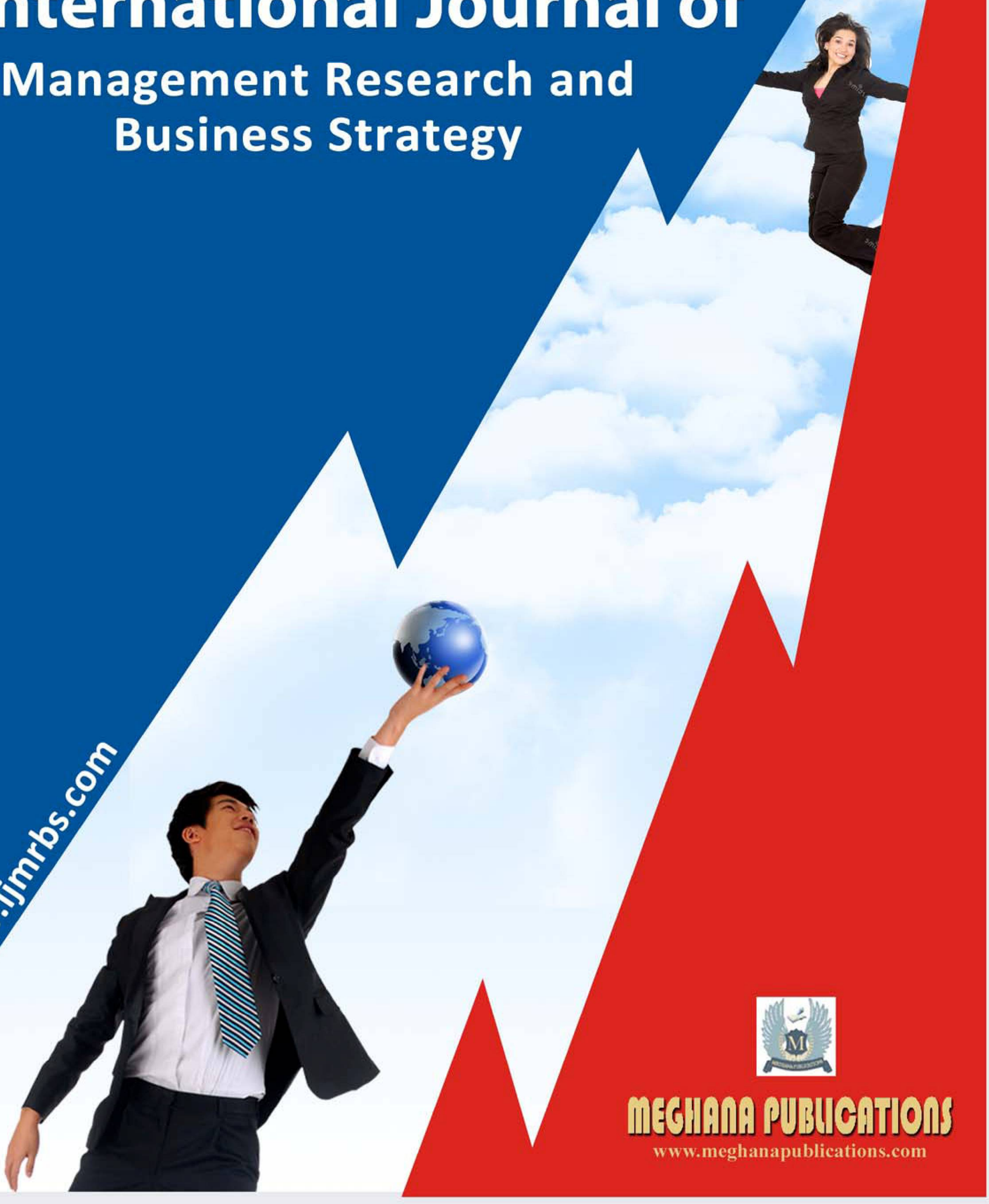
ISSN 2319-345X
Vol. 6, No. 3, July 2017

IJMRBS

International Journal of Management Research and Business Strategy



www.ijmrbs.com

MEGHANA PUBLICATIONS
www.meghanapublications.com

Int. J. Mgmt. Res. & Bus. Strat. 2017

International Journal of Management Research and Business Strategy

ISSN 2319-345X www.ijmrbs.com
Vol. 6, No. 3, July 2017

A STUDY ON ANALYSING THE FINANCIAL POSITION OF INITIAL PUBLIC OFFERS

I Satyanarayana[1]*, N B C Sidhu[2] and Shivalingam[3]

