

Underpricing of initial public offers in India

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Abstract

This paper examines the pricing of IPOs in India in the secondary market on the first day of aftermarket trading. The focus of this study is to highlight the underpricing of IPOs in India. This study is based on the sample of 27 IPOs issued from January 1, 2007 to December 31, 2009. In this study underpricing is measured through Average Market Adjusted Abnormal Return (MAAR) of IPOs. MAAR of 27 IPOs has been reported 17.72 per cent. The study found existence of underpricing in Indian IPO market. The activity of Indian IPO Market has been observed very sluggish during year 2012-13. To perk up the state of IPO market, SEBI has abolished the mandatory grading of IPOs (Economic Times, Dec. 25, 2013).

Keywords: IPOs, SEBI, market, trading, investor

Introduction

Capital Market plays a significant role in capital formation and economic development of developing countries just like India. It provides capital resources to the enterprising investors. Capital market is divided in to (a) Primary Market and (b) Secondary market. Primary Market is the one in which the company approaches investors to raise capital through debt capital or equity capital or combination of both. The mechanism of determining the offer price during the Controller of the Capital Issues regime was to offer shares at fixed price. The firm and merchant banker decide an offer price without

taking into account the investor's feedback. SEBI introduced book-building for pricing of new issues. Book – building is not a method of price calculation; it is a price discovery method (Shollapur & Sunagar, 2008) [2].

Secondary markets deal is not possible to buy shares in a private company. Investor can approach the owners about investing, but they're not obligated to sell you anything. Public companies, on the other hand, have sold at least a portion of themselves to the public and trade on a stock exchange. This is why doing an IPO is also referred to as "going public." The growth of IPOs in India is presented in table-1.

Table 1: Growth of IPOs Market in India (Amount in Rs. Crore)

Years	Public Issues		Initial Public Offers		Right Issues	
	Number	Amount	Number	Amount	Number	Amount
2006-07	85	29797	77	28504	39	3711
2007-08	92	54511	85	42595	32	32518
2008-09	22	3582	21	2082	25	12637

Source: Annual Reports of SEBI

Table -1 provides detail regarding number and amount (in terms of crore) of public issues, initial public offer and right issues from 2006-07 to 2008-09. During 2006-07, 124 companies accessed the primary market and raised Rs. 33,508 crore through public and right issues compared to 139 companies which had raised Rs. 27,382 crore in 2005-06. Of the 85 public issues, 77 were IPOs. Resources raised through IPOs and FPOs were Rs. 28,504 crore and Rs. 1,293 crore respectively. In 2008-2009 only 21 companies raised 2082 crore Rs. as compare to 85 IPOs in 2007-2008. During 2007-08, 124 companies accessed the primary market and raised Rs. 87,029 crore through public (92) and right issues (32) as against 124 companies which raised Rs. 33,508 crore in 2006-07. While the number of issues remained same in the both years. The amount mobilized was more than twice in 2007-08 as compared to 2006-07. Of the total 92 public issues in 2007-08; 85 were IPOs (Rs. 42,595 crore) and 7 were FPOs. The Indian securities markets displayed downward trend in 2008-09. The downswing in the domestic equity markets was in consonance with the downward spiral in global equity markets

triggered by the international financial crisis. Sharp fall in the benchmark indices, across the board fall in share prices, decline in market capitalisation, turnover and soaring volatility characterised the stock market behavior during 2008-09 (Annual Report, SEBI, 2008-09). But, the Indian primary market again remembered its golden era. The continuous growth has observed in Indian IPO market for the year 2009-10, 2010-11, and 2011-12. The number as well as amount raised by IPOs has witnessed a constant expansion during these years. The number of IPOs also reduced in year 2012-13, because SEBI has imposed mandatory the grading of IPOs. To boost up again the primary market & to attract the issuer companies SEBI has abolished the condition. The Sebi's board approved the proposal to make the IPO grading system voluntary as against the current provision of being mandatory (Economic Times, Dec. 25, 2013). The IPO market in India as recently invited the attention of the media for under pricing. It seems that there is a significant difference between the prices at which the IPOs are offered to the investors and the price at which they are traded on the day of the listing. So if the investors get shares allotment

in an IPO at lower offer price and then sell them on the first day of the listing at higher prices then they can make substantial gains. This phenomenon is known as “Underpricing” in the IPOs market.

