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A study of performance analysis of initial public offers under the financial services sector listed in NSE

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Abstract
This study aims to analyse the performance of the IPOs under the much booming sector in the recent times i.e., the Financial Services sector for the year 2016-17 in which the investors earned excellent abnormal return. SEBI has termed 2016-17 as the 'year of IPOs'. Accordingly there are 5 companies which fell under this category, which is considered as the sample for this study. The techniques used for this study are Raw returns, Market Adjusted Excess Returns, Annualised Returns and Wealth Relative Index. The results of the study reveal that there is a significant under pricing of the IPOs in the short-run as well as long-run.

Keywords: IPO, NSE, raw returns, market adjusted excess returns, wealth relative, under pricing

1. Introduction
Initial Public Offer (IPO) is a kind of public offering in which shares of firms are sold to public for first time. Through this procedure, a privately held organization changes into a public organization. IPOs are generally utilized by organizations to raise the capital, potentially to adapt the ventures of early private financial specialists, and to become publicly traded undertakings. IPOs have always been a source to gain excellent returns. Especially the year 2016-17 has seen many successful IPOs due to which SEBI has termed it as the 'year of IPOs' [2]. The reward for the investors of IPOs comes in the form of abnormal listing day returns in case the company flourishes thereafter. Also they become the first shareholders of the company. But everything comes with its own risks. Here the risk for investors is that if the company fails to perform, then they will end up losing their money. Also there is no guarantee that the past data of the company (based on which an investor invests) will give fruitful results in the future [3].

2. Theoretical Framework
Going public is one of the most important phase of any company that aims at growth and expansion. Those firms which have attained certain growth would wish to expand its business operations. For this purpose it needs huge amount of funds which cannot be solely contributed by its promoters. And thus a firm goes public by creating a liquid market for their company's stock to be issued and traded. Also the company gets the privilege of getting listed in a country's stock exchange like NSE or BSE.
Although going for an IPO is an important step for any firm, it is not very easy to successfully complete the IPO process. It is a highly demanding and an expensive process. The work for IPO starts almost a year before, from selection of underwrites till the shares are sold in the market. The investment bankers act as the underwriters of the stock of the company. Underwriters are those who buy the shares of the company at a discount and sell it to the public. They are the intermediaries between the company and the public. The investment banks do not underwrite any company's shares. They always prefer large companies with strong financials. This is because of the inherent risk present in the IPOs. Just because a company goes public it doesn't mean all the shares will be subscribed. The past data will not guarantee future performance. In case it fails to impress the public it will lose all the money spent on the IPO process. This is the reason why investment bankers conduct a detailed screening of the company and its financial position before agreeing to act as its underwriter.
Many theoretical studies support the statement that managers usually time their initial public offerings for a favourable condition. Usually the company waits for a bull market to issue their shares as the prices are going high and there is good scope to capture the high prices. Also they consider the investment sentiments before taking the decisions about going public. Sometimes the investors will be willing to pay much more than the actual value of the stock. The company utilises such timing of sentiments and issues it stock. There are more chances that the IPO will become successful if it is issued at the right time when it will get the maximum subscription.
Also one of the main concepts surrounding around the new issues is its attractive initial returns. Usually most of the IPOs give their investors high initial return which is calculated as the difference between the first day of trading closing price and offer price. There are also empirical evidences that the initial returns are because of both underpricing and overvaluation of the market. This is proved in the study by [11] on 'IPO initial returns in China: Underpricing or Overvaluation?'. In this study, the result reveals that in the initial returns, the overvaluation has taken a greater proportion than underpricing [1].

3. Empirical support for the study
The sample for this study consists of 5 companies under the Financial Services sector whose IPOs are listed in the NSE

between 2016-17. They are:

a. PNB Housing Finance Ltd.,
b. Ujjivan Financial Services,
c. ICICI Prudential Life Insurance Company Ltd.,
d. Equitas Holdings Ltd., and
e. RBL Bank Ltd.

S&P CNX Nifty has been used as the market index from where the closing values were taken. The study is based on secondary data primarily collected from the official website of the National Stock Exchange of India www.nseindia.com. And the offer details of the IPOs were collected from www.chittorgarh.com.

3.1 Price performance of IPOs: Short run analysis

The methodology adopted for analysing the short-run and long-run performances has been kept simple and is based on the methodology used by previous such researchers.

To understand the price performance of the IPOs in the short run the buy-hold period of the first trading day, one month after, 3 months after and 6 months after the day of listing have been considered. [8], in their study of performance of IPOs in the Indian context have used the Raw returns to analyse the initial returns. Similarly [7] studied about the 'Australian IPO pricing in the short and long run', where they have analysed both the initial raw returns and the post-listing returns of the IPOs. The results of this study show that the IPOs were overpriced significantly which means the IPOs have not performed well when compared to the market performance. Also in a study by [4], about the 'Aftermarket Performance of IPO in Latin America, the tools employed to analyse the IPOs were total returns, market return, market-adjusted abnormal returns and wealth relative. [5], have also conducted a study on the 'short-run under pricing and its characteristics in Chinese IPO markets' which reveals that a 129.16% underpricing is found in Chinese IPO.

