

E-ISSN: 2582-2160 • Website: <u>www.ijfmr.com</u> • Email: editor@ijfmr.com

# Examining the Under-Pricing of Select IPOs in India with Respect to Differences in Merchant Bankers' Reputation

### Prof. (Dr.) Siddhartha Sankar Saha<sup>1</sup>, Ms. Ankita Samanta<sup>2</sup>

<sup>1</sup>Professor of Commerce, Former Head, Department of Commerce, Former Dean, Faculty Council for Post Graduate Studies in Commerce, Social Welfare and Business Management, Former Director, CUCSE-CEFM & Former Director, IQAC, University of Calcutta, Kolkata, West Bengal, India <sup>2</sup>Research Scholar, Department of Commerce, University of Calcutta & Assistant Professor, Postgraduate and Research Department of Commerce, St. Xavier's College (Autonomous), Kolkata, West Bengal, India

#### Abstract

The performance of Initial Public Offerings (IPOs) in the financial markets is a relevant issue in the present day. Usually, the listing day performance of the IPOs shows under-pricing, which might be caused by the presence and occurrence of different factors. Since, the IPOs play a significant role in money mobilisation of an economy. Thus, it is significant to study the significant differences between the IPOs' closing price as on the first day after listing and the issue price. The merchant bankers play a vital role in setting the issue price of the IPOs. Their contribution in the process of capital formation can never be undervalued. Many IPOs companies rely on the reputation or the goodwill of the merchant banking companies while hiring them as book running lead managers (BRLMs) in the public issue process. The study explores the listing day price performance of the IPOs in respect of the various classifications of the IPOs according to the reputation of the merchant bankers who managed their issue.

KEYWORDS: IPOs; BRLMs; Merchant Bankers; Under-Pricing

#### **Background of the Study**

The existence of Initial Public Offerings (IPOs) in the new issue market, helps in the capital formation and economic progress of a nation by mobilising the surplus income of the people into investment in the deficit sectors of an economy. One of the means through which capital formation takes place is the direct investment in new securities (Tadesse, 2004). The issued Initial Public Offerings are subscribed by the investors. Following this, they are listed in recognised stock exchanges where the securities are traded (Saha, 2020). After the listing procedure is over, the stock market price of the IPOs fluctuates from the issue price. This issue price may significantly vary from the first day's closing price. In order to attract investors, companies may knowingly set the issue price lower than the market demand. In case, the first day positive returns are positive, it is called under-pricing. (Madhusoodanan and Thiripalraju, 1997). Now, it should be noted that under-pricing of IPOs is not always deliberate. Usually, the merchant bankers help the issuing company to fix the issue price (in case of fixed price method of pricing of IPOs) or the priceband (in case of book-building method of pricing of IPOs) (Daily et. al., 2005). Additionally, cases of



E-ISSN: 2582-2160 • Website: <u>www.ijfmr.com</u> • Email: editor@ijfmr.com

over-pricing of IPOs are also prevalent. Companies sometimes issue over-priced securities in order to satisfy some long-term goals as well (He, 2020). Under the book-building method, after the bids are received and the book is built, the BRLMs choose an appropriate method to determine the 'cut-off' price called issue price. The 'cut-off' price is published along with the total number of shares offered by the company in the Prospectus (Brycz et al., 2017). A common tendency is seen among companies or merchant bankers to reduce the issue price to attract the potential investors. This is one of the primary causes of under-pricing. The issuing companies do so in expectation of higher profits (Kong, 2018). Against this setting, the current paper looks around to explore the discrete measurements of the listing day returns of the sample IPOs pondered for the study, in the occasion they are analysed based on the reputation of merchant bankers who managed such IPOs.

#### Past Studies and Research Gap

According to Sreyas (2014), merchant bankers provide indispensable financial advisory services. Dubey (2017) mentioned in his study that merchant bankers have supported the development of the Indian financial market and overall, the Indian economy. Chen et. al. (2018) found that corporate insiders have an incentive to liquidate their shares in the secondary market. Insider information leads to exploitation of mis-pricing of IPOs in the stock market after trading begins. Kong (2018) studied that companies or merchant bankers may have a tendency to reduce the issue price to attract potential investors, which causes under-pricing. Balwani (2020) found that with the growth of registered merchant bankers in the Indian financial market, the money generated through IPOs have continuously increased. Jain et. al. (2022) observed in their study that a significant difference exists between valuation provided by merchant bankers and the listing day valuation based on market sentiments. Bose et. al. (2024) opined that companies making large equity issues relied more on foreign merchant bankers than national ones due to their extensive network. However, no study has been conducted with regard to studying under-pricing or listing day price performance of IPOs in India with respect to differences in merchant bankers' reputation