Literature Review

The extant of literature is available regarding underpricing in India as well as abroad. The reviews of various studies are as: Muhammad Khalid Sohail and Mohamed Nasr (2008) ^[1], studied the short-run and long-run performance of 50 IPOs listed on Karachi Stock Exchange from 2000 to 2006. Study found that the average under-pricing is 35.66 per cent.

Shollapur and Sunagar (2008) ^[2], considered two case studies: Tech-Mahindra Ltd. and Voltamp Transformer Ltd. both the companies followed 100 percent book-building method for determining the issue price. Price band in the both companies differs due to variation in their P/E ratio. Study is based on field survey of 50 investors.

Sehgal Shikha & Singh Balwinder (2008) ^[3], has conducted a study to check underpricing and long run performance of 438 Indian initial public offers listed on BSE during June 1992-March 2001. The mean underpricing has been found to be 99.2 percent. Age of the firm, listing delay at IPO and number of times the issue is subscribed have been found to be the significant determinants of underpricing. Indian IPOs do not tend to underperform in the long-run. Average BHAR after 60 months of listing was 90.13 percent.

Sahoo Seshadev & Prabina Rajib (2010) ^[4], covered 92 Indian IPOs issued during the period 2002-2006. It is reported that on an average IPOs are underpriced to the tune of 46.55 per cent on the listing day. The average BHAR after 3 years reported 41.91 per cent on offer price.

Jain Neeta C & Padmavathi (2012) ^[5], study on 227 book-built IPOs for the period of 2004-2009 found that the average underpricing during this period was 28 percent while the maximum underpricing was around 242 per cent.

Kumar Vinod & Dhanda Neelam (2013) ^[6], cover 488 IPOs offered through BSE during 1993 to 2007; Study proves existence of underpricing in Indian IPO market. Average market adjusted return & wealth relative are used as price performance indicators. The average market adjusted abnormal return has been reported 82.67 per cent on the listing of IPOs. All the twenty three sectors have shown existence of underpricing with more than one value of wealth relative.

Kumar Vinod, Dhanda Neelam (2013) ^[7], compared at par (170) & premium (318) IPOs, the degree of underpricing for at par IPOs reported significantly higher as compare to premium IPOs.

Kumar Vinod, Dhanda Neelam (2013) ^[8], proved through multivariate regression model that level of subscription has significantly positive impact on underpricing of initial public offers on listing day. It has been also reported that offer price and offer size have negative impact on underpricing.

Research Methodology

Previous studies found that IPOs in India and outside are underpriced. Underpricing is not due to market inefficiency but it derives from sound fundamentals of companies. This study is conducted on the IPOs which got listed in NSE during Jan. 1, 2007 to Dec.31, 2009 and therefore attempts to understand the

critical differences with the previous studies due to changes in regulation as well as the growth of IPO market.

Objectives of the study

The study is conducting to fulfill the following objectives:

- To ascertain the Market Adjusted Abnormal Return of IPOs on listing day.
- To measure the Raw Return of IPOs on listing day.
- To identify the Over Priced and Under Priced IPOs.
- To present the comparative position between Market Adjusted Abnormal Return of IPOs; year 2007, 2008 and 2009.

Period of the Study: The study period ranges from 2007 TO 2009. The period has been selected because number of IPOs during this period was capricious.

Population: IPOs are offered on NSE during 2007 to 2009 and traded after listing.

Data Collection: In view of the main objectives of the study, Secondary data used for the study. Secondary data is collected from the following sources; Annual Reports of SEBI, Newsletters of NSE, Bulletins of RBI, The Economics Times, www.icicidirect.com, www.nseindia.com. and www.sebi.gov.in.

