

“A STUDY ON FACTORS INFLUENCING THE PRICING OF INITIAL PUBLIC OFFERINGS IN INDIAN CAPITAL MARKET”

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Abstract : Economic growth of any country depends on strong financial system in general and vibrant capital markets in particular. Financial system plays a significant role in enhancing economic growth by mobilizing savings in the economy. Financial system is combination of markets, regulations and techniques through which financial instruments are traded, interest rates are determined and financial services are produced and delivered around the world (Pietrzak, Polański and Woźniak, 2008; Rose and Marquis, 2009). Primary market is a platform for the corporate to raise money by issuing shares for the first time to the public through the prospectus by inviting large segment of investors is referred to as initial public offerings. The pricing of IPOs is influenced by various factors such as method of issue; issue size, subscription status etc. For instance, the work of Kedar M Phadke, Manoj S Kamat (2018) show that the subscription rate and repo rate plays a significant role in the pricing. Daljono (2000) Underwriter’s reputation and financial leverage influence the returns of Initial public offerings. In this backdrop, this paper aims to study the various factors influencing pricing of Initial public offerings in Indian capital market.

Keywords : *Financial system, Initial Public offerings, Underwriter, Issue size.*

I. INTRODUCTION

Financial system plays a significant role in enhancing the growth of the economy. Financial system increases investment activity by mobilizing savings through its components. Financial market is a place where securities are bought and sold. Primary market plays a momentous role in transferring the financial resources from savers to the borrowers. It provides a platform to the investors (to buy and sell securities) and corporate to raise money. Initial public offering refers to the first time issue of a share made by the firm. In other words, the firm issues share for the first time to the public through prospects by inviting large segment of people in capital market. Every share has a true value which is termed as intrinsic value. This intrinsic value is the worth of a share which is a combination of the firms’ historical performance, future prospects, goodwill to name a few. Generally the shares are underpriced or overpriced depending on various factors like economic situations, company performance, and industry variables in order to move towards the intrinsic value to adjust to the market performance. Underpriced securities are those, where the closing prices of the share on the first day after listing is higher than the offer price. This is beneficial for the investors as they would have bought the share at a lesser price. On the other hand, Overpriced securities are those, where the closing prices on the first day after listing are lower than the offer price. It is not simple/easy to identify whether the security is underpriced or overpriced directly. But, one can make profits from the capital markets, if mispricing is identified. Therefore, in this context, this paper attempts to analyse the various factors influencing the pricing of Initial public offering in Indian capital market.

Objectives

- To study the concept of underpricing and overpricing of securities with reference to Initial public offerings.
- To identify the factors influencing the performance of Initial Public Offerings in Indian Capital market.

Review of Literature

Kedar M Phadke, Manoj S Kamat (2018) has explained in his paper that the relationship between the macroeconomic factors influencing initial public offerings in National stock exchange by considering 239 initial public offerings during the period from 2000- 2014 by considering marginal adjusted return on opening as dependent variable and other factors like issue type, issue size, subscription rate, repo rate and exchange rate as independent variables. Researcher has shows that the subscription rate, repo rate has positive impact on level of underpricing. Whereas the book building method of pricing, large cap stocks (issue size greater than 1000 crore) and mid cap stocks(between 200 crore to 1000 crore), exchange rate has negative impact on level of underpricing.

Mahesh R, Melyaeaty S D (2014) has analysed the various factors affecting towards the level of under pricing by considering 27 companies which fulfils the criteria for the study during the period from 2001 to 2011. By using Generalized linear model of Multiple regression model has examined the relationship between variables and concluded that the none of the factors does not influence the level of pricing of Initial public offerings.

Asim Kumar Mishra (2012) has examined the methods of pricing (fixed price method or Book building method) affects the pricing of Initial public offerings by analysing 235 IPOs of (144) industrial sector, services and (25) financial sector during the period from 1997 to 2008 on the Indian Stock exchanges. Researcher has finally concluded in his study that the Book building method of pricing helpful in reducing underpricing of initial public offerings in India. Henceforth, the Book building method of pricing help in reducing the asymmetry between issuer, investment banker and investors and not necessarily show pricing of initial public offerings in India.

