Overpricing or under pricing of Public Offering: An Empirical Study of Primary Market of India

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Abstract:

The phenomenon of under pricing is present worldwide and not only in the Indian context. Here the study has made an attempt to analyze the primary market of India, in order to observe the under pricing phenomenon. The duration considered for the study is between the years 2014 to 2017, which includes the companies listed in the stock markets such as BSE as well as NSE. As Ritter have also suggested about the risk which is undertaken by the investors who are uninformed for making a venture in the public issue is quite unknown to the investors. For the purpose of analysis in the study the numbers of companies considered is around 141 companies between the duration 2014 to 2017. So finally study declares the presence of under pricing in the Indian context as it is widely documented worldwide through the various extant literatures.

Key Words: Initial Public Offering, Primary Offering, Secondary Offering, Stock Exchange, Book Building.

1.0 Introduction:

A privately held company issues shares of stock to the public for the first time, which is also known as "going public," through a process of IPO process. A small business is transformed from a privately owned and operated entity into one which is owned by public stockholders by an IPO. As the IPO provides the company with access to the public capital market and also increases their credibility and exposure, so an IPO is a significant stage in the growth of many small businesses. A significant change for a small business, including a loss of flexibility and control for management, is because of becoming a public entity. However, an IPO may be the only means left of financing growth and expansion, in many cases. Sometimes, the decision to go public may be influenced by founders or venture capitalists who wish to cash in on their early investment.

So in general going public is quite a complex decision which requires planning and careful consideration. Small business owners consider all the alternatives first (such as securing venture capital, forming a limited partnership or joint venture, or selling shares through private placement, self-underwriting, or a direct public offering) which are as recommend by the experts. That examines their current and future capital needs for the company, and is aware of how an IPO will affect the availability of future financing for the company.

1.1 The advantages and disadvantages of going public

Advantages:

Money is generated for the company because of new investors buying the newly issued shares, which goes directly to the company (primary offering), when a company goes public. And along with this, the early private investors may decide upon to sell some of their stakes in the company that is (secondary offering). So in order to attract the new investors, who can provide the capital for the company for accelerate growth? Therefore, an IPO is a lucrative way for an issuing company.

In order to quickly raise large amounts of capital, In a nutshell it can be said that many companies decide to go public as it allows the companies to:

- Diversifying equity base
- Increased exposure
- Cheaper access to capital
- Ability to retain better management
- Facilitating acquisitions
- More financing opportunities

Disadvantages:

With an IPO one of the main disadvantages is its complexity. Before deciding to start the process of IPO, Issuing Company should have a solid idea of its core business functions which can be a very time consuming.

- There is a risk that funding targets will not be met
- A company is required to disclose all its financial information
- It is expensive
- Loss of control in the sense are answerable to the shareholders

1.2 Review of Literature:

David R. Williams, W. Jack Duncan and Peter M. Ginter (2010) have analyzed the relationship among secondary-market, Pre-market, and the primary-market characteristics. Signaling theories and the agency theories have been utilized in the study. Study examines the high-technology firms which are seeking for an IPO for the agency and market signals which is related to a sample chosen for the study. For the purpose of examining for IPO offer process in high-technology firms a model have been tested. The results of the study indicates the secondary market factors have not affected the offer price of the IPO but the offer price is affected by certain primary market and Pre-market factors which is received by the entrepreneurs and the investors.

Sonia Falconieri, Albert Murphy and Daniel Weaver (2009) have made an observation in the study that vast empirical literature of the IPO's is categorized by under pricing phenomenon. The under pricing of IPO is directly related to the amount of ex-ante uncertainty which is concerning the valuation of IPO's as shown by number of studies. By considering the observation of the theoretical papers of quite recent, which suggests that prior to the start of trading the stocks not all the value uncertainty is resolved, but rather in the beginning of the aftermarket it continues to be determined. So this type of uncertainty is termed by the study as ex-post value uncertainty and hence will develop proxies for it. Finally for the existence of ex-post value uncertainty study also finds a strong support.

Somnath Das, Re-Jin Guo and Huai Zhang (2006) the authors have examined the analyst's ability in order to forecast the performance of future firms which is based on the selective coverage of firms newly listed. As hypothesized by the study that the decision to provide the coverage contains information about underlying expectation of a firm's future prospects and an analyst. So the IPO's with high residual coverage have significantly operating performance and better returns compared with the low residual coverage in the subsequent three years as documented by the study. So the evidence obtained from the study indicates that superior predictive abilities are possessed by the analysts and the coverage is provided selectively for the companies for which their true expectations are favorable.

