ABSTRACT

Initial public offering (IPO) or stock market launch is where shares of stock in a company are sold to the general public, on a securities exchange, for the first time. Public offerings are used by companies to raise expansion capital, to possibly monetize the investments of early private investors, and to become publicly traded enterprises. The IPOs have gained more exposure in the Indian scenario as credit rating agencies are also providing opinions in the form of credit ratings which is beneficial and used by the investors in the decision making process of IPO. This paper studies the Performance of Initial Public Offerings effected through the National Stock Exchange of India during the time period starting January 2009 to December 2013. This study also analyses the short term and long term returns from the IPOs at equal intervals of time and the post issue performance of credit and non credit IPOs.

Keywords: IPO, credit rating, NSE, under pricing

Introduction

An initial public offering is the sale of a company’s stock to the public for the first time. The primary impetus for an IPO is generally either to raise capital or to offer an exit strategy to some of the firms existing owners, but a number of other motivations and considerations also influence a firm’s decision to go public. The Initial offering can be primary, in which new shares are sold, or secondary, in which the owners of the shares sell their existing shares. Shares are sold to raise capital for the company or money for the individuals, depending on whether the offering is primary or secondary. A mixed offering is when the company decides to go public with a primary and a secondary offering.

Initial public offerings (IPOs) over the last few decades has emerged as a strong alternative for investors and the last few decades, have witnessed a boom of IPOs. In this context, Credit rating agencies like, CARE, CRISIL, ICRA, etc play an important role for investors to choose IPOs. These agencies rate IPOs with respect to their past performance, future prospects considering demand and growth, nature and basis of competition, their exposure to change as per government policies and so forth. Thus, both qualitative and quantitative analysis is employed before rating a company’s IPO. Thus to an investor, credit ratings can be beneficial, considering them not having time and access to company information.

Statement of the problem

Initial public offerings (IPOs) over the last few decades has emerged as a strong alternative for investors. The last few decades, witnessed a boom of IPOs, most of which have been listed at a premium and almost all of them oversubscribed. This winning streak of IPOs has been impossible to
ignore as it has sometimes, left many investors with high double digit stock gains. It is in this context that this study aims to explore the performance of IPOs during 60 months ending December 31 2013.

**Rational of the Study**

The economic reforms of 1990 paved the way for growth and integration of global markets with Indian markets. Industrial de-licensing, tariff reduction, deregulation of capital and financial markets and fiscal reforms has lead to a flurry of activity in several sectors, mainly IT sector, services sector, telecommunications sectors, consumer goods sectors and consumer durables sectors triggering the need for corporates in this sector to raise increased finance through novel and innovative ways from the market- significantly the IPO route.

The impetus achieved by the IPOs in terms of providing substantial returns to investors also gave raise to the substantial body of research that examined how the IPO stocks performed. There is little study which has evaluated the performances of IPOs for the year 2009-2013. After a short dip in the IPO market in 2009, the market post the sub-prime crisis has been very promising. In this context, this research study on the IPOs and their performance- short term as well as long term- is well justified. Although there are numerous studies on IPOs in developed countries and market, there is dearth of study in the Indian context. It is in this scenario that, this research thesis titled “Performance Evaluation of Initial Public Offerings With Reference To the National Stock Exchange of India” assumes significance.

**Objectives of the study**

The objectives of the study are as follows: (1) To evaluate the short term returns from IPOs at equal intervals of time.(2) To assess the long term returns from the IPOs at the end of 6 months and 1 year and (3) To examine the post issue performance of credit and non credit rated IPOs.

**Research methodology**

**Data**

**Sample**

A list of companies which made Initial Public Offerings between January 2009 and December 2013 was extracted from the Capital Line database. A check was also made as to whether the offering was a type other than equity shares. Other types of securities were eliminated from the sample. An exhaustive sample of IPO issues of 158 companies was available. After eliminating companies with inadequate data, non availability of data, non synchronisation of trading days and companies with inadequate trading days, 97 companies were considered for the final study. Thus this study is based on a total sample size of 97 companies from a population of 158 companies spread across 60 months.

**Tools for data collection**

The data was collected from secondary sources of information. Mainly, the data was collected from the websites of National Stock Exchange and Capital line Database. Websites which provided reliable data was also referred to countercheck the data during the course of the study. The secondary data consisted of all those companies which opted for IPO for the period of 60 months ending December 31 2013.
Statistical analysis

Tables, charts and graphs were used to depict the pictorial representation of the IPO returns for various intervals of time. They were used to analyse the changing trends in the performances (positive or negative) of the IPO. Basic statistical analysis tools such as measures of central tendency, correlation and independent T-test were used in the data analysis.