Corresponding Author: **N B C Sidhu ✉sidhunaga@gmail.com*

Initial public offering (IPO) or stock market launch is a type of public offering in which shares of a company usually are sold to institutional investors[1] that in turn, sell to the general public, on a securities exchange, for the first time. Through this process, a privately held company transforms into a public company. Initial public offerings are mostly used by companies to raise the expansion of capital, possibly to monetize the investments of early private investors, and to become publicly traded enterprises. A company selling shares is never required to repay the capital to its public investors. After the IPO, when shares trade freely in the open market, money passes between public investors. Although IPO offers many advantages, there are also significant disadvantages, chief among these are the costs associated with the process and the requirement to disclose certain information that could prove helpful to competitors. The IPO process is colloquially known as going public.

Keywords: Financial Positions of the companies, Stock markets, Stock market fluctuations

INTRODUCTION

Initial public offering (IPO), also referred to simply as a “public offering” or “flotation,” is when a company issues common stock or shares to the public for the first time. They are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately-owned companies looking to become publicly traded.

In an IPO the issuer may obtain the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price and time to bring it to market.An IPO can be a risky investment. For the individual investor, it is tough to predict what the stock or shares will do on its initial day of trading and in the near future since there is often little historical data with which to analyze the

[1] Principal, Sri Indu Institute of Engineering & Technology, Sheriguda (Vill), Ibrahimpatnam (MD), Ranga Reddy (Dt), Telangna State, India.

[2] Associate Professor & HOD of Master of Business Administration , Sri Indu Institute of Engineering & Technology, Sheriguda (Vill), Ibrahimpatnam (MD), Ranga Reddy (Dt), Telangna State, India.

[3] Student of Master of Business Administration,Sri Indu Institute of Engineering & Technology, Sheriguda (Vill), Ibrahimpatnam (MD), Ranga Reddy (Dt), Telangna State, India.

company. Also, most IPOs are of companies going through a transitory growth period, and they are therefore subject to additional uncertainty regarding their future value. However, in order to make money, calculated risks need to be taken. Initial public offering (IPO) or stock market launch is a type of public offering in which shares of a company usually are sold to institutional investors[1] that in turn, sell to the general public, on a securities exchange, for the first time. Through this process, a private company transforms into a public company.

Initial public offerings are mostly used by companies to raise the expansion of capital, possibly to monetize the investments of early private investors, and to become publicly traded enterprises. A company selling shares is never required to repay the capital to its public investors. After the IPO, when shares trade freely in the open market, money passes between public investors. Although IPO offers many advantages, there are also significant disadvantages, chief among these are the costs associated with the process and the requirement to disclose certain information that could prove helpful to competitors. The IPO process is colloquially known as going public.Details of the proposed offering are disclosed to potential purchasers in the form of a lengthy document known as a prospectus. Most companies undertake an IPO with the assistance of an investment banking firm acting in the capacity of an underwriter. Underwriters provide several services, including help with correctly assessing the value of shares (share price) and establishing a public market for shares (initial sale). Alternative methods such as the dutch auction have also been explored. In terms of size and public participation, the most notable example of this method is the Google IPO.[2] China has recently emerged as a major IPO market, with several of the largest IPOs taking place in that country

