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Short-Term Performance of Indian Initial Public Offerings (IPOs)


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Abstract

The pricing of IPO's in the short-term has been analyzed by several theoretical and empirical studies referring to the world's major stock markets. Studies have also observed that IPOs cause increase in price considerably on the first day of trading and provide huge returns to investors who buy at the initial offer price and sell immediately in the secondary market. This research presents the results of the analysis related to the short-term performance of the Indian IPOs under study. Event study methodology is used to analyze the short term performance of IPOs from January 2016 to December 2022 issued in Bombay Stock Exchange (BSE), India. The average positive return on the listing day is 18.5 percent which indicates that the IPOs are underpriced.

Keywords: Initial Public Offer, Market Adjusted Abnormal Return, Listing Returns, Abnormal Returns, Wealth Relative, Pricing Behaviour

Introduction

An Initial Public Offering is one of the ways in which a corporate raises capital in the primary market, also called as 'going public', is the largest source of funds with long or indefinite maturity for the company. IPOs gives an opportunity for the investors to buy the shares of the company at offer price. Various studies reveal that there is difference between the price which the company decides for their shares and the price at which the investor is willing to buy them and this gives the investor a good listing gain for the shares allotted. From the company's perspective, IPO's help them to know the real value of their shares through millions of investors once it is listed in the stock market.

Literature Review

(Kumar and Narang) found that average market adjusted abnormal return for 488 IPOs is 82.67 percent. The results reveal that during the study period 1993 to 2007 Indian IPO markets remain underpriced in the short-run.

(Chhabra) examined the IPO pricing performance of companies which have been listed on National Stock Exchange for the period, November 1994 to April 2006. It was observed that there is an average initial return or underpricing of 40.08 percent, and if underpricing is adjusted to market return, the return declined to 39.36 percent.

(Kunz and Aggarwal) conducted a study of IPOs in Swiss stock market between 1983 and 1989 using a sample of 42 companies. The findings showed an average initial return of 35.8 percent.

(Anton et al.) analysed the profitability of Spanish IPOs in the period 2000-2010 for short-term and medium-term. It was concluded that Spanish IPO outperformed in the short-term. After one year the out performance of the analysed companies gradually got diluted and showed under performance.

(Chalk and Peavy) investigated the daily returns for 649 IPOs for the year 1975 through 1982. The findings indicated that a high abnormal return occurred on the initial trading day. Further IPOs originally priced at \$1.00 or less per share had the greatest abnormal returns on the issuance day.

(Purnanandam and Swaminathan) examined a sample of 2000 and more IPOs from 1980 to 1997 and found that the IPOs are overvalued at 50 percent the offer price relative to the market. Further the analysis revealed that a temporary higher sales growth rates are observed in overvalued IPOs and gradually over the next five years these IPOs exhibit lower profit margins and lower return on assets.

(Gounopoulos) analyzed the performance of the Greek IPOs and revealed that on an average they were under priced by 63.92 percent. Industrial firms were under priced at 67.14 percent, finance firms at 54.55 percent and other firms at 56.19 percent. Further from the results it is suggested that the IPO market in Greece is 'good' only for large offerings.

(Heerden and Alagidede) studied a sample of 138 IPOs of South Africa for the period of 5 years ranging from 2006 to 2010. It was found that there was significant short- run underpricing and in sectoral analysis, financial sector had the largest IPO underpricing.

(Baluja and Singh) studied survival of IPOs and found that growth rate and the environments of the respective industry sector of the IPOs strongly support its survivability. Taking a sample of 3374 IPOs from BSE, 2501 IPOs are categorized as "survivors". The findings support that issue with significant underpricing decrease the likelihood of their survival in the after market.

(Acedo-Ramirez and Ruiz-Cabestre) analyzed the price formation process of IPOs in London's

Alternative Investment market. The study revealed that the underpricing of IPOs is significantly positive and that the price variation is related to proportion of subscription, offer price and the share adjustment of IPOs.

(Hawaldar et al.) examined the performance of 464 Indian IPOs for 15 years , i.e., from 2001 through 2015. Performance of book built IPOs and fixed price IPOs were studied using event methodology. The results reveal that IPOs are under priced by lesser magnitude in case of book built as compared to fixed price IPOs.

Objectives

1. To examine the performance of Indian IPOs for short period.
2. To examine the abnormal returns of the IPOs on the listing day.

