SHORT-RUN PERFORMANCE OF SME IPOs IN INDIAN CAPITAL MARKET

Dr Rajesh Wasudeorao Raut

*Assistant Professor, Modern Institute of Business Management,
Shivajinagar, Off JM Road, Pune 411052.*

Abstract

This paper is based on the belief that Indian SMEs have limitations regarding the financing of capital.As the cost of financing plays a significant role in the growth of SME, it is important to raise money efficiently. Large companies can raise equity using BSE platform whereas for SMEs it becomes difficult to raise money through equity. Considering this limitation, the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) has facilitated a platform for SMEs to raise money in a cost-efficient way. This study is based on how Indian SMEs are utilizing this platform to raise capital. The study has observed atrend of SME IPOs issued in the Indian capital market during the period 2014-2018. The study measures the short-run price performance of IPOs using market-adjusted excess return as criteria. The paper also studies the impact of issue size and issue price on the short-run performance of the IPO.

Keywords: Micro, Small and Medium Enterprises, Initial Public Offer, Market Adjusted Excess Return

INTRODUCTION:

As per Micro, Small and Medium Enterprises (MSME) Act, Small and Medium Enterprise (SME) is defined as a company whose investment in plant and machinery does not exceed INR 100 million. SMEs plays an important role in economic growth. SMEs contribute 37.5 per cent in Indian gross domestic product (GDP) (IDFC, 2013). Today, Indian SMEs are operating in almost every sector such as education, retailing, ITES, media, entertainment, etc. Indian SMEs have tremendous potential as they are offering products and services to compete at a global level.Now, SMEs can raise money through Initial Public Offer (IPO)using platforms such asBSE's SME or NSE's EMERGE. SMEs looking for growth and expansion can avail this opportunity to raise money. Apart from ease of access to finance these platforms provides other advantages like recognition of company at the national level, lesser regulatory control as compared to other platforms and facility to migrate to mainboard exchange.

IPO is anevent when shares of a private company are offered to the public. Since 2011, Indian SMEs are using IPO to raise the capital. This paper is an attempt to study the short-run performance of SME IPOs in the Indian capital market. Most of the research related to IPOs are based on a study of short-run and long-term performance of regular IPOs. This study is an attempt to understand the trend of SME IPOs in India and how investors are pursuing it. The study also focuses on analyzing the short-run performance of SME IPOs in India issued from 2014 to 2018.

REVIEW OF LITERATURE:

In this section, the literature on SME IPO is discussed. Kim, Lee and Krinsky (1995), Sullivan and Unite (1999), Vong (2006) and Reber and Fong (2006) studied the performance of regular IPOs. The focus of these studies was measuring the listing day performance of IPOs. All these studies observed that IPOs are underpriced on initial listing day and thereafter underperforms compared to the market benchmark. Following are some of the studies related to IPO performance.

82

Loughran and Ritter (1995) observed that organisations issuing IPOs when the valuation of a business is high, provide low returns to long term investor. The study noted that during high IPO activity period businesses manages to overprice the issue. Even businesses without substantial value manage to raise capital during this period. However, the capital market quickly corrects this scenario and bring all such companies to their real valuation.

Ghosh (2005) studied the post-offering performance of IPOs in the Indian banking industry. The study evaluates 24 banks listed on BSE in the year 1990. The study found that there is no underpricing of banking sector IPOs. The study noted that key financial indicators of banks have improved post-listing period. The study also noted that the performance of IPOs did not differ based on the ownership pattern.

Datta, Grusin and Datta (2015) studied post IPO stock price performance between RLBOs and IPOs. The study found that RLOBs outperform IPOs for 5 years post listing. The study also noted that public to private RLBOs performs better as compared to other types of RLBOs.

Gao, Cong and Evans (2015) studied the relationship between earning management and an initial public offering. The study examines the performance of 464 IPOs listed on China's Shenzen   Stock Exchange SME board for period 2006-2010. The study observed a high level of underpricing from 2006 to 2010.

Velamuri and Wilson (2017) studied SME IPOs in China. The study is based on 783 SME IPOs issued from 2009 to 2012. The study examines the drivers of IPO performance. The study noted that there is no difference in the performance of IPOs with venture capital investment and those that did back by venture capital.

Samanta, Dam, Saluja, Bansal and Chhabra (2018) studied the short-run pricing performance of Indian IPOs. The Study measures the short-run performance of 117 IPO's issued during 20092013. The study observed that IPOs are underpriced during the study period.The study observed that IPO's from infrastructure sector performed better than another sector IPO's.The study also found that there is no correlation between issue sizeand market abnormal excess return (MAER).

From the literature, it is observed that there are very few studies related to SME IPO performance. Most of the studied is based on the measuring short term and long-term performance of regular IPOs. SME IPO is a relatively new concept for the Indian capital market as this platform is launched in the year 2011. Therefore, there is a limitation to the literature available related to the performance of SME IPOs in India. Also,in the literature, the relationship between issue size, issue price and market excess return remain relatively unexplored. This paper attempts to study these areas with the following objectives.

