange (BSE) and the National Stock Exchange of India limited (NSE). The total market capitalisation of BSE is around Rs.1,44,90,494 crores as of 17 November 2017. Out of 5,567 companies listed on BSE, 5,146 companies have shares listed on the equity segment. However, about 2,924 companies are traded on the market with 22,70,86,007 orders being placed by the investors. BSE has introduced a number of stock market indices to track the market movement. The prominent among them are the S&P BSE Sensex, S&P BSE Sensex 50, S&P BSE-100, S&P BSE-200, S&P BSE mid-cap, S&P BSE small-cap. Apart from these general indices, there are also sectoral indices. NSE is relatively younger exchange but has captured the market share of the daily volumes both on cash and derivatives segment. Trading mechanism on both these stock exchanges in India is based on an open electronic limit order book where order matching is done by the trading computer. The entire process is order driven where orders placed by investors are matched with the best available limit orders, automatically. This means, both buyers and sellers remain unidentified in the entire process. Such order-driven market ensures more transparency in the entire process. All orders are placed through registered brokers who provide online trading facility to retail investors. However, institutional investors can use **Direct Market Access (DMA)** option where they can use trading terminals provided by their brokers and place orders directly into the trading system. The settlement cycle for equity spot market is **T+2** rolling settlement. With all these features, Indian market presents an interesting scenario to study one of the issues of capital market, the performance of IPOs. While there have been well-documented studies on the western market on the pricing and performance of IPOs, the literature on the Indian market is scanty in this area. Therefore, we examine pricing as well as long run performance of IPOs in Indian stock market.

Review of Literature

The underpricing of initial public offerings (IPOs) is referred to in the literature as one of the anomalies observed in primary markets all over the world. The extent of it, however, varies from country to country. Underpricing refers to the positive initial returns over the offer to listing dates of the new issues. It is defined as the percentage difference between the closing price on the listing date from the offer price of the issue. It is a cost to the issuers and has drawn considerable attention in the academic literature over the last three decades.

In India, **Narasimhan and Ramana (1995)** found significant underpricing of Indian IPOs consistent with international observations. Study also revealed that premium issues are underpriced than par issues attempting to identify the causal variables responsible for underpricing of Indian IPOs.

Chaturvedi, Pandey, and Ghosh (2006) found that the extent of oversubscription of an IPO determines the first day gain; signals that lead to oversubscription are market index during the period of IPO, type and nature of business, foreign collaboration, or the track record of promoters/company.

Garg, Arora, and Singla (2008) also documented that Indian IPOs are significantly underpriced and noted that the level of underpricing does not vary much in the hot and cold IPO market.

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S S S Kumar (2010) In the long run the IPOs offered positive returns up till twenty four months but subsequently they underperform the market. Studying book-built and fixed-price IPOs in India.

Bora, Adhikary, and Jha (2012) found underpricing of 21.42% for fixed-price IPOs and 18.22% for book-built IPOs. However, when adjusted for market movement, the corresponding figures are 16.71 and 16.75, respectively.

Einar (2015) using a sample of more than 5,000 IPOs, documented significant abnormal returns up towards 5% (excluding Initial Day Returns) during the first months of trading. These abnormal returns are greater and more persistent if general market conditions are strong, supporting a bounded rationality explanation.

Objectives of the study

This study analyses both initial pricing and long run performance of IPOs. Therefore, the objectives of the study are:

- To ascertain the factors contributing to the under pricing or over pricing of IPO in India.
- To ascertain the listing day performance (underpricing) of IPOs in India.
- To ascertain post-listing aftermarket performance of IPOs in India.
- To analyse post-listing aftermarket performance of book-built and fixed-price IPOs, separately.