#### **Objectives of the Study**

Following are the objectives of the present study:

- 1. To analyse the segregation of the specimen IPOs into the distinctive segments of reputation of the merchant bankers who managed the issue of the IPOs companies during the issue of IPOs;
- 2. To examine the average initial returns, average Market Adjusted Abnormal Returns (MAARs), average annualised initial returns, average annualised MAARs of the chosen IPOs from each of the categories depending on the reputation of the merchant bankers who managed the issues of the select IPOs companies at the time of the IPOs' issue;
- 3. To test the statistical significance of those returns of each classification of reputation of the merchant bankers who managed the issues of the specific IPOs companies at the time of issuance of IPOs.

#### **Research Methodology**

#### Data and Sample Design

The study is based on secondary data and is exploratory in nature. The data has been collected from the respective websites of National Stock Exchange, Securities & Exchange Board of India and the websites of the respective companies. Each IPO is studied as on the first day after getting listed with the NSE. The study is based on the initial returns or the listing day returns of the sample IPOs. The study period of the



E-ISSN: 2582-2160 • Website: <u>www.ijfmr.com</u> • Email: editor@ijfmr.com

selected IPOs is during 1<sup>st</sup> April 2000 to 31<sup>st</sup> March 2017. A total of 224 IPOs (sample for the study) is selected using non-probabilistic sampling technique called judgement sampling for the purpose of the study. Several parameters, like non-consideration of FPOs, IPOs with continuous trading data, sufficiency of data, etc. are considered for the judgement sampling (Saha and Samanta).

#### Data related to Merchant Bankers' reputation

In case of book building method, the merchant bankers who play the role of BRLMs help the company to determine the issue price. In this study, an initiative is undertaken to explore the relation between the average returns generated on listing day by select IPOs and the merchant bankers' reputation. For considering the reputation, the weighted average of the number of issues managed by any merchant banker within the sample IPOs companies is considered here.

#### Statistical Measures, Tools and Package used

Four measures of returns are considered namely, initial return, MAAR, annualised initial return and annualised MAAR (Saha and Samanta) as follows:

Measures	Computation				
Initial return	$(P_1 - P_0) \div P_0 \ge 100$ ; where $P_1$ : closing price of the IPO as on listing day $P_0$ :				
	the offer price				
Market Adjusted	$[(P_1 - P_0) \div P_0 - (M_1 - M_0) \div M_0] x 100$ ; where $M_1$ : the closing NIFTY 50 as				
Abnormal Returns	on listing day and $M_0$ : the closing NIFTY 50 on the last day of the offer period				
(MAARs)					
Annualised Returns	(Initial Return x 365) ÷ Number of days it took for listing				
Annualised MAARs	(MAAR x 365) ÷ Number of days it took for listing				
One-sample t-test	One-sample t-test is adopted to test the statistical significance of the average				
	returns under every classification under each parameter considering a				
	significance level of 5%				
Package used	MS Excel (version) 2016 and SPSS (version) 21 are applied.				

#### **Results and Analysis**

Merchant bankers as BRLMs perform a crucial role in the capital issue management. This section aims to analyse as to whether the reputation of the merchant bankers have any bearing on the various measures of average returns earned by the sample companies. For the purpose of the analysis, the merchant bankers who have managed the sample companies for their IPOs, are ranked on the basis of their reputation. In case of companies where more than one merchant banker has taken part in the IPO issue mechanism, the average reputation of the merchant bankers is combined.

# Analysing the segregation of the sample IPOs into the distinctive segments of reputation of the merchant bankers who managed the issue of the IPOs companies during the issue of IPOs

Analysis of the distribution of the specimen IPOs into the various categories of reputation of the merchant bankers who managed the issue of the IPOs companies at the time of IPOs' issue are made here.