Methodology

IPOs floated by 327 companies listed on the Bombay Stock Exchange (BSE) during the years 2016 to 2022 was analysed for the study. FPOs (Follow on Public Offers) are excluded from the study.

Event study methodology is used to find the abnormal returns of IPOs on the listing day. The market model is used for event study methodology. This model tracks the abnormal returns on the specific day of an event. It reveals the effect of the event on the company.

To examine the price performance on listing day, abnormal return and wealth relative are calculated.

- Raw return on a stock (R_i) = $(P_1 - P_0)/P_0 \times 100$
 - Return on market index (R_m) = $(M_1 - M_0)/M_0 \times 100$
 - Market Adjusted Abnormal Return (MAAR) = $R_i - R_m$
- Wealth Relative (WR) = $1 + 1/N \sum_{i=1}^n r_i \div 1 + 1/N \sum_{i=1}^n r_m$
- P_1 = Closing price of the IPO on the listing day
 - P_0 = Issue price of IPO
 - M_1 = closing index value on the listing day
 - M_0 = Closing index value on the last day of the period when the issue was open.
 - N = Total number of IPOs in the Sample
 - $r_i = R_i/100$

- $r_m = R_m / 100$
- Returns on Listing day = $(P_1 - P_0) / P_0 \times 100$
- P_1 = the opening price on the listing day
- P_0 = Issue price. The opening price represents the initial expectations of the market.

reflects the strength of the economy.

Table 1 Number of IPOs 2016-2022

Year	2016	2017	2018	2019	2020	2021	2022	Total
No. of IPOs	82	33	24	16	17	65	90	327

Table 1 presents the number of IPOs that were issued during the calendar year 2016 to 2022. It is observed that there are variations in the IPOs that were issued in over the years. Maximum of IPOs were issued in the year 2022 & the least in the year 2019.

Discussion & Analysis

The primary issue market provides the scope for the emerging companies to issue shares and raise capital from individuals and institutional investors. This phenomenon leads to wealth generation by the companies and also by the investors. On a holistic view, the whole economy of the country develops. In other words, the number of IPOs in the stock market

Table 2 Year wise distribution of Abnormal Returns and Wealth Relative

Year	No. of IPOs	Raw returns (%)	Average Raw Return (%)	MAAR (%)	Average MAAR (%)	Wealth Relative WR	Pricing Behaviour
2016	82	668.63	8.5	564.56	6.88	1.07	Underpricing
2017	33	656.84	19.90	643.76	19.51	1.18	Underpricing
2018	24	180.75	7.53	188.15	7.84	1.08	Underpricing
2019	16	327.49	20.47	322.57	20.16	1.20	Underpricing
2020	17	670.30	39.43	655.30	38.55	1.38	Underpricing
2021	65	2028.90	31.21	2020.20	31.08	1.31	Underpricing
2022	90	1660.085	18.45	1653.52	18.37	1.18	Underpricing
	327	6192.995	18.9	6048.06	18.5		

Table 2 presents the year wise distribution of abnormal return, average raw return, and wealth relative. Average MAAR denotes the level of underpricing. It is observed that for all the year's returns are positive indicating that the stocks remain under priced. The underpricing ranges from 6.88 percent to 38.55 percent. Wealth Relative also verifies the results of underpricing. Wealth Relative above one indicates that the stocks are under priced on the listing day. It is observed that wealth relative is highest for the year 2020, i.e., 1.38 even though we see only 17 IPOs that year. The lowest wealth relative is 1.07 in the year 2016.

The average MAAR for the 2020 is 38.55 percent which shows the highest abnormal returns and lowest in 2018(7.84). The average MAAR for all the IPOs under study is found to be 18.5 percent. The results from other studies reveal extreme differences in abnormal returns to this present study

(Kumar and Narang, Chhabra). Kumar and Narang reported 82.67% of average MAAR for 488 IPOs, Chhabra observed 40.08 % of average MAAR, (Kunz and Aggarwal) took a sample of 42 companies and showed an average MAAR of 35.8%, The present study shows underpricing of IPOs but it is at diminishing rate (18.5%) relative to the previous Indian studies.

