

## **To study Influence of IPO Rating on demand in Indian IPO market in special context to Retail Investors.**

**Mrs. Amita Jadhav**

*(Research Scholar, The Indian Institute of cost and Management Studies and Research (IndSearch) Pune)*

**Dr. Netra Apte**

*(IndSearch)(The Indian Institute of cost and Management Studies and Research (IndSearch) Pune)*

**Abstract:** IPO demand is influenced by IPO signaling parameter as Investment Banker, Underwriter, Venture Capitalist involvement, Business Group affiliation, Grading, Underpricing or Issue Size, Market timing as Bullish or Bearish etc. Many research has evolved around it. The Research paper tries to examine the impact of IPO Rating by Capital market, the significance of it on IPO subscription or demand. The paper tries to understand significance of IPO rating in terms of Investors behavior and does it tends to influence demand of retail investor by helping in decision making, in Indian IPO market which has institutional voids and information asymmetry.

**Keywords:** Initial Public Offering (IPO), IPO Rating, Retail Investor, IPO signaling

### **Introduction**

Initial Public Offer (IPO) is first Issuance of IPO by a Firm. While going public Promoters of Firm try to signal IPO by a certification mechanism. Literature studies are done around the signaling mechanism or certification mechanism used by firms as underwriters reputation, investment bankers, Business group affiliation, grading by credit Rating agencies, Bank relationship, venture capitalist and various other instruments. The literature review done so far is not extensive as well as bit contradictory. The role of certification mechanism as credit rating is not been analyzed in the Indian context. It becomes very crucial to study impact of IPO rating in Indian context. Indian Capital market faces many institutional void and information asymmetry. It becomes very difficult and challenging for retail investors who is not an informed retail investor to analyze an IPO as an investment avenue for short term or long term gains.

IPO Grading was introduced by SEBI (The securities and Exchange Board of India) as an assessment of Fundamentals of the issue and mandatory IPO grading was dismissed in 2013. It was introduced with an intent to provide an unbiased issue related information to Retail investors.

The researcher in this paper tries to analyze the impact of capital market rating in IPO Investment or subscription decision marking. IPO Grading was considered as unbiased assessment of IPO as incentives are not liked with IPO Grading. IPO rating is considered as a market signaling mechanism and are usually misunderstood by Uninformed Retail Investors. IPO Grading is grade assigned by authorized Grading agency as CARE, CRISIL, ICRA and Fitch. The Grades are assigned based on five point scale from point '5' indicating strong fundamentals to grade '1' as Poor Fundamentals. IPO rating are assigned by Capital market analyst as Money Control or Capital Market.

IPO Grading doesn't advise on whether to subscribe or skip an IPO. However the rating advises on whether to buy an IPO or skip it. The rating is based on 100 point scale which is evaluated on the basis of Risk return and advices on Buy or skip. The scale is bifurcated as 51 or more points represent Low risk & moderate to high return and usual advice is to subscribe for IPO. Scale 45 to 50 represents Low risk low return or Moderate risk, moderate return and advice is could buy or may buy. Scale 40 to 44 represents High risk and high returns. Informed investors may subscribe but the usual recommendation is to avoid. Below 40 is not to buy at all and Retail investor must skip the subscription.

The uninformed investor usually looked for information passed by news channel, advisor or other signaling advice readily available to subscribe. Wide-ranging studies are done on IPO initial returns, underpricing, information asymmetry but it seems a gap on analysis of rating as a signaling factor and impact of rating on Initial return.

The gap based on the study is whether the ratings provided by capital market are credible and could be considered while IPO analysis and subscription decision by retail investors. The details of the study with respect to the impact of any IPO signaling mechanism as IPO grading, IPO rating or involvement of venture capitalist or underwriter is mixed. There is no evidence which explains that using any of the certification mechanism or signaling mechanism reduces IPO asymmetry and subsequent underpricing.

The paper tries to find out the impact of rating Agencies, rating on investors demand whether investors or specifically retail investors get influenced by the ratings which are provided by capital market rating agency, does a retail investor trust and have confidence on the ratings and subscription decision is based on it.

### **Literature Review**

The available studies on IPO signaling is bit contradictory. Arif (2011) studies indicate that IPO book building in India provides efficient credit signaling or act as a stronger certification mechanism. In Book Building the demand for the number of shares proposed to be issued by a company is mentioned and the price is assessed on the basis of the bids obtained for the number of bids offered for subscription by the issuer. This method provides an opportunity to the market to discover price for securities. The researcher even supported that venture capitalist or sponsor is not significant in Indian market. However, Bubna, A and Prabhala, N R (2011) argued that book building allocations generate kickback for underwriters.

Deb, S. S. and Marisetty, V. B. (2010) explained that the certification mechanism gives a better opportunity to evaluate an IPO in emerging market as India which has many Institutional voids and it helps in reducing underpricing and the retail investor demand is influenced by the positive grades.

Rock, K. (1986) build underpricing models based on information asymmetry which represents that underpricing is higher for IPO which hold major information asymmetry.

Though many initiatives have been reported from government and regulating bodies, but still IPO market lacks a systematic approach for retail investors to successfully evaluate an IPO with all the considered parameters.

The Investment decision for Retail Investor in an IPO depends on

1. Red herring document
2. Price band ( Lower band and higher band)
3. Assumed Listing price

However, the Retail IPO investor in India fails to take an informed IPO investment decision.