E-ISSN: 2582-2160 • Website: www.ijfmr.com • Email: editor@ijfmr.com

#### Table 1: Specimen size of companies segregated based on reputation of the merchant bankers who managed the issue of the select IPOs companies during the issue of IPOs

No.	Classifications	Specimen Size
1	No. of companies managed by most reputed merchant bankers	48
2	No. of companies managed by moderate reputed merchant bankers	45
3	No. of companies managed by reputed merchant bankers	41
4	No. of companies managed by moderate ordinary merchant bankers	32
5	No. of companies managed by most ordinary merchant bankers	58
Total		224

[Source: Presentation of secondary data implementing MS Excel 2016]





[Source: Derived from Table 1]

It is seen from the result that the maximum number of companies are managed by most ordinary merchant bankers based on the merchant bankers of the sample IPOs. It means that a greater number of companies have hired merchant bankers who did not make the higher end of the reputation ranking, while the second lead for maximum number of companies managed is taken by reputed merchant bankers. The number of reputed merchant bankers might not be very high but all together they have managed much greater number of companies.

Examining the average initial returns, average Market Adjusted Abnormal Returns (MAARs), average annualised initial returns, average annualised MAARs of the chosen IPOs from each of the categories depending on the reputation of the merchant bankers who managed the issues of the select IPOs companies at the time of the IPOs' issue and Testing the statistical significance of those returns of each classification of reputation of the merchant bankers who managed the issues of the specific IPOs companies at the time of issuance of IPOs.

In this segment, the distinctive measures of average returns considered are examined and tested for statistical significance with the help of one-sample t-test.



E-ISSN: 2582-2160 • Website: <u>www.ijfmr.com</u> • Email: editor@ijfmr.com

No.	Classifications	Average	Statistic	Р-	Decision Rule	Decision on H <sub>0</sub> (
		Initial Return for 1 <sup>st</sup> Day (in %)		Value	(5% significance level considered)	<b>Ho:</b> The average initial return as on 1 <sup>st</sup> Day after listing is equal to 0 )
1	Initial return for companies managed by most reputed merchant bankers	28.87%	5.414	0.000	P-Value < 0.05	Rejected
2	Initial return for companies managed by moderate reputed merchant bankers	26%	3.117	0.003	P-Value < 0.05	Rejected
3	Initial return for of companies managed by reputed merchant bankers	18.32%	3.664	0.001	P-Value < 0.05	Rejected
4	Initial return for companies managed by moderate ordinary merchant bankers	16.25%	2.618	0.014	P-Value < 0.05	Rejected
5	Initialreturnforcompaniesmanagedbymostordinarymerchantbankers	12.52%	2.981	0.004	P-Value < 0.05	Rejected

#### Table 2: Results of One-Sample t-test of average initial return

[Source: Compendium of secondary data with the help of SPSS version 21.0]

The highest average initial return shows for the companies managed by most reputed merchant bankers, followed by companies managed by moderate reputed merchant bankers and so on. The result shows concentration of the maximum average initial return towards the most reputed merchant bankers, followed by moderate reputed merchant bankers and so on. As the merchant banker's reputation decreases, the average return generated from the companies managed by them also decreases. This result is tested for statistical significance as under.

It is observed that the null hypothesis is not accepted at 5% significance level for all the cases. This means that the average initial returns under all the categories are significantly different form 0. Irrespective of the reputation of the merchant bankers, the IPOs companies under all the categories show the presence of under-pricing.



E-ISSN: 2582-2160 • Website: <u>www.ijfmr.com</u> • Email: editor@ijfmr.com

No.	Classifications	Average	Statistic	Р-	Decision	Decision
1100		MAARs	Statistic	Value	Rule	on H <sub>0</sub> (
		for 1 <sup>st</sup>			(at 5%	H <sub>0</sub> : The
		Day (in			significance	average
		%)			level	MAAR as
					considered)	on 1 <sup>st</sup> Day
						after
						listing is
						equal to $0$
						)
1	MAARs for companies managed by	27.24%	4.792	0.000	P-Value <	Rejected
	most reputed merchant bankers				0.05	
2	MAARs for companies managed by	25.14%	3.318	0.002	P-Value <	Rejected
	moderate reputed merchant bankers				0.05	
3	MAARs for of companies managed	17.36%	3.616	0.001	P-Value <	Rejected
	by reputed merchant bankers				0.05	
4	MAARs for companies managed by	19.45%	3.258	0.003	P-Value <	Rejected
	moderate ordinary merchant				0.05	
	bankers					
5	MAARs for companies managed by	10.11%	2.297	0.025	P-Value <	Rejected
	most ordinary merchant bankers				0.05	