Analysis Pattern of the Study: With a view to know raw return, market return and Market Adjusted Abnormal Return of IPOs the following pattern is used:

$R_i = 100 * (P_i/P_o - 1)$, $M_i = 100 * (M_1/M_o - 1)$, R_i = Raw return, M_i = Market return

P_i = Closing price on the day of listing of the IPO, P_o = Issue price of IPO, M_i = Closing value of nifty index on the day of listing of the IPO, M_o = Closing value of the nifty index on the day of issue closed

$MAAR = R_i - M_i$, $MAAR$ = Market adjusted abnormal return

Hypothesis Testing

1. IPOs in India are not underpriced
2. No significant difference in the Average Market Adjusted Abnormal Return of all three years IPOs

Average Listing Day price performance computed by following equation:

To test the first Hypothesis t –test has been used. The value of t statistic has been computed by the following equation (Janakiraman, S. 2007) ^[9].

$$t = \frac{\overline{MAAR}}{S} * \sqrt{n}$$

Here, t = computed value of t statistic

ANOVA test has been used to test the second hypothesis (Kothari, 2002).

Under Priced IPO: If MAAR of IPO is positive or greater than zero.

Over Priced IPO: If MAAR IPO is negative or less than zero.

Analysis & Results

All the IPOs offered during 2007 and 2009 at NSE are covered under this paper. The status of price performance of IPOs selected the study for the year 2007 is presented in Table 2.

Table 2: Price Performance on Listing Date of 2007 IPOs

Name of the Issue(2007)	Date of Issue	Issue Size (lakh shares)	Issue Price (Rs.)	Date of listing	MAAR (%age)
Kaushalya INFRA. Dev. Corporation Ltd.	20/11/2007 to 23/11/2007	85	60	14-Dec-07	29.59
Supreme INFRA. India Ltd.	21/09/2007 to 26/09/2007	34.75	108	18-Oct-07	53.82
SEL Manufacturing Company Ltd.	26/07/2007 to 31/07/2007	41.3841	90	21-Aug-07	70.86
Central Bank of India	24/07/2007 to 27/07/2007	800	102	21-Aug-07	21.37
DLF Ltd.	11/06/2007 to 14/06/2007	1750	525	5-Jul-07	4.12
MIC Electronics Ltd.	30/04/2007 to 08/05/2007	51	150	30-May-07	121.20
Page Industries Ltd.	23/02/2007 to 27/02/2007	28.04	360	16-Mar-07	-17.17
Indus Fila Ltd.	12/02/2007 to 14/02/2007	48.43789	170	8-Mar-07	-14.21
Technocraft Industries (India) Ltd.	18/01/2007 to 23/01/2007	83.2	105	12-Feb-07	-4.52

Form the study it is found that on average the investors outperform (i.e. there is under pricing of IPOs in the market in 2007), through buying stocks at subscription prices in the primary market and selling them on first trading day in stock market.

The average raw return of nine IPOs (used as sample) was 28.55%. The IPOs scored MAAR between 121.20 per cent to -4.52. Six IPOs out of nine were underpriced. The average market adjusted abnormal return was 29.45 per cent. MIC Electronics Ltd. scored market adjusted abnormal 121.20 per cent return.

Table 3: Price Performance on Listing Date of 2008 IPOs

Name of the issue (2008)	Date of Issue	Issue Size (lakh Shares)	Issue Price (Rs.)	Date of listing	MAAR (%age)
Resurgere Mines & Minerals India Ltd.	11/08/2008 to 13/08/2008	44.5	270	1-Sep-08	101.59
Vishal information technologies Ltd.	21/07/2008 to 24/07/2008	27.9	150	11-Aug-08	25.52
Lotus Eye Care Hospital Ltd.	12/06/2008 to 20/06/2008	100	38	11-Jul-08	0.68
Sejal architectural glass Ltd.	09/06/2008 to 12/06/2008	91.94155	115	1-Jul-08	-15.19
Gokul Refoils and Solvent Ltd.	08/05/2008 to 13/05/2008	71.58392	195	4-Jun-08	0.87
Titagarh Wagons Ltd.	24/03/2008 to 27/03/2008	23.83768	540	21-Apr-08	26.62
Rural Electrification Corporation Ltd.	19/02/2008 to 22/02/2008	1561.2	105	12-Mar-08	20.20
Tulsi Extrusions Ltd.	01/02/2008 to 05/02/2008	57	85	25-Feb-08	70.87
Bang Overseas Ltd.	28/01/2008 to 31/01/2008	35	207	20-Feb-08	-16.22

The average raw return of 9 IPOs (used as sample) was 20.156%. Seven IPOs out of nine were underpriced. The average market adjusted abnormal return was 23.88%. Resurgere mines & minerals India Ltd. scored 101.59 market adjusted abnormal return. Form the study it is found that on

average the investors outperform (i.e. there is under pricing of IPOs in the market in 2008), through buying stocks at subscription prices in the primary market and selling them on first trading day in stock market. The price performance of the IPOs on the listing day for the year 2009 is listed in Table 4.

