International Journal of Applied Research 2015; 1(13): 304-305

International Journal of Applied Research

ISSN Print: 2394-7500
ISSN Online: 2394-5869
Impact Factor: 5.2
IJAR 2015; 1(13): 304-305
www.allresearchjournal.com
Received: 17-10-2015
Accepted: 19-11-2015

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Short term wealth creation in Indian IPO – An empirical evidence

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Abstract
Initial Public offering is issuing new securities on an exchange. The issuing company offers its equity to investors or groups and receives cash proceeds from the sale, which is then used to fund operations or expand the business. It is the largest source of funds with long or indefinite maturity for the company. The sample period is for 2012-2014 and includes all companies which went public during the sample period. The study examines the initial returns and long term performance of the sample data.

Keywords: wealth creation, Indian IPO, empirical evidence, investors

Introduction
An Initial Public Offer is first sale of shares by the privately owned company to the public. The funds are raised through IPO to pay debts, increase working capital, new plant induction, acquisitions and host of other uses. Investors apply for IPO stocks by filing an application form which is available with the brokers or investment bankers free of cost.
India has a unique Initial Public offering method which is governed by regulatory bodies and which in turn has led to increase in the investor participation in the same. India's IPO market raised resources equalling to 20% of domestic savings in 1994-95. IPO has gained importance over the years bring the primary market in the limelight and making it an important source of resource generation and allocation. Hence it is very important to understand the dynamics of IPO pricing and performance to increase the profitability through investment in primary market.

Review of Literature
Brealy and Myers (2005) [2] in their study throw light on firms in the USA and state that they go for public funding only in the later years of their operation and do with private equity in the initial years.
LaPorta (1999) had pointed out that for emerging market countries, ownerships structure plays an important role in corporate finance.
Stoughton (1998) concluded that IPO companies use underpricing to create a more practical ownership structure.
Kunz and Aggarwal (1994) and Loghran *et al*. (1994) [5] in their study examined the returns of IPO for a number of countries and concluded that they all performed very poor in the long run.
Loughran and Ritter, 1995; McGuinness, (1992) in their study document that IPO are found to underperform in the long run and observe an abnormal return on the listing day.
Madhusoodanan and Thiripalraju (1997) analyse both short-run and long-run after-market pricing performance of the Indian IPOs issued prior to 1997. They indicate that in the short run, the Indian IPOs generate more market-adjusted initial return than the international IPOs. In the long run too (after one year of listing), Indian IPOs generate higher returns compared to the negative returns reported from other countries.

Objectives
1. To analyse the Degree of underpricing from the sample.
2. To analyse the initial performance of companies on first trading day.
3. To analyse which company facilitated wealth creation from the first trading day.

Data and Research Methodology

The IPO sample is derived from the Prime Database2 annual reports for the period 2012-2014. Multiple online databases, including CMIE Prowess, http://www.nseindia.com, http://www.bseindia.com, http://www.sebi.gov.in, and www.capitaline.com for listing and post-listing price information.

The performance on listing day as well as long term performance from the day of listing is calculated. Market-adjusted abnormal return (MAAR) is calculated to explain the degree of underpricing and abnormal returns on the listing day.

Market-Adjusted Abnormal Return (MAAR)

It is calculated to understand the degree of underpricing and calculate the abnormal returns on the first day of listing. It is calculated as the difference of of initial return calculated for the security (i) on day one to the benchmark return on that day. Miller and Reilly (1987) calculated MAAR using the formula as given in Eq. (1).

The MAAR for the IPO stock (i) on day 1 is calculated by using Eq. (1).

$$MAAR_{i1} = \left[\frac{(1+R_{i1})}{(1+R_{m1})} - 1 \right] \times 100 \text{ - - - - - - - - - - } (1)$$

Where, MAARi1 is the market-adjusted abnormal rate of return for the stock i on day 1, Ri1 reflects the percentage change in list price vis-à-vis offer price. Rm1 is calculated as the percentage change in closing market index value on the listing day to market index on the date of closure of issue. The initial day price performance of each IPO has been calculated by using Eq.(1). The S & P CNX Nifty (hence after Nifty) closing value has been used to calculate the market index return.

Descriptive Results

Company name	Maar
Monte Carlo Fashions Limited	-5.1125
Shemaroo Entertainment Limited	-25.3686
Sharda Cropchem Limited	81.6261
Snowman Logistics Limited	21.08871
Wonderla Holidays Limited	0.496458
Engineers India Limited	576.0668
Power Grid Corporation of India Limited	22.35011
Just Dial Limited	-6.01862
Repco Home Finance Limited	0.104537
V-Mart Retail Limited	1.873478
Bharti Infratel Limited	-6.38056
PC Jeweller Limited	1.246399
Credit Analysis and Research Limited	29.03397
Speciality Restaurants Limited	-0.0676
Tribhovandas Bhimji Zaveri Limited	0.107297
Mt Educare Limited	2.000222
National Buildings Construction Corporation Limited	-3.99835

Using the MAAR it can be concluded that majority of the companies listed at a higher price compared to the offer price. Engineers India Ltd recorded a high Market Adjusted Abnormal Return at 576.06 and the lowest Shemaroo Entertainment Limited which saw a negative value of -25.3686 which implied that the listing price was lower than the offer price and the investors faced a loss.

Other companies like Sharda Cropchem Limited, Snowman Logistics Limited, Wonderla Holidays Limited, Power Grid Corporation Of India Limited, Repco Home Finance Limited, V-Mart Retail Limited, PC Jeweller Limited, Credit Analysis and Research Limited, Tribhovandas Bhimji Zaveri Limited, MT EDUCARE LIMITED reaped profits on the first trading day whilst companies like Monte Carlo Fashions Limited, Shemaroo Entertainment Limited, Just Dial Limited, Bharti Infratel Limited, Speciality Restaurants Limited, NATIONAL BUILDINGS CONSTRUCTION CORPORATION LIMITED failed to outperform the offer price resulting in loss to the investors.

Limitations and Discussions

The results indicate that companies adopt underpricing to attract investors to invest in their companies. Majority of the companies provide bountiful profits as a result of their underpricing. The same phenomenon has been widely used by investors for speculative purposes. Whereas certain analytics must be used to select the right companies before investing in their IPOs to avoid ‘winners curse’.

The limitations of this study is that only fresh IPO was selected and companies offering follow up issues were omitted due to time constraint.

With view for further research determinants of IPO underpricing, long term performance of the Indian IPO can be studied to find out if primary market is more successful than secondary market.

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