How Do Underpriced IPOs Behave In Short Run

Dr.M.Padmavathi
Assistant Professor
School of Management, SKCT
padmavathiramakrishnan@gmail.com

Ms.D.Suganya
Assistant Professor
MBA, SNTGAMSAT

ABSTRACT

IPO is generally issued by the company seeking capital to expand the business. However from the investors’ point of view it is difficult to predict the price of the share on its initial day of trading or the beginning days of trading. Hence the current study has been done with the objective of analyzing the IPOs underpriced and their behavior during the study period (2008-2012). To analyse the behavior various factors such as Issue Size, Age, Listing delay, Issue price, Over subscription times, Credit rating have been considered. The data required for the study have been obtained from the published information on the various websites such as NSE, BSE, and CHITTORGARH. The data so collected have been analyzed with the help of following statistical tools like Correlation and Percentage Analysis. The study revealed that the listing delay is statistically significant with respect to return on listing in short run. Likewise Age of the company affects the short run performance of IPOs by taking the initial raw returns.

Key words: Listing delay, Credit rating, Oversubscription times, Issue price

INTRODUCTION

Initial public offering (IPO), also referred to simply as a “public offering” or “flotation,” 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.

An IPO 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. However, in order to make money, calculated risks need to be taken.

A worldwide survey of literature on the phenomenon of under pricing of IPOs exhibit three fundamental characteristics:
(a) The Initial price reaction phenomenon or in other words ‘underpricing’: the immediate after market price, on average is significantly higher than price at which the initial offer was made.
(b) The Hot Issue Phenomenon: there are distinct cycles outlined, both in the number of issues that come to the market and the level of initial price reactions
(c) The long-run “underperformance” phenomenon: initial offers are said to perform dismally in the long-run compared to the industry counterparts for the same period.

OBJECTIVES OF THE STUDY

➢ To find out the IPOs underpriced during the study.
To look at the behaviour of IPO during the study-
the influence on returns considering various factors such as Issue Size, Age, Listing delay, Issue price, Over subscription times, Credit rating.

REVIEW OF LITERATURE

Aminul Islam et al (2010) analyzed the levels of underpricing in IPOs and its determinants of the Chittagong Stock Exchange (CSE). The degree of underpricing in the Bangladesh capital market is rather high compared to that of other Asian and advanced stock markets. Key trends in the levels of underpricing and overpricing are highlighted on a year to year, and industry to industry basis. The overall level of underpricing at the Chittagong Stock Exchange was 480.72% with a standard deviation of 1217.25. Out of the 191 companies that were listed in the years 1995 to 2005, 173 (90.57%) IPOs were found to be underpriced, 16 (8.37%) overpriced while only 2 were accurately priced. The overall level of overpricing was 17.87% with a standard deviation of 14.14. Regression analysis shows that age of the firm, and size of the company is positively related to the degree of underpricing. The industry type and offer size are found to be negatively related to the degree of underpricing. However the timing of offer was found to have no significant influence on the degree of underpricing of IPOs in the Chittagong Stock Exchange.

Chan-Hyun Sohn et al (2012) investigated the under-pricing and long-run performance of 230 A-share IPOs issued in the Chinese markets using comparable firm multiples. We find that A-share IPOs are severely under-valued by issuers and underwriters at the offer, but over-valued by investors on the listing day. Both contribute to the severe under-pricing of IPOs in China. Their findings are robust across stock exchanges, classification of firms, criteria for choosing matching firms; absence of CSRC regulation and B-share market prices, respectively. The results also showed that those over-valued IPOs by investors on the listing day under-perform those under-valued IPOs in the long-run.

Nashirah Binti Abu Bakara, Kiyotaka Uzakib (2013) stated that Initial Public Offerings (IPO) underpricing is an important factor for investors to predict the profit from investment activities. Numerous empirical research reports the existence of IPO underpricing in various investment environments around the world. However, the factors that influenced IPO underpricing vary between each country and still remain a largely unexplored. Examining 420 IPOs for shariah-compliant companies listed on the Malaysian Stock Exchange (MSE), this study investigates the average degree of IPO underpricing for shariah-compliant companies and the effect of determinant factors on the degree of IPO underpricing for shariah-compliant companies. The result showed that the degree of IPO underpricing for shariah-compliant companies is 28.82 percent. Using a multiple linear regression analysis, the study found that the time of oversubscription has a significant effect on the degree of IPO underpricing for shariah-compliant companies.