HISTORY

The earliest form of a company which issued public shares was the *publican* during the Roman Republic. Like modern joint-stock companies, the *publican* were legal bodies independent of their members whose ownership was divided into shares, or *parties*. There is evidence that these shares were sold to public investors and traded in a type of over-the-counter market in the Forum, near the Temple of Castor and Pollux. The shares fluctuated in value, encouraging the activity of speculators, or *quaestors*. Mere evidence remains of the prices for which *partes* were sold, the nature of initial public offerings, or a description of stock market behavior. *Publicanis* lost favor with the fall of the Republic and the rise of the Empire. The first modern IPO occurred in March 1602 when the Dutch East India Company offered shares of the company to the public in order to raise capital. All the shares were tradable, and the shareholders received receipts for the purchase. A share certificate documenting payment and ownership such as we know today was not issued but ownership was instead entered in the company's share register. In the United States, the first IPO was the public offering of Bank of North America around 1783.When a company lists its securities on a public exchange, the money paid by the investing public for the newly issued shares goes directly to the company (primary offering) as well as to any early private investors who opt to sell all or a portion of their holdings (secondary offering) as part of the larger IPO. An IPO, therefore, allows a company to tap into a wide pool of potential investors to provide itself with capital for future growth, repayment of debt, or working capital. A company selling common shares is never required to repay the capital to its public investors. Those investors must endure the unpredictable nature of the open market to price and trade their shares. After the IPO, when shares trade freely in the open market, money passes between public investors. For early private investors who choose to sell shares as part of the IPO process, the IPO represents an opportunity to monetize their investment. After the IPO, once shares trade in the open market, investors holding large blocks of shares can either sell those shares piecemeal in the open market, or sell a large block of shares directly to the public, at a fixed price, through a secondary market offering. This type of offering is not dilutive, since no new shares are being created.Once a company is listed, it is able to issue additional common shares in a number of different ways, one of which is the follow-on offering. This method provides capital for various corporate purposes through the issuance of equity (see stock dilution) without incurring any debt. This ability to quickly raise potentially large amounts of capital from the marketplace is a key reason many companies seek to go public.

An IPO accords several benefits to the previously private company:

· Enlarging and diversifying equity base

· Enabling cheaper access to capital

· Increasing exposure, prestige, and public image

· Attracting and retaining better management and employees through liquid equity participation

· Facilitating acquisitions (potentially in return for shares of stock)

· Creating multiple financing opportunities: equity, convertible debt, cheaper bank loans, etc.

There are several disadvantages to completing an initial public offering:

· Significant legal, accounting and marketing costs, many of which are ongoing

· Requirement to disclose financial and business information

· Meaningful time, effort and attention required of management

· Risk that required funding will not be raised

· Public dissemination of information which may be useful to competitors, suppliers and customers.

· Loss of control and stronger agency problems due to new shareholders

· Increased risk of litigation, including private securities class actions and shareholder derivative actions[6]

The Final step in preparing and filing the final IPO prospectus is for the issuer to retain one of the major financial “printers”, who print (and today, also electronically file with the SEC) the registration statement on Form S-1. Typically, preparation of the final prospectus is actually performed at the printer, where in one of their multiple conference rooms the issuer, issuer’s counsel (attorneys), underwriter’s counsel (attorneys), the lead underwriter(s), and the issuer’s accountants/auditors make final edits and proofreading, concluding with the filing of the final prospectus by the financial printer with the Securities and Exchange Commission. Before legal actions initiated by New York Attorney

General Eliot Spitzer, which later became known as the Global Settlement enforcement agreement, some large investment firms had initiated favorable research coverage of companies in an effort to aid corporate finance departments and retail divisions engaged in the marketing of new issues. The central issue in that enforcement agreement had been judged in court previously. It involved the conflict of interest between the investment banking and analysis departments of ten of the largest investment firms in the United States. The investment firms involved in the settlement had all engaged in actions and practices that had allowed the inappropriate influence of their research analysts by their investment bankers seeking lucrative fees.[16] A typical violation addressed by the settlement was the case of CSFB and Salomon Smith Barney, which were alleged to have engaged in inappropriate spinning of "hot" IPOs and issued fraudulent research reports in violation of various sections within the Securities Exchange Act of 1934.