Table 4: Price Performance on Listing Date of 2009 IPOs

Name of the issue (2009)	Date of issue	Issue Size (lakh shares)	Issue Price (Rs.)	Date of Listing	MAAR (%age)
Godrej properties Ltd.	09/12/2009 to 11/12/2009	94.29	490	5-Jan-10	6.50
Mbl infrastructures Ltd.	27/11/2009 to 01/12/2009	57	180	11-Jan-10	12.26
Astec Lifesciences Ltd.	29/10/2009 to 04/11/2009	75	82	25-Nov-09	-6.00
Indiabulls power Ltd.	12/10/2009 to 15/10/2009	3398	45	30-Oct-09	-4.45
Euro Multivision ltd	22/09/2009 to 24/09/2009	88	75	15-Oct-09	-31.04
Oil India Ltd.	07/09/2009 to 10/09/2009	264.4998	1050	30-Sep-09	3.20
Jindal Cotex Ltd.	27/08/2009 to 01/09/2009	112.5	75	22-Sep-09	7.86
Adani Power Ltd.	28/07/2009 to 31/07/2009	3016.5203	100	20-Aug-09	4.95
Excel Infoways Ltd.	14/07/2009 to 17/07/2009	56.67	85	3-Aug-09	5.07

The average raw return of 9 IPOs (selected as sample) was 2.67per cent. Six IPOs out of nine were underpriced. The average market adjusted abnormal return was -0.18 per cent.

Mbl Infrastructures Ltd. scored 12.26 per cent market adjusted abnormal return. Form the study it is found that on average the investors underperform (i.e. there is no under pricing of IPOs

in the market in 2009), through buying stocks at subscription prices in the primary market and selling them on first trading day in stock market.

Table 5: Summarized Position of Under Priced and Over Priced IPOs of Year 2007

Sr. No.	Name of the issue(2007)	MAAR (%)
Under Priced IPOs		
1	MIC Electronics Ltd.	121.20
2	SEL Manufacturing Company Ltd.	70.86
3	Supreme Infrastructure India Ltd.	53.82
4	kaushalya infrastructure development corporation Ltd.	29.59
5	Central Bank of India	21.37
6	DLF Ltd.	4.12
Over Priced IPOs		
1	Techno craft Industries (India) Ltd.	-4.52
2	Indus Fila Ltd.	-14.21
3	Page Industries Ltd.	-17.17

Six IPOs out of nine were underpriced. The average market adjusted abnormal return was 29.45%. MIC Electronics Ltd. scored market adjusted abnormal 121.20% return.

Table 6: Summarized Position of Under Priced and Over Priced IPOs of Year 2008

Sr. No.	Name of the issue(2008)	MAAR (%)
Under Priced IPOs		
1	Resurgere Mines & Minerals India Ltd.	101.59
2	Tulsi Extrusions Ltd.	70.87
3	Titagarh Wagons Ltd.	26.62
4	Vishal Information Technologies Ltd.	25.52
5	Rural Electrification Corporation Ltd.	20.20
6	Gokul Refoils And Solvent Ltd.	0.87
7	Lotus Eye Care Hospital Ltd.	0.68
Over Priced IPOs		
1	Sejal Architectural Glass Ltd.	-15.19
2	Bang Overseas Ltd.	-16.22

Seven IPOs out of nine were underpriced. The average market adjusted abnormal return was 23.88%. Resurgere mines & minerals India Ltd. scored 101.59 market adjusted abnormal return.