Ping-fu LAI (2012) analysed the issue of IPO pricing depending on different determinants to decide in under-pricing or over-pricing as offer. The paper tackles the issue of under-pricing IPO and the relevant mechanism from the perspectives of behavioral biases and agency conflicts. In addition, it evaluates between the under-pricing mechanism and any information asymmetry involvement for generating abnormal return in IPO investment. They examined the IPO listed to help to investigate the influence in the offer price from the various factors of determinants. A methodology of multiple regression technique used to define the null hypothesis as “With the Initial Offer Price to the IPO reflected its fundamental information significantly.” is adapted or not. It showed that initial offer price has influenced in earnings per share, retained ownership, growth prospects, leverage and under-pricing level significantly.

Michelle Lowry (2007) found that about one-third of US IPOs between 1996 and 2000, executives received stock options with an exercise price equal to the IPO offer price rather than a market-
determined price. Among firms with such “IPO options”, 58% of top executives realize a net benefit from underpricing: the gain from the options exceeds the loss from the dilution of their pre-IPO shareholdings. If executives can influence either the IPO offer price or the timing and terms of their stock option grants, there should be a positive relation between IPO option grants and underpricing. They found no evidence of such a relation. Their results contrast sharply with the emerging literature on managerial self-dealing at shareholder expense.

The empirical studies on Indian IPO markets primarily focused on the initial returns. Unlike the underpricing issue, the long-run performance of IPOs in India is less explored and has so far mixed results have been depicted. The studies undertaken in Indian context on under pricing have been done by Shah (1995), Majumdar (1999). Shah (1995) empirically studied India's vibrant IPO market, via a dataset of the 2056 IPOs. The study analyzed the overall underpricing, the delay between issue date and listing date, the time-series of monthly volume of IPO issues and average underpricing in a given month, the cross-section of underpricing across companies, the post-listing trading frequency, the long-run returns to new listings, and price discovery by the market shortly after first listing. Madhusoodan et al. (1997) documented a positive return of 16.33% for 1922 IPOs after three years from issue.

METHODOLOGY
This study is analytical, since the present state of affairs is studied and a thorough analysis is made using the available facts. The data required for the study have been obtained from the published information on the various websites such as NSE, BSE, and CHITTORGARH. The study is based mainly on the secondary data through the published information. For the purpose of carrying out the analysis, the data available in the websites have been regrouped and rearranged suitably. The period of study is for five years from 2008 to 2012. The main reason behind choosing the companies which have issued the IPOs during these years is that, it was the times the Indian securities market has seen its maxima and the minima. The data so collected have been analyzed with the help of following statistical tools like Correlation and Percentage Analysis.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of IPOs (underpriced)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>29</td>
<td>21.2</td>
</tr>
<tr>
<td>2009</td>
<td>19</td>
<td>13.9</td>
</tr>
<tr>
<td>2010</td>
<td>57</td>
<td>41.6</td>
</tr>
<tr>
<td>2011</td>
<td>21</td>
<td>15.3</td>
</tr>
<tr>
<td>2012</td>
<td>11</td>
<td>8.00</td>
</tr>
<tr>
<td>TOTAL</td>
<td>137</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Secondary reports

From the above table it is clear that the number of IPOs which were issued at underpricing were in a down trend till 2009. There is uptrend in the year 2010 and down trend continues, because of the fact the companies are adopting an efficient book building process. One of the major disadvantages as a result of underpricing is that it leads to speculation by major parties for earning short term profit. The disadvantages of these are just being eliminated by the tight Indian securities system.
The number of IPOs which were issued at underpricing differs proportionately in different sector. When it comes to Information technology there has been a lot of underpricing because of the economic boom during those years and companies went for underpricing in order to face the competition and build the reputation. When it comes to ever running sector such as Infrastructure, Services and the Pharmaceauticals there has been an average number of IPOs.