Research problem

One major source of business financing is through Initial Public Offerings (IPOs). Historically, IPOs received high initial first day gains compared to the market performance. These gains reflect external factors and not the company’s true value, thereby suggesting the under-priced IPO. The recent researches on IPOs in different markets for different industries in various countries have focused on under-pricing and show that the under-pricing is evident in case of book-building route as well as fixed price-band offers. This study attempts to identify causal variables behind high initial gains for Indian IPOs using earlier researches and

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testing them over a sample of Indian IPOs to examine the influence of non-fundamental factors and signaling effects on under-pricing.

Scope of the proposed study

The scope of the study is limited to only the IPO's issued.

Data Collection

The study is based on the secondary data. Secondary data has been collected from the National Stock Exchange of India. The data is collected for the period 2001 to 2017 for IPOs and FPOs and there are total 375 listed IPOs and 9 FPOs in this period. The collected data is given in the table below:

Table 1 IPOs

Years	**No of IPOs**	**No of listed IPOs**
2001	2	1
2002	2	1
2003	5	5
2004	21	14
2005	50	40
2006	73	72
2007	94	89
2008	36	32
2009	21	20
2010	71	69
2011	41	39
2012	12	9
2013	6	4
2014	8	6
2015	23	21
2016	27	2
2017	55	53

Table 2 F

Years	**No of FPOs**	**No of listed FPOs**
2006	1	0
2007	2	0
2008	0	0
2009	0	0
2010	5	5
2011	2	2
2012	0	0
2013	1	1
2014	1	1
2015	0	0
2016	0	0
2017	0	0

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Post-Listing Performance:

Present study uses cumulative average abnormal return (CAAR) to evaluate the long run performance of IPOs. Excluding the initial return, which is based on the offer price and listing day closing price, daily returns are computed using the adjusted closing price starting from the listing day. The daily raw return for security i, is computed as under:

$$R_{it} = \frac{P_{it} - P_{it-1}}{P_{it-1}}$$

where, *Rit* is the raw return on security *i* for day *t*, *Pit* is the adjusted closing price of security *i* on day *t* and *Pit*−1is the adjusted closing price of security *i* on day *t*−1.

The market return for the same period is computed as under:

$$R_{mt} = \frac{I_t - I_{t-1}}{I_{t-1}}$$

where, *Rmt* is the market returns on day *t*, *It* is the closing index level on day *t* and *It*−1 is the closing index level on day *t*−1. Daily benchmark-adjusted returns are calculated as daily raw return on the security minus the daily benchmark return for the corresponding day. Using return on BSE 200 as the market return, the benchmark-adjusted return (abnormal return) for stock *i* on day *t* is defined as:

$$\mathrm{AR}_{it} = R_{it} - R_{mt}$$

Key Indicators:

1. **Issue price**: The price at which a company's shares are offered to the market for the first time, which might be at par or at a premium or discount. In case of Book building issue, the issue price is decided by the registrar after receiving all the applications for the shares. When they begin to be traded, the market price may be above or below the issue price.

2. **List price:** After closing of the issue the IPO lists on the stock exchange. The Market price after the listing on the stock exchange is known as the list price of the issue. The list price reflects the market expectations associated with the company performance in the future.

3. **Age**: The difference of the time in years from the year of incorporation of the company and the year when the company came with the IPO in the market.

4. **Subscription**: An IPO subscription is an offer to a buyer to purchase soon-to-be issued Stocks. The subscription is expressed in terms to the times, by which the issue is subscribed. The subscription represents the demand of the IPO among the investors in the market.

5. **Issue Size:** Issue size is the amount which a company wants to raise by offering equity shares to the public.

6. **Listing day return:** This is the return earned by the investor by selling the allotted shares on the listing day.

7. **Long term returns:** In case the investor holds the allotted shares for longer period and sells them thereafter then the returns earned are considered as long term returns. There long term returns should also be adjusted with the market return in order to analyze the performance of individual IPOs.

8. **Market (Benchmark Index) Return:** The Nifty index is considered as the benchmark index for the study.

