European Journal of Business & Social Sciences
Available at https://ejbss.org/
ISSN: 2235-767X
Volume 07 Issue 02
February 2019

Pricing And Performance Of Ipo's: Indian Stock Market

V. Surendhar Rao,
Lecturer in Commerce, Sri Venkateshwara Degree College, Hyderabad, TS

Abstract:

In this study we are gone through, how the IPO'S are priced in the Indian stock market. Evaluation of their performance in the Indian capital markets and the source from the point of view of Indian stock market.

Keywords: Indian Stock market, Pricing, IPO's, Evaluation, IPO's performance, IPO's process,

INTRODUCTION:

Initial public offering (IPO) is the first time that the stock of private company is offered to the public and IPO'S are often issued by younger, smaller companies seeking capital to expand, but they can also be done large privately owned companies looking to become public traded. Initial public offering (IPO) is the process that a privately owns enterprises into a public company whose shares are traded on a stock exchange. When a company goes public, it is owned by the shareholders who purchase its stock. What to be considered while pricing the IPO'S. The evaluation process to decide the IPO Price is quite complex. Several methods are applied to determine the price of an IPO. The three most common methods are described below:

- Factors that influence the pre-IPO Valuation.
- Absolute Valuation.
- Relative Valuation.

Factors that influence the pre-IPO Valuation

Deciding factors that influence IPO pricing the most are:

- The quality of stocks currently being sold in an IPO
- The organizational or management set-up of the private company
- The current market prices of the stocks of similar companies in the same sector
- Company's future growth potential
- Financial effectiveness of Company's business model
- The demand from the potential customers for company's shares
- General overall market trend
- Sometimes, any positive news like the company's recent achievements, success story, or products they offer may also affect pricing.

ABSOLUTE VALUATION

ISSN: 2235-767X
Volume 07 Issue 02
February 2019

Absolute valuation method is the process to estimate the company's basic value by analysing the company's fundamentals according to the market value. Below list the two most popular techniques used to calculate the IPO price.

DISCOUNTED CASH FLOW:

It is the net present value (NPV) of the anticipated cash flows from an investment as at today or at any given time. The gross revenue streams are figured out by using a series of assumptions about the future business performance and then forecasting how much this business performance can generate revenue.

ECONOMIC VALUE:

The value is calculated mathematically by accounting the economic factors like company's residual income, assets, risk bearing potential, and outstanding debts.

A simplified formula is: ***Value of equity = (Enterprise value + Value of cash and investments) - Value of debt and other liabilities.***

Relative Valuation:

Relative Valuation Method determines the share price by comparing the financial health of the company in question to similar companies within the same sector. That is why this method is also known as comparable valuation. The two most popular techniques used in relative evaluation methods are as follows:

Price-to-Earnings-Multiple

It is one of the most common evaluation method used to determine share price, also known as P/E Ratio. This compares a company's market capital to its annual income. To compute the value of the company, its estimated equity value is divided by its recent year's net income. This technique is used when the company has positive cash flows and when other companies operating in the same industry have similar growth and capital structure.

Value-to-EBITDA-Multiple:

This method measures the total value of business operations (enterprise value), instead of measuring the value of the equity. When the enterprise value is estimated, only the operational value of the business is considered. So, it accounts for the capital value and the cash & security holdings. The investments in bonds, treasury bills, or any investment in stocks of other companies, are excluded. If you are evaluating any company which has huge outstanding debts, it will show negative earnings but will have a positive EBITDA value.

Performance of IPO'S;

There are several factors that may affect the return from an IPO which is often closely watched by investors. Some IPOs may be overly-hyped by investment banks which can lead to initial losses. However, the majority of IPOs are known for gaining in short-term trading as they become introduced to the public. There are a few key considerations for IPO performance.

ISSN: 2235-767X
Volume 07 Issue 02
February 2019

Lock-Up

If you look at the charts following many IPOs, you'll notice that after a few months the stock takes a steep downturn. This is often because of the expiration of the lock-up period. When a company goes public, the underwriters make company insiders such as officials and employees sign a lock-up agreement. Lock-up agreements are legally binding contracts between the underwriters and insiders of the company, prohibiting them from selling any shares of stock for a specified period of time. The period can range anywhere from three to 24 months. Ninety days is the minimum period stated under Rule 144 (SEC law) but the lock-up specified by the underwriters can last much longer. The problem is, when lockups expire, all the insiders are permitted to sell their stock. The result is a rush of people trying to sell their stock to realize their profit. This excess supply can put severe downward pressure on the stock price.

Waiting Periods

Some investment banks include waiting periods in their offering terms. This sets aside some shares for purchase after a specific period of time. The price may increase if this allocation is bought by the underwriters and decrease if not.

Flipping

Flipping is the practice of reselling an IPO stock in the first few days to earn a quick profit. It is common when the stock is discounted and soars on its first day of trading.

Tracking Stocks

Closely related to a traditional IPO is when an existing company spins off a part of the business as its own standalone entity, creating tracking stocks. The rationale behind spin-offs and the creation of tracking stocks is that in some cases individual divisions of a company can be worth more separately than as a whole.