OBJECTIVES:

1. To study the trend of SME IPOs in India during 2014-2018.
2. To study the short-run performance of SME IPOs in the Indian capital market.
3. To study the impact of issue size and issue price on the short-run performance of the IPO.
   To study this objective, the following hypothesis is established.

H_{a1}: Issue price and issue price have a significant impact on Market Adjusted Excess Return H_{01}: Issue price and issue price have no significant impact on Market Adjusted Excess Return

DATA SOURCE AND SAMPLING:

The study is based on secondary data. The necessary information for the study is gathered from https://www.moneycontrol.com and https://www.bseindia.com. The study considers the following parameters for selection of SMEIPO, viz. SME IPO should be listed on BSE SME platform, it should be offered through a fixed price mechanism (as most of the SME IPOs are listed using fixed-price mechanism) and it should be a successful IPO. A time period from

January 1, 2014, to December 31, 2018, is considered for the study. During this period a total of 148 SME IPOs are issued which are considered for the study.

RESEARCH METHODOLOGY:

I) **The trend of SME IPO's in India:** Trend of SME IPOs in India during the period 2014-2018 is observed using following parameters viz. the number of SME IPO's issued, sector-wise classification of IPOs and capital raised per IPO.

II) **Short Run Performance of SME IPO:** Short-run performance of IPO is measured using

IPO Listing Day Return. Equation 1 is used to calculate IPO Listing Day Return (Ri)

$$(Ri) = [P_1 - P_0 / P_0] \times 100 \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

Where,

Ri = IPO listing day return

P1= Closing price of the share on listing day

P0= Issue Price

If Ri is positive then it is considered that IPO is underpriced and if it is negative then IPO is overpriced.

IPO listing day return is not the best way to measure the performance of IPO as it does not consider the market conditions. Hence to get the best results about IPO performance marketadjusted excess return (MAERi) is used as a tool. MAERi discounts the market perception and calculates the performance of the IPO. It is calculated using equation 2.

$$MAERi = [Ri - Rm] \times 100 \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2)$$

Where,

MAERi= Market Adjusted Excess Return,

Ri = IPO Listing Day Return,

Rm = Market Benchmark Return

The MAERi can take a positive and negative value. If MAERi value is positive then IPO is considered as underpriced and if it is negative then IPO is considered as overpriced. Market Benchmark Return (Rm) is calculated using the following equation.

$$Market\ Benchmark\ Return\ (Rm) = [M_1 - M_0 / M_0] \times 100 \ldots\ldots\ldots\ldots\ldots\ldots\ldots (3)$$

Rm = Market benchmark return (Here SME BSE is considered as the benchmark)

M1= Closing price of a market benchmark on the IPOs listing day

M0= Closing price of a market benchmark on the closing day of the issue.

The market-adjusted return gives the representative value about the capital market. The positive value of Rm indicates that the market is moving upward and a negative value indicates that the market is declining.

III) Impact of issue size and issue price on MAERi: Regression Analysis is used to measure the impact of issue size and issue price on MAERi.

DATA ANALYSIS:

I)   The trend of SME IPO's in Indian capital market: Following table indicates the trend of SME IPOs in the Indian capital market. During the study period, a total of 148 SME IPOs are issued with an average of 29.6 IPOs per year (Refer Table 1). A total of INR 17.18 billion is raised with an average capital of INR 3.44 billion per year and INR 0.10 billion per IPO. During the study period, a fluctuating trend in the number of IPOs issued is observed. In the year 2017 the highest number of IPOs i.e. 63 is recorded, while the least number of IPOs i.e.14 are recorded in the year 2016. During the study period, the highest total of INR 9.27 billion capital is raised in the year 2017. Also, INR 1.22 billion, INR 2.03 billion, INR 0.73 billion and INR 3.93 billion is raised in year 2014,2015,2016and 2018 respectively. The year 2018 recorded the highest average capital per IPO, i.e. INR 0.16 billion while the lowest average of INR 0.05 billion is recorded in the year 2016. Also, INR 0.06 billion, INR 0.08 billion and INR 0.5 billion capital is raised per

IPO in the year 2014,2015 and 2018 respectively.

Table 1-The trend of SME IPO's in the Indian capital market

Year	No. of SME IPOs	Capital Raised per Year(INR Billion)	Average Capital Raised per IPO (INR Billion)
2018	25	3.93	0.16
2017	63	9.27	0.15
2016	14	0.73	0.05
2015	26	2.03	0.08
2014	20	1.22	0.06
Total	**148**	**17.18**	**0.50**
Average	**29.60**	**3.44**	**0.10**

Sector-wise IPO distribution: During the study period, a total of 148 IPOs were issued. Following table indicates the sector-wise distribution of IPOs (Refer Table 2). The sectoral classification of SME IPOs shows that Indian SMEs are growing in almost all sectors. During the study period the highest number of IPOs, i.e. 25 are issued by manufacturing sector followed by cement and construction sector and IT sector which offered 11 IPOs each. Least number of IPO

i.e. only one IPO is issued by the pharmaceutical sector.Overall all sectors (ranging from agriculture, banking, engineering, IT, media, etc.) representation can be observed in the table. This means SMEs from all the sectors are utilizing the BSE platform to raise the capital. This is good news for the SME sector as well for the Indian economy.