Aggarwal. R and P. Rivoli (1990) the literature has highlighted one of the anomalies observed that the underpricing of initial public offering all over the world. Loughran & Ritter (1995) Ritter (1991) has documented ruthless underperformance of IPOs during the past 25 years in US.

Dr. Radhe S Pradhan and Kushal Shrestha has analysed in his study the various factors like size of the company, issue size, reputation of issue size, subscription rate, market condition (independent variables) and initial return (dependent variable) by considering 61 firms during the period from 2005 to 2011 in Nepalese stock market by using regression model to test the significance of hypothesis. Finally concluded that size of the company, subscription rate, market condition, reputation of issue manager positive significance towards the initial return of Initial public offerings. Whereas the issue size is negative significance towards the initial return of Initial public offerings in Nepalese stock market.

Neeta Jain and C Padmavathi (2012) has documented the research considering 227 book built initial public offerings during the period from 2004 to 2009 pointed out that the maximum underpricing was 242 percent. This study was made an attempt to examine the various factors affecting underpricing of IPOs. Author has documented few theoretical arguments for the reasons for underpricing of initial public offerings and also explored the empirical studies on various factors such as age of the firm, Pre IPO leverage, issue size, market condition, subscription, listing delay, return on opening towards the underpricing of initial public offerings. Finally researcher has examined that the variables return on opening, Pre IPO leverage and subscription is positive significant towards the underpricing of initial public offerings and further says that IPOs high value firms are more underpriced than IPOs low value firms.

Namrata N Khatri (2017) has documented by considering sample as 300 respondents (non-probability sampling) in Surat city to analyse the various factors such as advertisements, legal facts of the company, management efficiency influencing the investment decisions by investors and also to see the problems faced by investors while investing in initial public offerings. Finally she concluded that the company policy, future prediction and projection, news related to company and financial information are the factors which influence the investment decisions taken by investors in initial public offering.

Table 1: A summary of the factors influencing pricing of IPOs is presented below

Author	Title of the Paper	Factors influencing Pricing of IPO
Kedar M Phadke , Manoj S Kamat (2018)	“Impact of Macroeconomic and IPO factors on Underpricing of Initial Public offering on the National Stock Exchange in India”	Subscription rate, repo rate has positive impact on level of underpricing. Whereas the book building method of pricing, large cap stocks and mid cap stocks exchange rate has negative impact on level of underpricing.
Mahesh R, Melyaeaty S D (2014)	“Analysis of Factors Influencing Underpricing level During the Initial Public Offering: A Study Of Select Companies Going Public In Bombay Stock Exchange”	None of the factors does not influence the level of pricing of Initial public offerings.
Asim Kumar Mishra (2012)	“Underpricing of Initial Public offerings in India: A Comparison of the Book-Building and Fixed-Price Offerings”	Book building method of pricing help in reducing the asymmetry between issuer, investment banker and investors and not necessarily show pricing of initial public offerings in India.
Dr. Radhe S Pradhan and Kushal Shrestha	“Performance of the initial public offering (IPO) in the Nepalese stock market”	Size of the company, subscription rate, market condition, reputation of issue manager positive significance towards the initial return of Initial public offerings. Whereas the issue size is negative significance towards the initial return of Initial public offerings in Nepalese stock market.
Neeta Jain and C Padmavathi (2012)	Underpricing of Initial Public Offerings in Indian Capital Market	Researcher has examined that the variables return on opening, Pre IPO leverage and subscription is positive significant towards the underpricing of initial public offerings and further says that IPOs high value firms are more underpriced than IPOs low value firms.