PRICING

A company planning an IPO typically appoints a lead manager, known as a bookrunner, to help it arrive at an appropriate price at which the shares should be issued. There are two primary ways in which the price of an IPO can be determined. Either the company, with the help of its lead managers, fixes a price ("fixed price method"), or the price can be determined through analysis of confidential investor demand data compiled by the bookrunner ("book building").

Historically, many IPOs have been underpriced. The effect of underpricing an IPO is to generate additional interest in the stock when it first becomes publicly traded. Flipping, or quickly selling shares for a profit, can lead to significant gains for investors who were allocated shares of the IPO at the offering price. However, underpricing an IPO results in lost potential capital for the issuer. One extreme example is theglobe.com IPO which helped fuel the IPO "mania" of the late 1990s internet era. Underwritten by Bear Stearns on November 13, 1998, the IPO was priced at $9 per share. The share price quickly increased 1000% on the opening day of trading, to a high of $97. Selling pressure from institutional flipping eventually drove the stock back down, and it closed the day at $63. Although the company did raise about $30 million from the offering, it is estimated that with the level of demand for the offering and the volume of trading that took place they might have left upwards of $200 million on the table.The danger of overpricing is also an important consideration. If a stock is offered to the public at a higher price than the market will pay, the underwriters may have trouble meeting their commitments to sell shares. Even if they sell all of the issued shares, the stock may fall in value on the first day of trading. If so, the stock may lose its marketability and hence even more of its value. This could result in losses for investors, many of whom being the most favored clients of the underwriters. Perhaps the best known example of this is the Facebook IPO in 2012.Underwriters, therefore, take many factors into consideration when pricing an IPO, and attempt to reach an offering price that is low enough to stimulate interest in the stock, but high enough to raise an adequate amount of capital for the company. When pricing an IPO, underwriters use a variety of key performance indicators and non-GAAP measures.[17] The process of determining an optimal price usually involves the underwriters ("syndicate") arranging share purchase commitments from leading institutional investors.Some researchers (Friesen & Swift, 2009) believe that the underpricing of IPOs is less a deliberate act on the part of issuers and/or underwriters, and more the result of an over-reaction on the part of investors (Friesen & Swift, 2009). One potential method for determining underpricing is through the use of IPO underpricing algorithms.

DUTCH AUCTION

A Dutch auction allows shares of an initial public offering to be allocated based only on price aggressiveness, with all successful bidders paying the same price per share.[18][19] One version of the Dutch auction is OpenIPO, which is based on an auction system designed by Nobel Memorial Prize-winning economist William Vickrey. This auction method ranks bids from highest to lowest, then accepts the highest bids that allow all shares to be sold, with all winning bidders paying the same price. It is similar to the model used to auction Treasury bills, notes, and bonds since the 1990s. Before this, Treasury bills were auctioned through a discriminatory or pay-what-you-bid auction, in which the various winning bidders each paid the price (or yield) they bid, and thus the various winning bidders did not all pay the same price. Both discriminatory and uniform price or "Dutch" auctions have been used for IPOs in many countries, although only uniform price auctions have been used so far in the US. Large IPO auctions include Japan Tobacco, Singapore Telecom, BAA Plc and Google (ordered by size of proceeds).A variation of the Dutch Auction has been used to take a number of U.S. companies public including Morningstar, Interactive Brokers Group, Overstock.com, Ravenswood Winery, Clean Energy Fuels, and Boston Beer Company.[20] In 2004, Google used the Dutch Auction system for its Initial Public Offering.[21] Traditional U.S. investment banks have shown resistance to the idea of using an auction process to engage in public securities offerings. The auction method allows for equal access to the allocation of shares and eliminates the favorable treatment accorded important clients by the underwriters in conventional IPOs. In the face of this resistance, the Dutch Auction is still a little used method in U.S. public offerings, although there have been hundreds of auction IPOs in other countries.In determining the success or failure of a Dutch Auction, one must consider competing objectives.[22][23] If the objective is to reduce risk, a traditional IPO may be more effective because the underwriter manages the process, rather than leaving the outcome in part to random chance in terms of who chooses to bid or what strategy each bidder chooses to follow. From the viewpoint of the investor, the Dutch Auction allows everyone equal access. Moreover, some forms of the Dutch Auction allow the underwriter to be more active in coordinating bids and even communicating general auction trends to some bidders during the bidding period. Some have also argued that a uniform price auction is more effective at price discovery, although the theory behind this is based on the assumption of independent private values (that the value of IPO shares to each bidder is entirely independent of their value to others, even though the shares will shortly be traded on the aftermarket). Theory that incorporates assumptions more appropriate to IPOs does not find that sealed bid auctions are an effective form of price discovery, although possibly some modified form of auction might give a better result.