Table 7: Summarized Position of Under Priced and Over Priced IPOs of Year 2009

Sr. No.	Name of the issue(2009)	MAAR (%)
Under Priced IPOs		
1	Mbl infrastructures Ltd.	12.26
2	Jindal cotex Ltd.	7.86
3	Godrej properties Ltd.	6.50
4	Excel infoways Ltd.	5.07
5	Adani power Ltd.	4.95
6	Oil india Ltd.	3.20
Over Priced IPOs		
1	Indiabulls Power Ltd.	-4.45
2	Astec Lifesciences Ltd.	-6.00
3	Euro Multivision Ltd	-31.04

Six IPOs out of nine were underpriced. The average market adjusted abnormal return was -0.18%. Mbl infrastructures Ltd. scored 12.26% market adjusted abnormal return.

Table 8: Consolidated Position of IPOs: 2007-2009

Issue price (Rs.)	N0. of IPOs	Percentage	MAAR
Up to 100	10	37.04	14.84
100-200	10	37.04	22.13
200-300	2	7.41	42.69
300-400	1	3.70	-17.17
400-500	1	3.70	6.5
More than 500	3	11.11	11.31

Since the t calculated value for 26 degrees of freedom is 2.512 which is greater than t tabulated value (1.706). Hence, the Hypothesis one is true that IPOs in India are underpriced: The calculated F- value (for degrees of freedom 2,24) is 1.757 is less than tabulated value (2,24,5%=3.40). Hence, it may be concluded that no significant difference in the Average Market Adjusted Abnormal Return of all three years IPOs.

IPOs issued during 2008 were under priced but quantum was less as compare to previous year. The momentum witnessed in the primary market in 2007, favorable investment environment, positive corporate results, sound macro-economic fundamentals and optimistic secondary market

performance supported by institutional investors encouraged a number of companies to raise capital from the primary market. Indian securities markets witnessed significantly uptrend and volatility in 2007-08. The indices breached historic highs on several occasions. However, in mid January 2008; stock markets witnessed sharp corrections in tandem with the global equity markets (Annual Reports of SEBI). Due to adverse market sentiments few companies have withdrawn their issues adverse. It is cleared from the performance of IPOs 2008 and 2009. The listing day performance of 2008 and 2009 IPOs was stumpy as compared to 2007 IPOs. IPOs issued during 2008 were under priced and the quantum was bigger than 2009.

Table 9: Comparative Performance of IPOs (Figures in percentage)

Year	2006-07	2007-08	2008-09
Average Raw Return of IPOs	28.55	20.156	2.67
Average Market Adjusted Abnormal Return of IPOs	29.45	23.88	-0.18

The average raw return of 9 IPOs of 2009 (sample) was 2.67per cent. Six IPOs out of nine were underpriced. The average market adjusted abnormal return was -0.18The average raw return of 9 IPOs of 2008 (sample IPOs) was 20.156per cent. Seven IPOs out of nine were underpriced. The average market adjusted abnormal return was 23.88per cent. The average raw return of 9 IPOs of 2007 (sample) was 28.55per cent. Six IPOs out of nine were underpriced. The average market adjusted abnormal return was 29.45per cent.

Conclusion

It is evident from the study that IPOs in India during the study period (issued from 2007 to 2009) were under priced. IPOs 2007 to 2009 (sample 27 IPOs) scored 17.15 per cent average raw return. The average market adjusted abnormal return was 17.72 per cent. But the average market adjusted abnormal return of 2009 IPOs was negative. The Indian securities markets displayed downward trend in 2008-09. Sharp fall in the benchmark indices, across the board fall in share prices, decline in market capitalisation, turnover and soaring volatility characterised the stock market behavior during 2008-09(Annual Report, SEBI, 2008-09). The continuous growth has observed in Indian IPO market for the year 2009-10, 2010-11, and 2011-12. The number as well as amount raised by IPOs has witnessed a constant expansion during these years. The number of IPOs reduced again in year 2012-13, Because SEBI imposed mandatory the grading & tightens the norms of IPOs. To boost up again the primary market & to attract the issuer companies SEBI has abolished the condition. The Sebi's board approved the proposal to make the IPO grading system voluntary as against the current provision of being mandatory (Economic Times, Dec. 25, 2013)10. It is expected that it will enhance the activity of Indian primary market& future of Indian IPO Market would be bright.

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