

A STUDY OF INITIAL PUBLIC OFFER (IPO) ON INVESTOR-FRIENDLY MEASURES

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Abstract

Initial Public Offer (IPO) plays the vital role for the expansion of any company. Initial Public Offering (IPO) in India means the selling of the shares of a company, for the first time, to the public in the country's capital markets. It has the least risk and it is also diluted. The main function of the public offer is to facilitate the transfer of resources from the savers to users. This study concentrates on the decisions taken by the investors while investing in initial public offer. Study also identifies the factors, which are affecting primary market situation in India. This research paper discusses the various measures the revivals of investors' confidence in Indian primary market. This study is based on questionnaire survey results in Moradabad region of western Uttar Pradesh.

Introduction

The main function of a primary market is to facilitate transfer of resources from savers to the users. The fresh issue of securities takes place in primary market and trading among investors takes place in secondary market. Primary market is also known as new issues market. Companies with no earning record and with inexperienced directors got listed on stock exchanges. Their only objective was profit making out of inflated market price. The net result is private investors lost confidence in the market.

Initial Public Offering (IPO) in India means the selling of the shares of a company, for the first time, to the public in the country's capital markets. During an Initial Public Offer (IPO) the shares are given to the public at a discount on the intrinsic value of the shares and this is the reason that the investors buy shares during the IPO in order to make profits for themselves. IPO in India is done through various methods like book building method, fixed price method, or a mixture of both. The method of book building has been introduced in the country in 1999 and it helps the company to find out the demand and price of its shares. A merchant banker is nominated

as a book runner by the Issuer of the IPO. The company that is issuing the IPO decides the number of shares that it will issue and also fixes the price band of the shares. All these information are mentioned in the company's red herring prospectus. IPOs can be a risky investment. For the individual investor, it is tough to predict what the stock or shares will do on its initial day of trading and in the near future since there is often little historical data with which

to analyze the company. Also, most IPOs are of companies going through a transitory growth period, and they are therefore subject to additional uncertainty regarding their future value.

IPO also referred to simply as a "public offering", is when a company issues common stock or shares to the public for the first time. They are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately-owned companies looking to become publicly traded. In an IPO, the issuer may obtain the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price and time to bring it to market.

Reasons for Listing

When a company lists its shares on a public exchange, it will almost invariably look to issue additional new shares in order to raise extra capital at the same time. The money paid by investors for the newly-issued shares goes directly to the company (in contrast to a later trade of shares on the exchange, where the money passes between investors). An IPO, therefore, allows a company to tap a wide pool of stock market investors to provide it with large volumes of capital for future growth. The company is never required to repay the capital, but instead the new shareholders have a right to future profits distributed by the company and the right to a capital distribution in case of dissolution.

IPO Grading

The main objective of issuance of Initial Public

Offering (IPO) is to invest the corpus so accumulated, for either establishing of a new company or expansion of an existing private company. The shares held by such financier or investors give them the rights of the company and to its future profits, which are categorically mentioned in the offer document. The process of underwriting determines the issue size and type, offer price and best time of introduction into the market is called “underwriting”. The underwriting is generally done by the investment bankers. These underwriting firms or investment bankers are allotted some specified numbers of shares to sell to the general investor before the share is being traded on an exchange.

IPO Grading also called Rating is a process by which the back ground of an IPO issuing company is verified. The main objective of such verification of track record is to provide higher security to the money of the investor. The IPO Grading process does not involve any “pricing suggestion” related to buying or selling price. The rating agency only does the IPO Grading on the previous track record of the company which has issued such IPO. The IPO Grading process mainly checks-for any negative factor in the track record of the IPO issuing company. Further, IPO Grading also arrests scrupulous or fictitious company from entering in to the market and run-away with investor’s money.