#### Table 3: Results of One-Sample t-test of average MAAR

[Source: Organisation of secondary data with the help of SPSS version 21.0]

The result for the average MAARs is little different than the result for the average initial returns. The highest and second highest MAAR is observed for the companies managed by most reputed merchant bankers, followed by companies managed by moderate reputed merchant bankers. The third highest MAAR is however generated by the sample companies who were managed by moderate ordinary merchant bankers. The validity of the results will, however, be clear with the help of one-sample t-test. It is evident that the null hypothesis is rejected at 5% level of significance for all the classifications. This means that the average MAARs under all the categories are significantly different form 0. The reputation of the merchant bankers does not have any bearing on the statistical significance of the average MAARs. All the average MAARs portray underpricing of the IPOs.

#### Table 4: Result of One-Sample t-test of average annualised initial return

No.	Classifications	Average	Statistic	Р-	Decision	Decision
		annualised		Value	Rule	on H0 ( H0.:
		initial			(5%	The
		returns for			significance	average
		1 <sup>st</sup> Day (in			level	annualised
		%)			considered)	initial
						return as



E-ISSN: 2582-2160 • Website: <u>www.ijfmr.com</u> • Email: editor@ijfmr.com

1	Annualised initial <b>returns</b> for companies managed by most reputed merchant bankers	507.72%	5.815	0.000	P-Value < 0.05	<i>on</i> 1 <sup>st</sup> Day after listing is equal to 0) Rejected
2	Annualised initial <b>returns</b> for companies managed by moderate reputed merchant bankers	434.16%	3.560	0.001	P-Value < 0.05	Rejected
3	Annualised initial <b>returns</b> for of companies managed by reputed merchant bankers	407.75%	3.177	0.003	P-Value < 0.05	Rejected
4	Annualised initial <b>returns</b> for companies managed by moderate ordinary merchant bankers	325.15%	2.638	0.013	P-Value < 0.05	Rejected
5	Annualised initial <b>returns</b> for companies managed by most ordinary merchant bankers	333.60%	3.741	0.000	P-Value < 0.05	Rejected

[Source: Arrangement of secondary data with the help of SPSS version 21.0]

The highest average annualised initial return is observed for the companies managed by most reputed merchant bankers, followed by companies managed by moderate reputed merchant bankers. However, in this case unlike the previous two cases, the lowest annualised average initial return is generated by the companies by moderate ordinary merchant bankers. This is interesting as this category had the third highest average MAAR.

It is clear, that the null hypothesis is rejected at 5% significance level for all the cases. This means that the average annualised initial returns under all the categories are significantly different form 0. The average annualised initial returns give evidence of under-pricing irrespective of the reputation of the merchant bankers for all the sample IPOs.

No.	Classifications	Average	Statistic	Р-	Decision	Decision
		annualised		Value	Rule	on H <sub>0</sub> (
		MAAR for			(5%	Ho:The
		1 <sup>st</sup> Day (in			significance	average
		%)			level	annualised
					considered)	MAAR as
						on 1 <sup>st</sup> Day
						after

#### Table 5: Result of One-Sample t-test of average annualised MAAR



E-ISSN: 2582-2160	•	Website: <u>www.ijfmr.com</u>	•	Email: editor@ijfmr.com
-------------------	---	-------------------------------	---	-------------------------

						listing is equal to 0 )
1	Annualised MAAR for companies managed by most reputed merchant bankers	475.09%	5.006	0.000	P-Value < 0.05	Rejected
2	Annualised MAAR for companies managed by moderate reputed merchant bankers	423.87%	3.510	0.001	P-Value < 0.05	Rejected
3	Annualised MAAR for of companies managed by reputed merchant bankers	391.06%	3.143	0.003	P-Value < 0.05	Rejected
4	Annualised MAAR for companies managed by moderate ordinary merchant bankers	397.48%	3.276	0.003	P-Value < 0.05	Rejected
5	Annualised MAAR for companies managed by most ordinary merchant bankers	319.11%	3.578	0.001	P-Value < 0.05	Rejected

[Source: Presentation of secondary data with the help of SPSS version 21.0]

The average annualised MAARs show results similar or at par with the average MAARs. The highest average annualised MAARs are generated by the companies managed by most reputed merchant bankers, followed by companies managed by moderate reputed merchant bankers. The third highest average annualised MAARs are generated by the companies managed by moderate ordinary merchant bankers. The statistical significance of these results will be validated with the help of following statistical tests. Just like the previous results, the null hypothesis is unaccepted at 5% level of significance for all the categories. This means that the average annualised MAARs under all the categories are significantly different form 0. The average annualised MAARs provide evidence of under-pricing for all the categories of IPOs companies, considered based on merchant banker reputation.