From an investor's perspective, these can be interesting IPO opportunities. In general, a spin-off of an existing company provides investors with a lot of information about the parent company and its stake in the divesting company. More information available for potential investors is usually better than less and so savvy investors may find good opportunities from this type of scenario. Spin-offs can usually experience less initial volatility because investors have more awareness.

IPOs Long-Term

IPOs are known for having volatile opening day returns that can attract investors looking to benefit from the discounts involved. Over the long-term, an IPO's price will settle into a steady value which can be followed by traditional stock price metrics like moving averages. Investors who like the IPO opportunity but may not want to take the individual stock risk may look into managed funds focused on IPO universes. There are a few IPO index funds or ETFs that can also be a good investment such as the First Trust U.S. Equity Opportunities ETF (FPX).

To analyse the IPO performance in perspective of time, Short Term & Long Term

ISSN: 2235-767X
Volume 07 Issue 02
February 2019

1. Results of short run and long run returns given by IPOs conclude that positive returns are received in short run. More of the IPOs whether individual or market adjusted are paying returns more in short time duration, may it be one week, one month, one quarter and one year. Less number of IPOs are giving Returns more than zero in long term may it be two years, three years, four years and five years. Results are similar to the index adjusted returns in both time horizon which says that individual companies are not behaving paranormal the returns provided by them are as similar to the index only.
2. Average returns earned on the listing day alone is positive and it started reducing, became negative and more negative. Further fall in average returns is noticed in long run also. This indicates that firms with the sole motive of raising capital comes in stock market and issues IPO, less or no dividend is paid after wards which make these securities less marketable and fall in prices can be seen. As the time increases, similar fall in average returns is noticed.
3. The results of the cross tabulation between age of issuing company and IPO returns in long and short run, indicates that there is no significant difference in the mean returns of the IPOs for the companies in different age groups. In other words it can be concluded that, there is no relation between, the returns of IPOs and the age of the company issuing an IPO.
4. Test of association between IPO rating and IPO returns concludes that null hypothesis is not rejected saying that no association is there between these two factors, in all time horizon. Other factor is age of issuing company and the results are same showing no association between age of company and IPO returns in both short and long term. Only in case of one year market adjusted returns of IPOs, association was found between age of company and returns on IPO.
5. Bivariate regression concludes that significance is found between qualified institutional buying and long term IPO returns. Correlation is found to be negative in case of retail investors and IPO returns at the end of year one. And no correlation was found significant with other factor variables like overall subscription, HNI, QIB, IPO rating, age of issuing company with the returns of IPO of year one. IPOs performance is not good nor in short run or long run, but if compared IPOs may give positive returns in short span of time but in long run, no returns are received.
6. The rational investor are more likely to invest in short term period and make short term gains because the IPOs are over performed only unto a month after listing day and after this the IPOs started to fall and negative return IPOs performance was recorded as above price performance chapter. From this study results, it is concluded that the investors are more willing to invest in the metals and mining industry due to their positive return performance recorded up to a month after listing. The investors have to earn profits only from short-term investments. And in the case of issue size of the IPOs, if recorded larger issue size then the IPO was less over performed and smaller issue size IPOs performed more under Priced. The issue size of IPOs showed negative relationship with the IPO returns. As the issue size of IPO increased, the IPOs return recorded overpriced performance. The small issue size offerings performed better than the large issue size offerings in this study.

CONCLUSION:

ISSN: 2235-767X
Volume 07 Issue 02
February 2019

This study results may be helpful for the investors who make their IPO investment decisions on guesses or blindly follow the others reactions. The above suggested readings help us in analysing the performance of the IPO'S. As observed that the IPOs were unevenly distributed during the study period. The market momentum affected the issuance of the IPOs. The more number of IPOs issued when the market is rising and the sentiment of investors for IPOs is also rising. It is suggested to the issuing companies and regulatory authorities to issue the IPOs evenly every year. Thus, the IPOs capital is raised when it is ensure that the IPOs are evenly distributed. When the IPOs will evenly distribute, the investors will rationally behaved.

REFERENCES:

1. R. Aggarwal and P. Rivoli, "Fads in the Initial Public Offering Market?" Financial Management (Winter 1990), pp. 45-57
2. Krishnamurti C, P. Kumar, (2002) "The initial listing performance of Indian IPOs", Managerial Finance, Vol. 28 Iss: 2, pp.39 – 51.
3. . Jegadeesh, N.; M. Weinstein; and I. Welch. 1993. "Initial Public Offering and Subsequent Equity Offerings." Journal of Financial Economics 34, 153–175.
4. Rajan, Raghuram; Servaes, Henri, "Analyst Following of Initial Public Offerings" Journal of Finance, Jun 97, Vol. 52 Issue 2, p507-529
5. Ritter, J.R. (1991), "The long run performance of initial public offerings", Journal of Finance, 46(1), pp. 3-27.
6. Madan, A.A. (2003), "Investments in IPOs in the Indian Capital Market", Bimaquest, 3(1)
7. Shah, A. (1995), "The Indian IPO Market: Empirical Facts", Technical Report Centre for Monitoring Indian Economy, Bombay
8. . Kasim Alli, , Jot Yau and Kenneth Yung, "The underpricing of IPOS of financial institutions", Journal of Business Finance & Accounting, 21(7), October 1994, pp.1013-1030.
9. www.slideahare.net
10. Investopedia.net