Raw returns refers to the initial price performance of the IPO which is calculated as the difference between the closing price on the 1st day of trading and the offer price multiplied by 100. This is then compared to the Market Returns (MR-Ret) for which the data has been taken from the Nifty Index.

The formula is represented below:

R_Ret = (P1-P0)/P0*100 Eq. (1)

Where,

R_Ret – initial or raw returns

P1 – Closing price on the 1st day of trading

P0 – Offer price

Table 1: Short-run returns

Time Frame	R_Ret%	MR_Ret %
On listing day	14.06232	0.664035
1 month after listing	13.15445	-0.91409
3 months after listing	-30.1535	1.479579
6 months after listing	50.2082	7.0137

From the above table it is clear that on the listing day the returns to the shareholders are positive and quite high. This means that the investors who purchased the shares on the offer date and held till the listing have gained high returns from the holding. Then in the following 3 months there is a negative return and after 6 months the returns touched new highs. The market returns have remained stable throughout the period when compared to the returns. The market returns were negative 1 month after listing. The above analysis shows that there is definitely overpricing in the Indian IPOs market.

Since there is usually a time lag between the offer date and the listing date, there can be market changes that can affect the listing day prices. To nullify this effect, the annualised returns are calculated by multiplying the returns with the annualising factor.

Annualizing factor= 365/ Listing Lead Time Eq. (2)

Table 2: Values of Ann. R_Ret. and Ann. MR_Ret.

Time Frame	N	Ann. R_Ret	Max Ann. R_Ret	Min Ann. R_Ret	Ann. MR_Ret	Max Ann. MR_Ret	Min Ann. MR_Ret
On listing day	5	514.7049	1508.667	-497.914	16.91261	126.3073	-96.6337
1 month after listing	5	571.515	2679.767	-124.958	-0.91409	3.578311	-4.64867
3 months after listing	5	-1228.49	-39.1006	-3953.64	1.479579	8.715992	-6.39298
6 months after listing	5	2035.696	3878.765	927.5412	257.4689	369.0062	48.50077

From the table above, it is clearly seen that there is a huge difference between the annualised R_Ret and the MR_Ret. The Ann R_Ret on the listing day is almost 30 times than that of the Ann MR_Ret. Thereafter we can see the decline of the returns which comes to 7 times the Ann MR_Ret.

The other tool used is the Market Adjusted Excess Returns [6], conducted a study on the performance of IPOs of companies listed in NSE and Gulf Base GCC Index. Here the authors have used MAER as one of their tools for analysis. This was a short-run and long- run analysis. The period of study is from Jan 2013 to December 2014 and the samples for the study are 9 companies listed in NSE. One of the main purposes of this study is to find out if the returns are more in short term or long term.

By the term MAER what we mean is the abnormal returns earned from the IPO when compared to the normal market returns. It is calculated as below:

MAER = [(P1-P0)/P0 – (M1- M0)/M0] *100 Eq. (3)

Where,

MAER - Market Adjusted Excess Returns

M1 – Closing value of market index on the 1st day of trading

M0 - Closing value of market index on the offer closing date

Table 3: Values of MAER and ANN. MAER

Time Frame	N	MAER	Max MAER	Min MAER	Ann. MAER	Max Ann. MAER	Min Ann. MAER
On listing day	5	13.39828	31.28736	-8.79517	497.7923	1427.486	-401.28
1 month after listing	5	14.06854	55.1563	-0.74648	593.6271	2516.506	-34.0582
3 months after listing	5	-31.633	4.819125	-95.3711	-1258.49	219.8726	-4351.31
6 months after listing	5	43.19449	76.92623	18.21978	1778.228	3509.759	670.1896

As we are considering the Ann. MAER the impact of time gap between offer and listing date will be nullified. From the above table it is clear that the Ann MAER is much higher than the MAER, which shows the scope for overpricing in the IPO market.

(Puri, 2012) [9], studied about the short-run performance of IPOs in India. Here he has used Wealth Relative as one of the tool to understand the extent of overpricing or underpricing. The wealth relative index ($WR_{n)}$ is an important tool to measure the under pricing of IPOs. Here the wealth relative index calculated will be compared to '1'. When WR_n is greater than 1, it means the IPOs have been underpriced and also it has performed better than the market during that period. When the WR_n is lesser than 1, it means the IPOs have been overpriced and indicates poor performance when compared to the market. The wealth relative index is an important tool to measure the under pricing of IPOs.