In addition to the extensive international evidence that auctions have not been popular for IPOs, there is no U.S. evidence to indicate that the Dutch Auction fares any better than the traditional IPO in an unwelcoming market environment. A Dutch Auction IPO by WhiteGlove Health, Inc., announced in May 2011 was postponed in September of that year, after several failed attempts to price. An article in the *Wall Street Journal* cited the reasons as "broader stock-market volatility and uncertainty about the global economy have made investors wary of investing in new stocks".

Industry Profile: Financial Markets are place where financial instruments are made to purchase or sell indirectly through intermediaries. This may be a physical location (like the NYSE) or an electronic system (like NASDAQ). Much trading of stocks takes place on an exchange; still, corporate actions are outside an exchange, while any two companies or people, for whatever reason, may agree to sell stock from the one to the other without using an exchange.

Trading of currencies and bonds is largely on a bilateral basis, although some bonds trade on a stock exchange, and people are building electronic systems for these as well, similar to stock exchanges.

Financial markets can be domestic or they can be international

Types of financial markets

The financial markets can be divided into different subtypes:

a) Capital markets which consist of:

- Stock markets, which provide financing through the issuance of shares or common stock, and enable the subsequent trading thereof.
- Bond markets, which provide financing through the issuance of bonds, and enable the subsequent trading thereof.

b) Commodity markets, which facilitate the trading of commodities.

c) Money markets, which provide short term debt financing and investments.

Reasons for Listing

When a company lists its shares on a public exchange, it will almost invariably look to issue additional new shares in order to raise extra capital at the same time. The money paid by investors for the newly-issued shares goes directly to the company in contrast to a later trade of shares on the exchange, where the money passes between investors. An IPO, therefore, allows a company to tap a wide pool of stock market investors to provide it with large volumes of capital for future growth. The company is never required to repay the capital, but instead the new shareholders have a right to future profits distributed by the company and the right to a capital distribution in case of dissolution.

The existing shareholders will see their shareholdings diluted as a proportion of the company's shares. However, they hope that the capital investment will make their shareholdings more valuable in absolute terms.

In addition, once a company is listed, it will be able to issue further shares via a rights issue, thereby again providing itself with capital for expansion without incurring any debt. This regular ability to raise large amounts of capital from the general market, rather than having to seek and negotiate with individual investors, is a key incentive for many companies seeking to list.

Introduction of IPO in context of Indian market

The Indian primary market has come a long way particularly in the last decade after deregulation of the Indian economy in 1991-92. Both the primary and secondary markets have had their fair share of reforms, structural cum policy changes time to time. The most commendable being the dismantling of the Controller of Capital Issues (CCI) and introduction of the free pricing mechanism. This changed the whole facet of Initial Public.

Around 80 IPO's made its entry into stock market in this year, which was never in the history of Indian capital market. Maximum number of issues received enormous response from the investors. Coal India IPO which is raising around 15,000 crores is making its entry into stock market in this October, it is considered to be the largest IPO ever made in the Indian history. Many experts are viewing that it's going to change the Indian economic scenario.

Industries raises finance from capital markets through various instruments like

- Equity finance
- Debt finance

IPO'S comes under equity finance and debt finance. During the last decade, more than a third of the increase in net assets of large firms in Chile, South Korea, Malaysia, Mexico, Taiwan and Thailand has been secured through equity issuance. This pattern contrasts sharply with that of the industrial countries, in which equity financing during the same period has accounted for less than 5 percent of the growth in net assets.