Advantages and Disadvantages of IPO Collection of Data and Methodology

In this study, the primary data was collected from Moradabad of western Uttar Pradesh. A total 100 questionnaires were sent to the investors using brokers, investor associations, managers of companies, professionals, and other contacts. A response of 93 valid questionnaires was received. The responses were received from those investors who were willing to spend their time and wished contribute to research willingly only. So it constitutes a convenience sample. The questionnaire has three parts. In the first part, the investor preferences for the decisions in primary market issues were graded using Likert scale. The data collected from the questionnaires in this part are analyzed using factor analysis. Factor analysis is used to identify the important combination of decisions taken by the investors while investing in primary market. In the second part the factors affecting the primary equity market were studied using ranks. Ranks were analyzed using Fried-Man two-way analysis of variance, to see whether a significant difference exist between various ranks given by the investors. The

third part consisted of an open-ended question relating to measures to improve primary market situation. Content analysis was carried out to find out the important measures of revival.

Data Characteristics and Analysis

The primary data is collected from Moradabad region of UP in India and the total number of proposed sample size is 100. Out of proposed 100 sample size, only 93 responses were received and 74 respondents are aware of primary market and they invest in primary market out of 93. That is why this survey is based on 74 respondents. The results got after analyzing the questionnaire is given below -

1. Personal Data of the Respondents

1.1: Consumers' Awareness about Primary Market-

79.57% respondents are aware about the primary market. (See Appendix Table-1.1)

1.2: Age-wise Distributions-

The age of the respondents is categorized into four classes. 23.65% respondents are in the group of 18-30 years whereas 15.05% respondents are 46-60 years group. (See Appendix Table-1.2)

1.3: Occupation-wise Distributions-

The occupations are classified in four categories. Those who are employed with public or private sector enterprises are classified as service category. Professional such as doctor, lawyers, chartered accountants, professors/ lecturers constitute the profession category. Those who run their own business are classified under business persons including business women. Retired persons, housewives and students etc. are classified as others. 36.49% of respondents are from professional class. Others are only 9.46%. (See Appendix Table-1.3)

1.4: Income-wise Distributions-

The incomes of the respondents are categorized into three classes. 36.49% respondents are in the income group of more than Rs.2.5 lacs to 5 lacs. More than 5 lacs income group are 25.68%. Below 2.5 lacs the number of respondents is 35.14%. (See Appendix Table-1.4)

1.5: Education-wise Distributions-

The education is classified in four categories. Professional such as doctor, lawyers, chartered accountants and professors/ lecturers constitute are classified as post graduate.

Only 16.22% respondents are undergraduates whereas 32.43% respondents are having post graduation. More than 83.78% respondents have graduate and above qualification. It means that consumers overall are educated. (See Appendix

Table-1.5)

2. Investor Decisions in Primary Market

The responses given by the investors in questionnaire designed for the survey, decisions taken by the individuals for investing in primary market, are summarized as below.

2.1: Respondents take decision to invest in listed companies with good current market price offering further public offers (FPOs) or in the initial public offers (IPOs) received the following response:

70.27% respondents invest their money in both IPOs and FPOs. Only 13.51% invest only in FPOs and 16.22% invest in only IPOs. It means mostly investors invest their money in both IPOs and FPOs. (See Appendix Table-2.1)

2.2: The decision of investment based on the advice received the following responses-

40.54% respondents invest their money through the recommendation of analysts and 32.44% respondents invest on the advice of financial intermediaries. It means mostly investors invest their money in the stock market on the recommendation of experts. (See Appendix Table-2.2)

2.3: The investors who purchase shares with the help of finance-

Mostly 90.54% respondents purchase shares with own money and only 9.46% respondents purchase shares with the help of finance. (See Appendix Table-2.3)

2.4: The investors who sell shares after allotment on the listing day-

54.05% respondents sell their shares after allotment on the day of listing of the company and 45.95% respondents do not sell their shares after allotment on the listing day. (See Appendix Table-2.4)

2.5: Factors affecting primary market

The ranks obtained factor affecting the primary market situations are given as below:

Liquidity of the shares (easily selling or heavily transaction in the stock market) and regulatory environment (i.e. government policies and SEBI rules and regulation etc.) are most effecting factor to attract the investors to invest in the stock market whereas issue price and lead managers' image are least effecting factor for investors. (See Appendix Table-2.5)

Conclusion

1. The launch of IPO also brings about shareholders of the company. Shareholders have ownership in the company. The primary owners of the company or the people holding maximum

authority in the company cannot take decisions all by themselves once an IPO has been launched and shareholders have been formed.