From the above table it is clear that the number of IPOs which were issued at underpricing were issued at different size. The IPOs within >200 crore is in a major proportion, which were mostly done by well established companies and the information about the company was always towards the positive side. 14% of the companies came up with 201-400 crore issue size and 22% of the companies came up with >600 crore issue size.

**BEHAVIOUR OF IPO**

The behaviour of IPO is considered on various factors such as Issue Size, Age, Listing delay, Issue price, Over subscription times, Credit rating. It has been analyzed in the following table.

<table>
<thead>
<tr>
<th>Factors</th>
<th>Correlation coefficient</th>
<th>Factors</th>
<th>Correlation coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age of the company</td>
<td>0.050</td>
<td>Over subscription times</td>
<td>0.653</td>
</tr>
<tr>
<td>Index</td>
<td>0.178</td>
<td>Issue rating</td>
<td>0.397</td>
</tr>
<tr>
<td>Issue price</td>
<td>-0.138</td>
<td>No of shares</td>
<td>-0.057</td>
</tr>
<tr>
<td>Issue size</td>
<td>-0.050</td>
<td>Listing delay</td>
<td>-0.011</td>
</tr>
</tbody>
</table>

Issue Price: A negative relationship exists between return on listing and the issue price i.e. lower the issue price higher is the return accrued. The relationship is found to be statistically significant. Issue price is one of the factors to influence return, but it is not the only factor.

Issue Size: A negative relation exists between return on listing and the issue return is found to be higher in case of small-size issues in comparison to large-size issues. There is a gradual fall in the initial return on listing across issue-size. Minimum issue size is 19 crore and the maximum issue size is 15199 crore.

Age of the Company: There is a positive relation between return on listing and the age of the
company at the time of issue. The relationship is found to be statistically significant.

**Issue Rating:** There is a positive relation between return on listing and the issue rating for the said initial public offer made by the company. The relationship is found to be statistically significant. The issue rating assigned to the IPO is found to be significantly influence on the initial return of the IPO. A high rating assigned to the initial public offer is found to be significantly influence on the return of listing.

**List Delay:** The average time taken for listing is 17 days. The minimum time taken for listing is 5 days while the maximum is 40 days. Listing delay and the return on listing exhibit a negative relation; i.e. less the amount of time taken to list at the stock exchange, higher is the initial return. The relationship is found to be statistically significant.

**Index:** There is a positive relation between the return on listing and index value. The relationship is found to be statistically significant.

**Number of Shares:** There is a negative relationship between number of shares and return on listing.

**Over subscription times:** A positive relation exists between return on listing and over subscription times. Over subscription leads to higher initial return.

**TABLE 5: FACTORS VERSUS RETURN ON LISTING**

<table>
<thead>
<tr>
<th>Factors</th>
<th>Relationship with return on listing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listing delay</td>
<td>Negative, significant</td>
</tr>
<tr>
<td>Age of the company</td>
<td>Positive, significant</td>
</tr>
<tr>
<td>Stock value</td>
<td>Positive, significant</td>
</tr>
<tr>
<td>Issue price</td>
<td>Negative, insignificant</td>
</tr>
<tr>
<td>Issue size</td>
<td>Negative, significant</td>
</tr>
<tr>
<td>Oversubscription times</td>
<td>Positive, highly significant</td>
</tr>
<tr>
<td>Credit rating</td>
<td>Positive, highly significant</td>
</tr>
<tr>
<td>Number of shares</td>
<td>Negative, significant</td>
</tr>
</tbody>
</table>

**FINDINGS**

It has been found that there is a downtrend in the under pricing of IPOs from 2008 to 2009. Services sector seems to have produced more than 30 IPOs in the 5 years which were under priced. Various determinants and their relationship with the return on listing has been found out along with their relationship

**CONCLUSION**

The listing delay is statistically significant with respect to return on listing in short run. This implies that the companies should shorten the breadth of the delay so as to avoid the negative impact on return on listing. Age of the company affects the short run performance of IPOs by taking the initial raw returns. Many of the researchers found that age of the company affects both the long run and short run performance. The shares should be allocated in a huge lot size to avoid the increase in number of shares which might lead to adverse effect on the return on listing. Since this research is directed only to know the short run performance of underpriced IPOs, factors influencing the long run performance may be studied in future.

**References**