$WR_n = (1+1/N\sum R\ Ret)/(1+1/N\sum MR\ Ret)$ Eq. (4)

Where,

WR_n - the wealth relative for the 'n^{th}' day

N - Total number of IPOs in the sample

R_Ret - Raw Returns

MR_Ret - Market Returns

Table 4: Wealth Relative

Time Frame	WR_n
On listing day	1.133099
1 month after listing	1.141983
3 months after listing	0.688282
6 months after listing	1.403635

From the table above, we can see that the wealth relative on the first day of trading and 1 month after trading are 1.133 and 1.142 respectively. This under pricing is because that it is an IPO and it is newly introduced to the investors, so the investors are not much aware of its value. Further after 3 month the wealth relative falls to 0.688 due to the market forces. Everyone will now know about the stock and the demand goes up. This makes the wealth relative below unity and thus overpriced. Later, the value goes up to a maximum of 1.4 after 6 months. This shows that those investors who held the IPOs till 3 months after listing got greater returns than others, thus capitalising the abnormal returns.

3.2 Price performance of IPOs: Long run analysis

We can say from the above analysis that IPOs under the financial services sectors during 2016-17 ensures positive returns in the short-run. But it is equally important to understand if they are profitable in the long-run also. [10], in his study of Lon-run performance of IPOs has conducted the study for a period of 1975-84 and presents evidences that in the long-run IPOs tend to underperform. This is also supported by [4], studied about the 'Aftermarket Performance of IPO in Latin America'. The results suggest that when it comes to long run, the stocks were overpriced and thus underperformed when compared to the market performance.

The overall returns earned from the IPOs are shown in the table below. The returns calculated are raw returns and market returns for one year after the listing of the IPOs. These returns are then compared with the market returns which are calculated with the Nifty Index.

Table 5: Short-run and Long-run ruturns

Time Frame	R_Ret%	MR_Ret %
On listing day	14.06232	0.664035
1 month after listing	13.15445	-0.91409
3 months after listing	-30.1535	1.479579
6 months after listing	50.2082	7.0137
1 year after listing	49.25691	16.62992

From the above table and chart it is quite evident that the IPOs under the financial services sector continue to give positive returns to the investors. The returns after 1 year of listing comes to 49.25% which is more or less equal to the returns it gave 6 months post listing. When it comes to market returns, we can see that it has also increased from 7% to 16%.

Table 6: Ann. R_Ret and Ann. MR_Ret

	N	Ann. R_Ret	Ann. MR_Ret
On listing day	5	514.7049	16.91261
1 month after listing	5	571.515	-0.91409
3 months after listing	5	-1228.49	1.479579
6 months after listing	5	2035.696	257.4689
1 year after listing	5	2000.25	644.7899

From the above table it can be seen that the investor earns positive returns in the long run period. The market return also remains to be positive. By maximum and minimum annualised raw returns what we mean is that it shows the range between the data where the value can lie based on the highest and the lowest data. It also shows the rate or amount of change that market can undergo i.e., the maximum increase and decrease.

Table 7: Comparison of MAER and Ann. MAER

Time Frame	N	MAER	Ann. MAER
On listing day	5	13.39828	497.7923
1 month after listing	5	14.06854	593.6271
3 months after listing	5	-31.633	-1258.49
6 months after listing	5	43.19449	1778.228
1 year after listing	5	32.62699	1355.46

From the above table, it is that there was under pricing of the IPOs even after 1 year of listing i.e., in the long run. Generally

in the long run period, the market forces acts and brings down the IPOs to its intrinsic values. But in the financial services sector the IPOs continue to be underpriced even after 1 year of listing.

Table 8: Wealth Relative

Time Frame	WR_n
On listing day	1.133099
1 month after listing	1.141983
3 months after listing	0.688282
6 months after listing	1.403635
1 year after listing	1.279748

The values of the WR_n have been compared with 1 or unity. When the wealth relative is greater than 1 it signifies that the IPOs are under priced and outperformed the market. Similarly when it is below 1, it means the IPOs are overpriced and has not performed better than the market. So it can be observed that during the long run, i.e., 1 year after the listing the wealth relative is 1.27 (greater than 1) and thus remains under priced.

4. Conclusion

This study implies that there is a significant under pricing prevailing in the IPOs under the financial services sector which are listed in the NSE in the short-run and long-run. This study serves the main purpose to assist the investors in making decisions about the IPOs and its investments. This study gives scope for further research as in the long-run period only 1 year post listing could be analysed as this study relates to the period of 2016-17. The findings are also relevant to the current scenario of booming IPO market. Therefore such under pricing can also be due to the present bullish market trend. This study also shows that this is the right period to invest and gain out of buying and holding the shares of IPOs.

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