The literature review also reveals that the academic research so far done in this area is mostly by other countries and shows lack of contribution by Indian researchers.

Thus from the extensive literature review, following major gaps were identified:

- Need for a method to evaluate IPO based on demand and pricing efficiency which would lead IPO to a lucrative investment avenue and a rating parameters that will give a holistic approach to IPO review and will help an Retail investor to evaluate IPO and make an informed decision whether to subscribe for an IPO or not.
- IPO faces pricing asymmetry due to lack of past information about the firm. The parameters available to investors are external certifications as the capital market rating, advice for specific Advisors who had proven track record, details shared on various Business news channels, advice from Brokers etc.

### **Objectives of The Study**

The current study focuses on the following objectives:

1. To study influence of capital market rating on IPO demand.
2. To study influence of Market conditions, Issue Size and age of firm on IPO demand

### **Research Methodology**

Type of Research: The research conducted is of descriptive type. The study has evaluated parameters for effect of Rating on IPO demand and to access does it influence the demand of IPO. The other parameters considered to review the impact on IPO demand are Issue size as the IPO related variable, Market conditions as Bullish or Bearish.

Universe considered is all the IPO listed in Indian Primary market. The researcher has used random sampling technique for selecting the sample.  
 Source of Data : Secondary data from BSE site  
 Scope: The scope of the study is restricted to IPO listed at S&P BSE Sensex and all issued subscribed by Book Building process from 2000 to 2016.  
 The Data is evaluated using SPSS.

The Research methodology used is regression analysis based on the rating provided to the IPO. The anticipated impact of rating on IPO demand is evaluated by Regression equation.

$$OS_i = \alpha + \beta R_i + c$$

OS<sub>i</sub> describes the overall subscription and R<sub>i</sub> is Impact of Rating on demand of difference group of Investors. OS<sub>i</sub> determines the overall subscription of different group of Investors. The subscription is defined by the number of shares offered for issue for a particular category of investor and the quantum in which the bids are received. The Rating is again grouped in to appended Dummy

S.N	Rating	Description	Suggestion
1	51 or above	Low risk, moderate to High return	Must subscribe
2	45-50	Low risk low return or Moderate risk, moderate/high return	May subscribe
3	40-44	High risk high return	Avoid, however active risk seekers can try
4	Below 40	High risk, low/moderate return, Moderate risk low return	Do not subscribe

**Characteristics of data:**

IPO listed at mainline BSE from 2000 to 2016 calendar year is considered. Out of 459 data set 228 IPO are unrated and 231 IPO are rated.

S.N	Rating	count of IPO
1	51 or above	10
2	45-50	87
3	40-44	72
4	Below 40	62
	Unrated	228
		459

The regression is analyzed on the Subscription which is considered as total subscription at Model 1 and retail Investor demand is based on number of times IPO is subscribed by a Retail Investor.

**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.377 <sup>a</sup>	.82	.45	28.35

**ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	22268.907	19	1172.048	1.458	.107 <sup>b</sup>
	Residual	134285.302	440	804.104		
	Total	156554.209	459			

a. Dependent Variable: Total Subscription

<b>Coefficients<sup>a</sup></b>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-11.701	14.838		-.789	.431
	Bullish or Bearish	5.509	4.649	.094	1.185	.238
	Capital Mkt rating	.725	.301	.190	2.414	.017
	Issue Size (Rs.Cr.)	.002	.002	.097	.939	.349

The Model 1 represents the impact of capital market rating on the demand of IPO. The Total Subscription is the combined subscription by different categories of Investors which includes Qualified Institutional Buyers, Non Institutional Investors and Retail Investors. The Adjusted R square is nearest to 1 specifies the proportion of the variance of independent variable on the dependent variable. The R square observed shows the appropriates or goodness of fitness of both the model.

<b>Model Summary</b>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
2	.310 <sup>a</sup>	.096	.90	14.983

<b>ANOVA<sup>a</sup></b>						
Model		Sum of Squares	df	Mean Square	F	Sig.
2	Regression	3899.056	19	205.213	.914	.566 <sup>b</sup>
	Residual	36592.500	440	224.494		
	Total	40491.556	459			

a. Dependent Variable: RII

<b>Coefficients<sup>a</sup></b>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
2	(Constant)	3.148	7.860		.400	.689
	Bullish or Bearish	3.106	2.466	.103	1.259	.210
	Capital Mkt rating	.252	.159	.129	1.581	.016
	Issue Size (Rs.Cr.)	-.001	.001	-.068	-.629	.530

a. Dependent Variable: RII

The significance i.e.  $p < 0.05$  at both the models. The p value at total subscription model shows significant influence being 0.017 and model 2 shows 0.016 at model 2 which shoes the impact of rating on IPO demand. The significance for market conditions as Bullish or Bearish , issue size is not relevant on IPO demand

### Conclusion:

The IPO market faces significant information asymmetry but the rating influence is observed at IPO subscription. The Retail Investors purchasing is influenced by the rates or the information flashed by advisors. The Retail investor does not seems to focus on other factors of IPO as fundamentals, Issue size or other related parameters but the rating assigned shows significant effect.

The further scope of study is to analyze the behavioral biasness faced by retail IPO investor and other factors which influence it.

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