#### Conclusion

It is observed through the analysis of the study that the IPOs having merchant bankers with high reputation, have generated the highest average listing day returns, under all the four measures of average returns. All the segment of IPOs bifurcation has shown positive returns indicating under-pricing of IPOs and such under-pricing is significant. This means under-pricing is observed more for companies which are managed by most reputed merchant bankers. Overall, it can be concluded that under-pricing exists in all the groups, based on merchant banker's reputation-based division. Further studies need to be undertaken to understand whether such under-pricing exists in the long run.

#### References

1. Balwani, P. (2020). A Study on the Role of Merchant Bankers in the Primary Market. *JETIR*, 7(3), 1161-1164.



E-ISSN: 2582-2160 • Website: www.ijfmr.com • Email: editor@ijfmr.com

- 2. Bose, G., & Bhoagwar, M. (2024). A Study on Merchant Banking in India and How the Merchant Banking Works in India. *International Journal of Research Publication and Reviews*, 5(5), 6843–6846
- 3. Brycz, B., Dudycz, T., & Kowalski, M.J. (2017). Is the success of an issuer an investor success? Evidence from Polish IPOs, *Baltic Journal of Economics*, 17:1, 57-77
- 4. Chen, C., Li, T., Li, Y., & Zheng, S.X. (2018) Insider Selling and IPO Price Premium, *Emerging* Markets Finance and Trade, 54:15, 3500-3518
- 5. Daily, C.M., Certo, S. T. & Dalton, D. R. (2005), Investment Bankers and IPO Pricing: Does Prospectus Information Matter? *Journal of Business Venturing*, 20(1), 93-111.
- 6. Dubey, S.K. (2017). Recent Development in Merchant Banking in India: An Review. Journal of Advances and Scholarly Researches in Allied Education, 14 (1), 1112--1117
- 7. He, J. (2020). The Effect of Investor Sentiment on IPO Pricing: Evidence From China, *Business and Management Research*, 159, 413-419.
- Jain, L., Phirke, R., Bhajiawala, J., Aslam, K., & Tibrewala, S. (2022). Analysing the Fundamental and Behavioal Aspect of IPO Valuations by Comparing Merchant Bankers' and Market Valuations. *International Journal of Trend in Scientific Research and Development*, 6(5), 940-958
- 9. Kong, H. (2018) The Pricing of IPO by Investment Banks and Venture Capital: A Theoretical Model. *Open Journal of Social Sciences*, 6, 209-221
- Madhusoodanan, T. P., & Thiripalraju, M. (1997). Underpricing in Initial Public Offerings: The Indian Evidence. *Vikalpa*, 22(4), 17–30
- 11. S., S. B. (2014). Merchant Banking Past and Present: Indian Scenario. The International Journal of Business & Management, 2(10), 184-186
- 12. Saha, S.S & Samanta, A. (2023). Exploring Underpricing of Select NSE-listed IPOs in India with respect to Differences in Age at the Time of Listing. *Research Journal of Accounting and Finance, IISTE*, 14(2), 34-43.
- 13. Saha, S.S & Samanta, A. (2023). Exploring Underpricing of Select NSE-Listed IPOs in India with Respect to Different Macro-economic Sectors. *The Management Accountant*, 58(2), 70-76.
- 14. Saha, S.S & Samanta, A. (2023). Underpricing of Select NSE-listed IPOs in India with Respect to Differences in Issue Size: An Empirical Analysis. *European Journal of Business and Management, IISTE*, 15(1), 26-35.
- 15. Saha, S.S. (2021). *Indian Financial System*. New Delhi: McGraw Hill Education (India) Pvt. Ltd., New Delhi, 2<sup>nd</sup> ed.
- 16. Tadesse, S. (2004), The Allocation and Monitoring Role of Capital Markets: Theory and International Evidence, *Journal of Financial and Quantitative Analysis*, 39(4), 701-730.