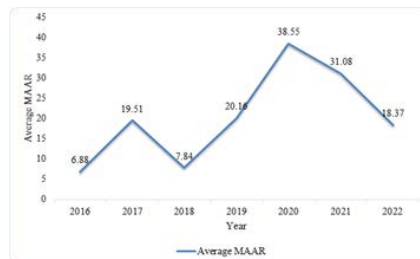


Figure 1 Average Market Adjusted Abnormal Returns

Table 3 The Frequency distribution of the Market Adjusted Abnormal Returns on the listing day

MAAR	2016	2017	2018	2019	2020	2021	2022	Total	Percent
Less than 0%	26	10	12	5	2	18	25	98	30.0
0%-10%	29	9	5	4	3	12	27	89	27.2
10%-20%	9	3	2	1	4	5	10	34	10.4
20%-30%	12	4	2	2	2	6	4	32	9.8
30%-50%	4	3	1	1	0	10	10	29	8.9
50% and above	2	4	2	3	6	14	14	45	13.8
Total	82	33	24	16	17	65	90	327	100.0

Table 3 indicate that 70 percent of the IPOs are above one (positive), while highest number of IPOs are in the range of 1 to 10 percent of MAAR (i.e., 27.2) on the listing day. 13.8 percent of the IPOs provide more than 50 percent abnormal returns on the listing day.

Figure 2 presents that of the 327 IPOs, 229 IPOs are underpriced and 98 are overpriced.

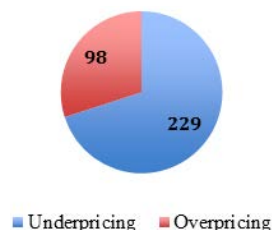


Figure 2 Pricing Behaviour on Listing Day

Table 4 Descriptive Statistics of IPOs Particulars

Particulars	N	Minimum	Maximum	Mean	Std. Deviation	Trimmed Mean (10%)
Issue price (Rs.)	327	10.00	2150.00	337.83	361.43	354.82
Listing Returns	327	-0.5	10.52	0.21	0.67	0.15
MAAR (%)	327	-126.74	268.81	18.49	36.76	14.58

The average Issue price of 327 IPOs is Rs.337.83. However, as anomalies are seen in offer price the trimmed mean at 10 percent records ~354.82. The issue price of “One 97 Communications Ltd (Paytm)” for the year 2021 is found the highest (Rs. 2150). Three companies (Safa Systems & Technologies Limited, Fone4 Communications (India) Limited, Healthy Life Agritech Limited) in the year 2022 has issued IPOs at Rs.10 (minimum value). Sigachi Industries Ltd documented the highest average market adjusted abnormal return that is 268.81 percent. The average MAAR is reported at 18.49 percent.

The calculated result of average return of 327 IPOs on the listing day is 0.21 percent.

The returns on the listing day is one of the important factors to analyze the performance of initial public offerings in the stock market.

Figure 3 indicates that 251 IPOs record positive returns. Majority of the IPOs listing day returns fall in the range of 0 percent to 10 percent.

Table 5 Frequency Distribution of Listing Day Returns

Year	Less than 0%	0%-10%	10%-20%	Total
2016	13	68	1	82
2017	9	24	0	33
2018	11	13	0	24
2019	4	12	0	16
2020	4	13	0	17
2021	19	46	0	65
2022	16	74	0	90
Total	76	250	1	327

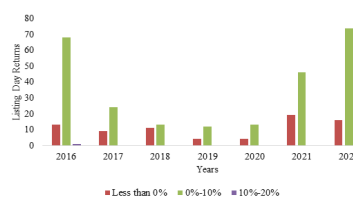


Figure 3 Frequency Distribution of Returns on Listing Day

Conclusion and Suggestions

An IPO is the first time that shares in a company are sold to public and subsequently trade in the secondary market. The present study has identified 327 IPOs in the Indian stock market for the period 2016-2022. It uses event study methodology to analyse the returns in the short run. It is observed that there is variation in the number of IPOs issued by the companies over the period of study. Highest numbers of IPOs were issued in the year 2022. 70 percent of the total IPOs documented positive abnormal returns.

Various studies have found that the investors who purchased IPOs shares on the offering day have experienced positive returns on the first day after listing. It indicates that the shares may have been valued at less than the intrinsic or fair value. The Average MAAR of the IPOs is found to be 18.5 percent. This results of the study supports the underpricing theory of IPOs in Indian stock market. The results confirm the findings of other Indian studies, (Kumar and Narang; Chhabra). The study supports the suggestion of (Welch) that marketing strategies should be used by underwriters that can trigger cascades, such that investors pay attention not only to their own information but also to whether other investors are interested in the IPOs.

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