Underpricing and Overpricing in Initial Public offerings

Initial public offerings refer to the company issue shares for the first time to the public through prospectus for large segment of the people for the purpose of their expansion or modernizing the activities of their company growth. Further it is a platform for investors to invest their money in shares to create their wealth. Generally the securities are mispriced Underpriced and overpriced securities) in Indian capital market. Underpriced securities are those whose closing prices on the first day of listing is higher compared to offer price of Initial public offerings which is beneficial to investors whereas it is cost for the company (money left on the table) in issuing shares to the public. Overpriced securities are those whose closing prices on the listing day are lesser compared to offer price of initial public offerings. Hence, there is prerequisite to analyse the various factors influencing the pricing of Initial public offerings in Indian capital market from the point of view of corporate , investors, stakeholders to enhance the growth towards the development of industry in general and boost the confidence level towards the investment decisions in Initial public offerings in particular.

Factors influencing the performance of Initial Public Offerings: The various factors influencing the performance of Initial public offerings they are

- **Age of the company:** The number of years of the company since its establishment to listing of company after issuing shares to the public through prospectus. has documented in his study that the age of the company has positive significance towards the initial returns of Initial public offerings that indicates that the age of the company increases, the returns of initial public offerings is also increases. My observation is that as the company age is more in number of years their experience will enrich the capacity of analyzing the factors before fixing a price of a share in initial public offerings.
- **Method of pricing:** There are two methods of pricing in Initial public offerings in India. Fixed price method refers to fixation of price of a share by issuer in association with merchant banker by considering various factors. Book building method of pricing refers to bids are collected within the price band specified by the issuer to know the demand in real time basis after closure of bids within the specified time limit and finally fix the price of a share by this process. Asim Kumar Mishra (2012) has documented that the Book building method of pricing helpful in reducing under pricing of initial public offerings in India. Henceforth, the Book building method of pricing help in reducing the asymmetry between issuer, investment banker and investors and not necessarily show pricing of initial public offerings in India. My view in this study says that the book building method of pricing will help companies to reduce the level of under pricing. Because its pricing is determined by knowing the demand in real time basis that gives precision in fixing a price by book building process that reduces the mispricing of securities.
- **Size of the issue:** Issue size refers to the number of shares and multiplied by its face value issued to the public in capital market. Generally the higher the issue size, lower will be the issue price.
- **Subscription ratio:** Subscription ratio refers to the right to buy number of shares in publicly traded in capital market. As subscription increases the demand for that particular share increases that leads to increase in the price of a share after listing on the stock exchange that benefit to the investors whereas it is cost for the company. Madhuri Malhotra and Manjusha Nair (2015) has recognized in his studies that the subscription increases above to the normal level (over subscription) that is difficult to allocate shares among investors because of greater demand for the share in turn that leads to greater underpricing of the Initial public offerings measured by initial return after listing on the stock exchange.
- **Reputation of Underwriter:** Underwriter is a person or institution underwrites or promises to the issuer to purchase specified number of shares at specified price in case if public do not subscribe the shares in primary market. Underwriter reputation is good that boosts the confidence level of investors to make investment decisions in initial public offerings. Hence it is also one of the factors which influence the pricing of initial public offerings in capital market.
- **Investors Perception:** Investors perception towards the stock market performance, investment avenues, intermediaries, capacity to forecast the future performance of shares etc.. which influence the investment decisions by investors (rational and irrational) in initial public offering in Indian capital market. Investors perception is also one of the reason which influence pricing of IPOs. Namrata N Khatri (2017) has pointed company policy, future prediction and projection, news related to company and financial information are the factors which influence the investment decisions taken by investors in initial public offering.

Conclusion: Economy of any country depends on strong financial system because financial system plays a significant role in enhancing economic growth by mobilizing savings through its components such as financial markets, financial instruments, financial markets and financial services in the economy. Primary market is a component of financial market provides a platform to the corporate to raise money for their expansion or modernization of company and to investors to invest their money in securities and enhance their wealth. Hence, it is very much required to the corporate as well as stakeholders to analyse the various factors such as age of the firm , method of pricing, subscription ratio, size of the issue , investors perception to take the right decisions by investors (investment decisions) and corporate (to issue share at right price) to enhance their intensification and contribute towards the growth of the economy.

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