2. The shareholders have an active participation in every decision that is being taken even if they do not hold 50 percent share of the company. They have their individual demands to be met as they own a certain percentage of stakes in the company.
3. The shares once traded have an assigned market value and can be resold. This is extremely helpful as the company provides the employees with stock incentive packages and the investors are provided with the option of trading their shares for a price.
4. The shareholders of the companies have an affinity towards IPO as it can increase the wealth of the company as well as shareholders, without dividing the authority as in case of partnership.
5. Such factors include the rules and regulations involved to set up public offerings and this entire process on the other hand involve a number of complexities which sometime require the services of experts in relevant fields. Some companies hire experts to do the needful to ensure a hassle-free execution of the task.
6. Indian stock market has come a long way and regulatory has done an exemplary job in terms of disclosures, introducing the book building concept, reducing the time frame to six weeks from pricing to listing as compared to the old fixed price era when it used to be 3-4 months etc.
7. Reducing the time frame from pricing to listing further is one of the most important steps required to make it close to the international standard (which is 3 days from pricing).
8. Indian stock market is more transparent both in terms of disclosures in offer documents and in the book building process.
9. Indian book building process is through an open book, it is not really helping in price determination as almost all bids come in on the last day and are either at the top end of price range (in bullish markets) or at the bottom end (in bearish markets).
10. With margin money requirement for institutions, even the QIB orders come in on the last day thereby not providing the guidance to retail investors--which was the intention of having an open book.

11. Grading is something, which is more relevant for debt issuance. In equity issuance, just grading the company may not give the right picture to the investors, especially when the pricing is not known.
12. The regulations require notifications from the shareholders of the company, meetings, and also approvals from them while making important business decisions.
13. A major risk with shareholders is that, they can sell off their stocks any time they want, in case they see the price band of the stakes of that company is going down. This will lead to a further drop of the value of shares in the market which in turn will decrease the overall value of the company.

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Advantages and Disadvantages of IPO

Advantages	Disadvantages
Stronger capital base	Short-term growth pressure
Increases other financing prospects	Disclosure and confidentiality
Better situated for making acquisitions	Costs - initial and ongoing
Owner diversification and	Restrictions on management
Executive compensation	Loss of personal benefits
Increase company and personal prestige	Trading restrictions

Appendix

1. Personal Data of the Respondents

Table-1.1: Consumers' Awareness about Primary Market

Response	Size	Frequency (%)
Yes	74	79.57
No	19	20.43
TOTAL	93	100

Table-1.2: Age-wise Distributions

Age Group	Size	Frequency (%)
18-30	22	23.65
31-45	16	17.20
46-60	14	15.05
60+	16	17.20
TOTAL	74	100

Table-1.3: Occupation-wise Distributions

Occupation	Size	Frequency (%)
Services	23	31.08
Professional	27	36.49
Business Persons	20	27.03
Others	07	09.46
TOTAL	74	100

Table -1.4: Income-wise Distributions

Yearly Income	Size	Frequency (%)
Upto Rs.2.5 Lacs	26	35.14
More than Rs.2.5 to Rs.5 lacs	27	36.49
More than Rs. 5 lacs	19	25.68
TOTAL	74	100

Table-1.5: Education-wise Distributions

Education	No. of Respondents	Percentage of the Respondents
Undergraduate	12	16.22
Graduate	21	28.38
Postgraduate	24	32.43
Professionals	17	22.97
TOTAL	74	100.00

2. Investor Decisions in Primary Market

Table-2.1: Respondents take decision to invest in listed companies with good current market price offering further public offers (FPOs) or in the initial public offers (IPOs) received the following response

Response	Size	Frequency (%)
Only IPOs	12	16.22
Only FPOs	10	13.51
Both IPOs & FPOs	52	70.27
TOTAL	74	100

Table-2.2: The decision of investment based on the advice received the following responses

Response	Size	Frequency (%)
Financial Intermediaries	24	32.44
Self - Evaluation of the based on Own Analysis	06	08.11
Friends or Relatives	14	15.05
Analyst Recommendations	30	40.54
TOTAL	74	100