9. **IPO Grading:** IPO Grading is provided by SEBI approved rating agencies including CRISIL, CARE and ICRA. IPO Grading is designed to provide investors an independent,

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reliable and consistent assessment of the fundamentals of IPO Issuer Companies. As IPO Grading is decided much earlier than the issue price or issue dates are finalize (usually on the IPO filing) and they just tell about the fundamentals of the company.

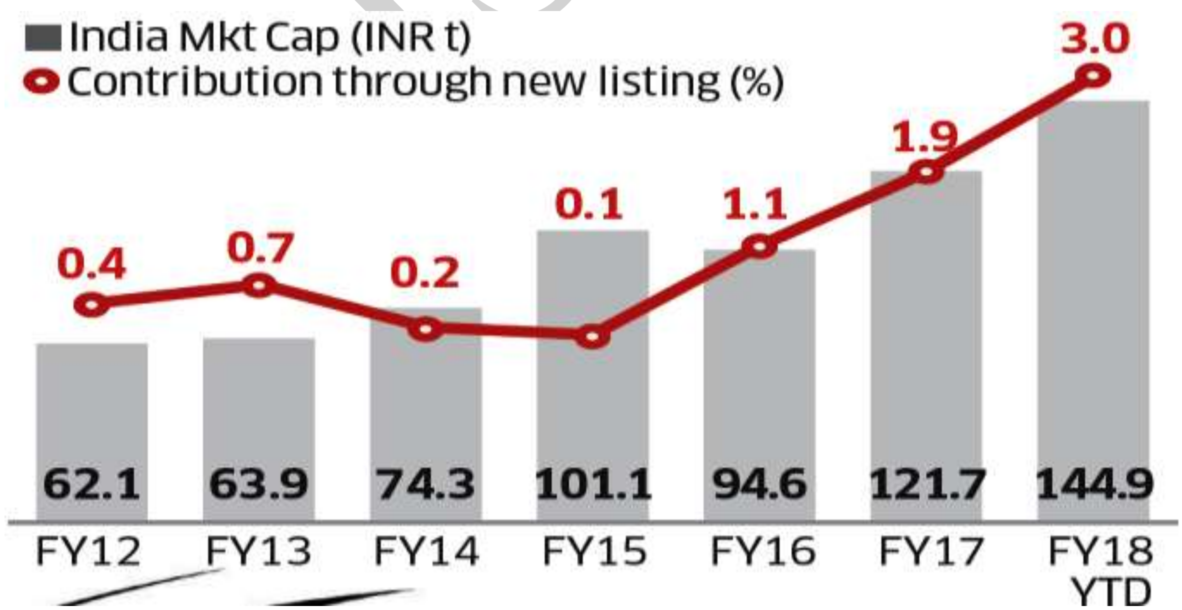
10. **Promoters' holding after the Issue:** This variable represents percentage of shares held by the promoters after the issue.

11. **Dummy variables** for bearish and Bullish period

12. **Market Adjusted Return:** The returns of the IPO over and above the market returns for the same period (From last day of the closing up to the listing day when IPO got listed on the stock exchange) is the market adjusted return.

13. **Long Term Performance:** The returns provided by the IPOs in one, two and three years after the listing over and above the market returns for the same period represents the long run performance of the IPO.

Recent Analysis:



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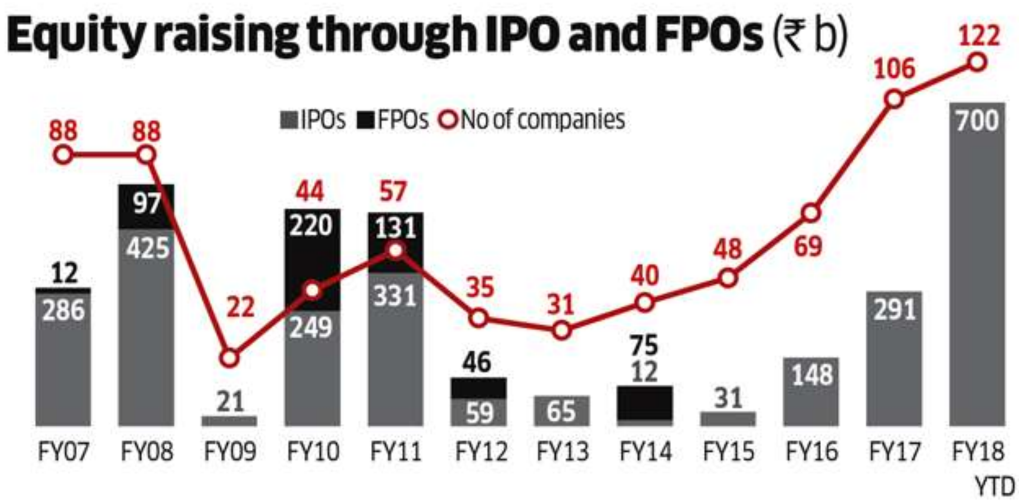
1. **Top Five in Fund Raising IPO**

Sector	Size (₹ b)	No. of Cos	Subscription (₹ b)	Times Over Subscribed
Insurance	434.3	5	1,031	2.4
NBFC	66.8	8	3,936	58.9
Construction	63.2	9	782	12.4
Misc	30	26	1,193	39.7
Consumer	23.9	9	980	41

Source: Motilal Oswal research



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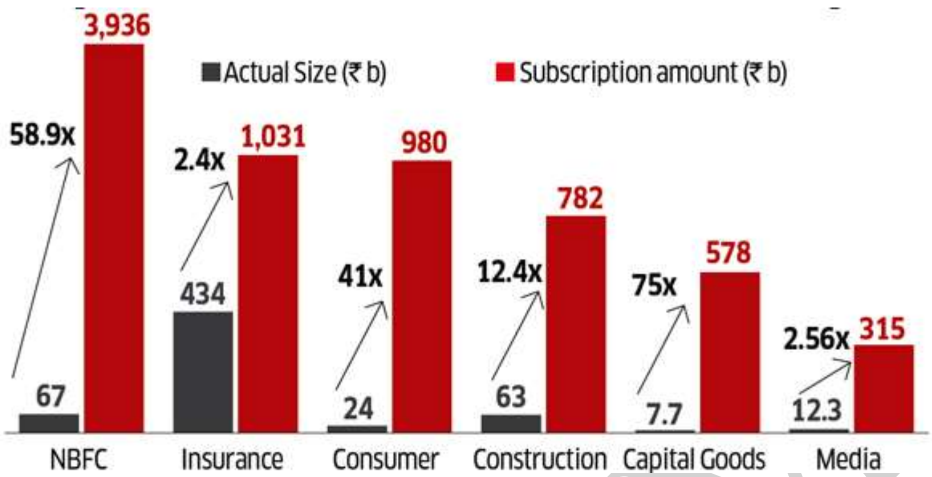
2. **Top Sectors that saw massive subscription**



Conclusion:

Initial public offerings consider as sale of company's stock to the public for the first time, when an IPO gets listed on the stock exchange there are certain parameters to evaluate the performance of the IPO. The performance of IPO can be evaluated in short run as well as in long run, for short run say after 1 month of listing, after 3 months of listing, after 6 months of listing and for long run it can be after 1 year of listing, after 2 years of listing, after 3 years of listing. IPOs can be underpriced, overpriced or they can be normal priced. Underpricing of an IPO means when listing price is more than offer price, over pricing means when offer price is more than listing price and normal priced means when both the prices are same. Offer price and listing price are two different prices. Offer price is price at which company issues the share to public but listing price is that price at which IPO gets listed in the stock market. On these two parameters, the price performance of an IPO is being evaluated. IPO and FPO performance is analyzed by applying different models such as MAAR, BHAR, CAAR. CAAR model (cumulative average abnormal return) to evaluate the long run performance of IPOs and FPO. It has been noticed that IPO and FPO behave differently in different phases, the behavior of IPO and FPO after 1 month of listing is different as compared to after 3 years of listing.

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