Table 2-Sector-wise IPO distribution during 2014-2018

Sector	No of IPOs
Agriculture and Allied	5
Banking and Financial Services	7
Cement and Construction	11
Chemical	3
Consumer Non-Durables	3
Engineering and Capital Goods	8
Food and Beverages	4
IT	11
Manufacturing	25
Media and Entertainment	4
Metal and Mining	7
Pharmaceuticals	1
Real Estate	4
Retail	6
Service	10
Telecom	2
Textile	2
Miscellaneous	35
Total	**148**

II)   Short Run Performance: Short Run Performanceof SME IPO is measured using Market Adjusted Excess Return ($MAER_i$). $MAER_i$ is the difference between listing day return (R_i) and market benchmark return (R_m) (Refer to Equation 1, 2 and 3). Refer Table 3 fordetails of descriptive statistics of SMEIPOs during 2014-2018.

Table 3- Descriptive Statistics of SMEIPO during 2014-2018

Statistical Parameters	Issue Size (INR Billion)	Issue Price (INR)	Ri (%)	Rm (%)	MAERi (%)
Minimum	0.01	10.00	-89.68	-22.16	-89.91
Maximum	0.93	920.00	64.35	42.66	73.71
Sum	17.22	7461.05	-351.99	72.32	-424.31
Mean	0.12	50.41	-2.38	0.49	-2.87

| Std. Deviation | 0.13 | 83.37 | 25.54 | 7.29 | 26.73 |

It can be inferred from Table 3 that INR 0.93 billion was the largest issue offered during the period. It was offered by East India SecuritiesLtd, while Shree Krishna Infrastructure Ltd.offered the smallest IPO of INR 0.01 billion. East India Securities Ltd, came with the highest offer price of INR 920, whereas Sungold Media andEntertainment Ltd. offered INR 10 as lowest share price during the period. Sun Retail Ltd. offered a maximum listing day returnof 64.35 per cent. Tejnaksh Healthcare Ltd. offered the lowest listing day returns of -89.68 per cent during the period. Athena Construction Ltd offered 73.71 per cent of highest and Airan Ltd. offered -89.91 per cent of the lowest market-adjusted excess return during the period. An average -2.38 per cent of listing day return, 0.49 per cent of market benchmark return and -2.87 per cent of marketadjusted excess return is observed during the study period. This indicates that investors subscribing to SME IPO earned a negative return on a listing day during the study period.

III) **Impact of issue size and issue price on MAER$_i$:** Each IPO has a different issue size and it comes with different issue price. For investors, it will be interesting to know whether issue size or issue price has any impact on MAER$_i$. For this MAER$_i$ is considered as an independent variable and issue size as well issue price is considered as the dependentvariable. Refer to Table 4 and 5 for details.

Table 4- Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.086a	.007	.001	26.72014
2	.147b	.022	.008	26.61873
a. Predictors: (Constant), Issue Size				
b. Predictors: (Constant), Issue Size, Issue Price				

Table 5- Analysis of Variance

ANOVAª					
Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	785.398	1	785.398	1.100	.296b
Residual	104239.056	146	713.966		
Total	105024.455	147			
2 Regression	2283.755	2	1141.878	1.612	.203c
Residual	102740.699	145	708.557		
Total	105024.455	147			
a. Dependent Variable: MAERi					
b. Predictors: (Constant), Issue Size					
c. Predictors: (Constant), Issue Size, Issue Price					

Regression analysis is used to measure the impact of issue size and issue price on MAERi. The R square value for issue size is 0.086 (refer Table 4) indicating that issue size can cause 8.6 per cent of the variation in MAERi. Whereas, the combined effect of issue size and the issue price is 14.7 per cent (refer Table 4) on MAERi, which is negligible. Referring to Table 5, which indicates p values of 0.296 for issue size and 0.203 for issue size and issue price combined as an independent variable. As p value is not significant, the null hypothesis is accepted and it can be concluded that issue size and issue price have no significant impact on MAERi.

CONCLUSION:

The study shows that around 148 SME IPOs are issued during the period.This implies that Indian SMEs are using BSE's SME platform to raise the capital. This is a good indicator of the Indian economy.The study also shows that almost all sectoral SME companies ranging from banking, chemical, textile, education, etc. are using this platform. This explains that all sectorsof the economy are participating in the growth and development of the economy. The short-run performance of SME IPO measured by listing day return (Ri) and market-adjusted excess return (MAERi) shows a negative return. The average value of Ri and MAERi is negative, which indicates that investors subscribing to SME IPO earned a negative return on a listing day. The study also shows that issue size and issue price have no significant impact on a market-adjusted excess return. This means investors can subscribe to SME IPO based on the value of the company rather than issue size or issue price.

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