Dan R. Dalton, S. Trevis Certo and Catherine M. Daily (2003) the primary results obtained are troubling to some observers. So an apparently naive view, a view which is contrary to empirical evidence, is that the investment banks will generate the more engagements when it more accurately prices the offer price at public offering. This is because investment banks which do not under price the IPO's produce more money for the IPO client treasury. Usually an investment banks is hired by the IPO firm in order to sell the agreed amount of stocks for the highest price. So quite obviously one would think that an investment banks by doing this it would be in a greater demand and also would have greater share of market for the business of IPO.

1.3 Objectives of the Study:

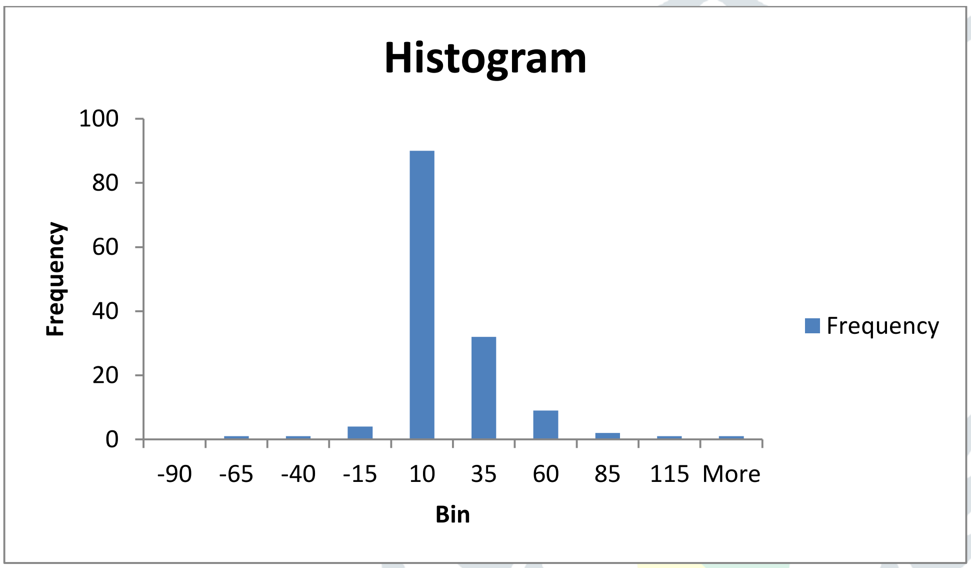
- To examine the Various IPO issues in the Indian capital Market.
- To empirically test the under pricing of IPOs in Indian Equity Market.
- To determine the whether the IPO's inn Indian equity market is under pricing or overpricing

1.4 Data Collection and Research Methodology:

- For this particular study, research design maintained is descriptive and exploratory in nature of which the approach of quantitative is been used.
- Study is based on the secondary sources of data and is collected from the capital line data base and other internet sources such as NSE and BSE official websites.

1.5 Analysis and Interpretation:

1.5.1 Graph: Shows histogram for the IPO issue for the years 2014 to 2017



Interpretation:

- The value of skewness obtained from the data analysis for different years, which is from 2014 to 2017 histogram is 2.39.
- Since the value obtained is positive it represents the presence of skewness which is positive in nature.
- And hence it can be concluded by saying that there exists a phenomenon of under pricing as the returns obtained by the investors are positive because of under pricing.

1.5.2 Descriptive Statistics is been represented in the below tables

Table: 1 shows the value of skewness

Column1	
Mean	8.929606763
Standard Error	1.967814961
Median	2.222222222
Mode	20
Standard Deviation	23.36650801
Sample Variance	545.9936964
Kurtosis	13.2185471
Skewness	**2.396228204**
Range	225.6431052
Minimum	-73.69866071
Maximum	151.9444444
Sum	1259.074554
Count	141

Table: 2 Shows the frequency of companies

Bin	*Frequency*
-90	0
-65	1
-40	1
-15	4
10	90
35	32
60	9
85	2
115	1
More	1

Table 1: Shows the value of positive skewness representing the presence of under pricing for those investors of which the invested investors get the positive returns because of the presence of under pricing phenomenon.

Table 2: Shows the no of companies scattered and also it can be observed that there are around 141 companies which is scattered between the frequencies 10 to 35.

1.6 Conclusion:

So finally it can be concluded that by analyzing the data for various years of public issues between years 2014 to 2017 for around 141 companies, study have observed that there is the presence of under pricing in the Indian equity market. More number of companies is scattered between the frequencies 10 and 35 which is equal to 122 companies and clearly defines the presence of under pricing phenomenon. As the fact which is known that uninformed investors don't posses any information relating to the company prior to the initial public offering. The argument of the Ritter is been accepted by the study, in order to compensate the risk undergone by the investors who are uninformed, under pricing is a pre-requisite in order to benefit for the uninformed investors.

1.7 References:

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