FUTURE OF THE CAPITAL MARKET

In the liberalized economic environment, the capital market is all set to play a highly critical role in the process of economic development. The Indian capital market has to arrange funds to meet the financial needs of both domestic and foreign resources. What is more critical is that the changed environment is characterized by cutthroat competition. Ability of enterprises to mobilize funds at cheap cost will determine their competitiveness.

Changes in the Capital Market

Four sets of changes in the *Indian capital market* can be identified which set the market of the twenty-first century different from what obtained earlier. These can be categorized as follows:

- Introduction of new institutions
- Introduction of new instruments
- Changes in administrative control and regulatory framework
- Some recent initiatives

Introduction of New Institutions

The composition of the Indian capital market has undergone a total change. Till very recent times, Bombay Stock Exchange dominated the capital market in India. The daily turnover on the Bombay Stock Exchange (BSE) alone exceeded the total turnover of all other exchanges put together. The BSE with the monopolistic claw like control over the market was posing a severe constraint on the spread and diversification of the capital market culture. It was content with practicing non-transparent time and resource consuming trading practices that failed to evoke confidence among new investors, both in primary and secondary market. Its trading practices were becoming somewhat totally out of tune with the ongoing communication revolution in India and worldwide. In response to this, the most important are the

OTCEI and NSE. What is more important is that the NSE has worked as a catalyst of change for other exchanges, which are introducing on-line trading systems.

Along with NSE, mutual funds have also emerged in the country. Different types of mutual funds catering to the needs of different types of investors have been set up in the country. The increasing growth of the capital market has witnessed the mergence of foreign institutional investors (FIIs) as significant players. Their sale and purchase decisions are already having a significant impact on the market conditions.

Along with these new players, a set of new supporting institutions have also emerged on the horizon such as the Discount and Finance House of India, Securities Trading Corporation of India, Stock Holding Corporation of India, settlement and depository systems, etc.

INTRODUCTION OF NEW INSTRUMENTS

Along with new institutions, new instruments have emerged on the capital market. These encompass both the domestic instruments and foreign instruments. Many new instruments of finance have already been introduced in recent years. Still, the current intensity of the Indian financial market reveals that there is a tremendous scope to deploy new financing instruments connected to equity, debentures, bonds, add-on products and derivatives. This may require appropriate changes in certain economic legislations and the will on the part of the Indian corporate enterprises to take risks and tune their decision-making to the investor psychology and market preferences.

CHANGES IN RULES AND REGULATIONS

Responding to the changes in the environment, the administrative framework has also undergone a total overhaul. The earlier chains have been totally removed. The Controller of Capital Issues has been done away with. The Indian capital market has been left free to find its own depth and strength. However, it is a paradox of a free market economy that whenever chains are removed effective watchdogs have to be employed. This latter function has now been entrusted to the Securities and Exchange Board of India. The SEBI in turn has been laying down guidelines to be followed by different players in the different segments of the market.

SOME RECENT INITIATIVES

- Buy-back of shares by corporate has been permitted; this will enable the promoters of Indian companies to consolidate their positions.
- Disclosure of end use of funds rose in public issue in annual statements; it will impart transparency to the manner in which the funds raised from the public are deployed. This will also impose greater accountability on companies.

BIBLIOGRAPHY

1. The above information regarding the project has been collected from the following different sources.
2. Secondary information
3. Books referred

4. Investment Banking and Analysis.
5. "Investment, Analysis and management" by Francis.
6. "Security Analysis" by Graham and Dodd.

SITES VISITED

1. www.sebi.gov.in
2. www.moneycontrol.com
3. www.investopedia.com
4. www.reliancemoney.com

International Journal of Management Research and Business Strategy
Hyderabad, INDIA. Ph: +91-09441351700, 09059645577
E-mail: editorijmrbs@gmail.com or editor@ijmrbs.com
Website: www.ijmrbs.com

ISSN 2319-345X