❖ **Initial returns**

The initial returns on IPO is computed as the difference between closing price on first day of trading and the offer price, divided by the offer price

\[ R = \frac{(P_1 - P_0)}{P_0} \times 100 \]

\( R \) = initial returns
\( P_1 \) = closing price on first day of trading
\( P_0 \) = offer price

❖ **Subsequent returns**

In the similar line, returns for day 2, day 3, day 4 and day 5 was computed. Also weekly returns, returns after 1 month, 3 months, 6 months and 1 year were calculated.

Return for a particular day is computed as the difference between closing price of the particular day and the closing price of the previous day of trading, divided by the closing price of the previous day.

\[ R_t = \frac{(P_t - P_{t-1})}{P_{t-1}} \times 100 \]

\( R_t \) = return on a particular day
\( P_t \) = closing price on the particular day
\( P_{t-1} \) = closing price on the previous day

The return so calculated can be called as raw return since such a return would be valid in a perfect market.

The credit ratings given for the IPO issued were collected from the National Stock Exchange website. The daily share prices of each company were collected for 1 year from the date of issue to understand the performance of the stocks over various time intervals (short, medium and long performance).

Results and discussions

Returns analysis

❖ **Short term and Long term returns:**

The returns earned by the IPOs is measured and analysed across the period of 60 months. Equal intervals of time have been considered for measuring the returns that the IPOs generate. On day 1, majority of companies recorded positive abnormal returns in the short term, signalling the possibility of IPOs having been underpriced. There are 50 companies which showed negative returns. Out of the few companies that showed negative returns, the negative return was less than 10% with an exception of one company showing a negative return of 90%. The analysis of returns at the end of week one revealed almost the same number of companies showing positive returns, however the percentage of returns witnessed a significant decline. Returns at the end of month one revealed not only a decline in
the number of companies showing positive returns but also a drop in gains from an average of 89.89% to 18.55%. The same trend continued in respect of the returns of month three, with a majority of companies recording negative returns of around 20%.

Analysis of returns of companies during a slightly longer run of 6 months to 1 year reveals a steady decline in the abnormal returns. Not only the number of companies but also the quantum of returns reveals a steady decline. The long term return analysis showed returns stabilising but with no scope for earning any abnormal returns.

**Performance of credit and non credit rated IPOs**

The post issue performance of credit and non credit rated IPOs was analyzed using the following hypothesis.

**Hypothesis 1**

H₀: The post issue performance (6 months) of credit rated IPOs is not significantly different than non credit rated IPOs.

H₁: The post issue performance (6 months) of credit rated IPOs is significantly different than non credit rated IPOs.

This hypothesis is tested with the help of a statistical tool- independent t-test. The results were at α=0.05 level of significance, there exists enough evidence to conclude that “The post issue performance (6 months) of credit rated IPOs is not significantly different than non credit rated IPOs”.

**Hypothesis 2**

H₀: The post issue performance (1 year) of credit rated IPOs is not significantly different than non credit rated IPOs.

H₁: The post issue performance (1 year) of credit rated IPOs is significantly different than non credit rated IPOs.

This hypothesis is tested with the help of a statistical tool- independent t-test. The results were at α=0.05 level of significance, there exists enough evidence to conclude that “The post issue performance (1 year) of credit rated IPOs is not significantly different than non credit rated IPOs”.

**Findings of the Study**

- The study revealed that the IPOs considered, showed abnormal initial returns. 47 out of 97 companies showed heavy positive returns on day 1 of trading. Several companies recorded more than 30% positive returns. Further analysis also revealed that the returns were the highest from day 2 to week 1 of the IPO being listed.
- This winning streak however started dipping from the end of month 1 to month 3 after which it showed signs of stabilising.
Long term return analysis for a slightly longer period of 6 months to one year showed returns stabilising but with no scope for earning any abnormal returns.

An interesting finding of the study, reveals that there is no significant difference in the post issue performance of the credit rated when compared to non credit rated IPOs. Returns from the IPOs which were highly rated did not significantly perform better when compared to non credit rated IPOs.

Conclusion

The study shows conclusive evidence of initial abnormal returns of a majority of IPOs considered for study. This finding is indicative of the presence of Underpricing of IPOs. It further reveals an opportunity for investors to exit in the first week of the listing with considerable abnormal returns. This scenario is also indicative that the market is positive to the issue of these IPOs. However this frenzy in increased returns considerably drops as the IPO gets older and later stabilises in the long term, wiping out the possibilities of any abnormal returns in the long run. It can also be concluded that, though credit ratings may be useful for an investor to choose the company in which he would like to invest, it is not an assurance for the good performance of the IPO as there has been no significant change in the returns earned by credit rated and non credit rated IPOs.

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