FACTORS AFFECTING GOAN INVESTOR’S CONFIDENCE IN INDIAN PRIMARY MARKET

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ABSTRACT

The capital market is a barometer of an economy. It reflects how much of economic activities are taking place in the given market. Especially the Initial Public Offerings (IPO) send positive signals about the economic activities as they represent management’s faith in future and investor’s belief in the economy. A study was conducted in Goa to know which factors influenced investors’ decisions to invest in IPOs and how they evaluate them. The exploratory factors analysis revealed four factors. The study discusses relationship between each variable within those factors.

INTRODUCTION

The capital market is the backbone of any country’s economy. It facilitates the conversion of savings to investments. Capital market can be classified as primary and secondary markets. The fresh issue of securities takes place in the primary market and trading among investors takes place in the secondary market. The primary market is also known as new issues market. Equity investors can enter capital market by either way i.e., primary or secondary market.

Globally, there are increased evidences to suggest that investor confidence has assumed an important role in the economic development of a country. The Economist (1998) indicated that a lot of issues need to be addressed to make capital markets safer. Transparency, strengthening the financial system and managing crises are the issues, which cannot be quickly fixed. But they add up to a stronger system. David Bullard (1998) in Business Times has indicated that the private investors are the biggest losers on the South African listings scam. Companies with no earning record and with inexperienced directors got listed on stock exchanges. Their only objective was a profit making out of inflated market price. The net result is private investors lost confidence in the market.

In India, common investors participating in the equity primary market are massive. The number of companies offering equity through primary markets increased continuously in the post independence period till the year 1995.
After 1995, there is a continuous slump experienced by the primary market offering equity. The main reason for the slump is the lack of investor confidence in the primary market. So it is important to understand the causes and measures of the revival of investor confidence leading to capital mobilization and investment in right avenues creating, economic growth in the country.

McCall (2002) in his testimony before the committee on financial services United States house representatives, observed that the integrity of the financial markets and economic well being of the country depends on corporate accountability and investor confidence. He indicated that regulators, the accounting professionals, analysts, brokerage firms, public companies, shareholders and the Government must contribute to ensure good corporate governance and reduce corporate failures.

Revival of confidence of the investors is necessary to make the securities market more efficient means of converting savings to investment. The Hindu (2002)\textsuperscript{4}, online edition of the Indian national newspaper has indicated that the spate of scandals in the United States were being addressed by stricter laws and strong actions against the culprits to prevent any recurrence of these events and to restore investor confidence.

**LITERATURE REVIEW**

1. John Hall (2002) has conducted research on broker’s recommendations. He found that investors who invested in the Johannesburg Securities Exchange (JSE) based on their brokers’ advice, we're able to get risk adjusted returns superior or equal to the market.

2. Fieldstein and Yitzhaki (2000) have presented evidence to suggest that the corporate stock owned by high-income investors appreciate substantially faster than stock owned by investors with lower incomes. They have indicated that high-income individuals have larger portfolios and can therefore denote more time or resources to their investments, thus resulting in higher returns.

3. Gupta L.C. (1996) has indicated that from the angle of investor protection, the regulation of the new issue market is important for several reasons. The number of small investors in the new issue market is massive. Most of new investors make their first entry into equity investments via the new issue market. So retaining common investor confidence in primary markets is important.

4. Madhusoodan T.P. (1997) has indicated that in the Indian stock market, higher risk is not priced; hence investment in higher risk instruments is of no use.

5. Kakati (1999) has indicated that Indian IPOs are under priced in the short run and overpriced in the long run. Selling after allotment, around the listing month, is the cause of major return differences between IPOs performance in the short run and long run.

6. Gokaran, Sabir (2000) have studied the financing patterns of the corporate growth in the country. The study indicated that equity markets suffer serious inadequacies as a mechanism for raising capital.
7. Murali (2002) has indicated that New issues market (NIM) focuses on decreasing information asymmetry, easy accessibility of capital by large sections of medium and small enterprises, national level participation in promoting efficient investments, and increasing a culture of investments in the productive sector. In order that these goals are achieved, a substantial level of improvement in the regulatory standards in India at the voluntary and enforcement levels is warranted. The most crucial steps to achieve these goals would be to develop measures to strengthen the new issues market.

8. Rachana Bed and Dhiren (2009): studied the various factors that an investor should look for investing in the primary market. This article categorized these factors into three broad categories. The qualitative aspects, pre-listing and post-listing of the IPO’s. Some of the important factors of this study are- management capability, ASAB, analysts and broker estimates, market volatility and sector performance over 3-4 quarters.

9. Ishwara P. (2009): this article discusses the reforms and policies adopted by Indian government towards IPO’s and primary market in India. The guidelines stressed on various aspects of issue price and pricing of IPO’s. The issuer in consultation with merchant banker should decide the price and disclosure of the pricing mechanism. These favorable developments led to a rapid growth in the primary market. The article concludes that the overall IPO performance is good now. It also states that the price after listing, trading at discount price are still the concern of the investor in the primary market.

10. Abhay Kumar (2009): studied the IPO performance during the crisis the capital market faced in 2008-09. The effect of recession in capital market had severely affected the primary market and its recovery along with the growth in the secondary market in the last few months. Also a successful launch of Adani Power and NHPC IPO has further boosted the confidence of companies and the investor. The study lists the factors responsible for the poor IPO performance during this period and it highlighted the various measures taken by SEBI and issuing companies to bring back the confidence of investors towards primary market.

11. Pallavi Rao (2005): studied the IPO performance after 2005 market boom. With strong demand for IPOs, issues are pricing aggressively. While subscribing to IPOs, the retail investors need to be cautious about the fundamentals of the company. He says that investor ends up paying an additional premium not just for company’s expected future growth but because of the market conditions as well. He concludes saying that the efforts being made by SEBI is helping common investor and what strategy should these retail investors should use for investing in the primary market.

12. R. Venkatesh Iyengar (2009): this article says “while the companies that either deferred or cancelled their IPOs in 2008 may decide to go public this year, there is no gainsaying the view that 2009 will not be any different”. Since the Indian economy was facing a slowdown due to recession in the US, many reforms from the government in the form of stimulus packages and bailouts started flowing in. Also many companies opted for IPOs to raise equity. The article shows the statistics that year 2008 was the worst year for
Indian IPOs where 34 companies raised only Rs 34000cr from a single issue. He concludes saying that the recovery of primary market depends on the health of the secondary market.

13. Eddy Chang and Martin Young (2008) divided Chinese IP market into primary market and the secondary market. They found that initial return is negatively and positively related to primary and secondary markets respectively. Whereas, initial turnover is opposite to offer volume.

STATISTICAL ANALYSIS AND FINDINGS

Discriminant Analysis using WinDAS (Ver. 1.0.0.0 © John Wiley & Sons, 1998) Application

File software was run. The findings are as below.

FIG. 1 DISCRIMINANT ANALYSIS OF THE 24 VARIABLES USING WIN-DAS SOFTWARE

The above graph shows the output of the WIN-DAS software for Discriminant analysis. The graph shows the most similar ranked factors closely clustered with each other. Based on these
clusters obtained from the software, the most dominating factors can be grouped into following four factors:

**FACTOR 1**
- Broker’s advice.
- Personal analysis.
- Publicly circulated analyst’s recommendations.
- Easy availability of issue information.

**FACTOR 2**
- Secondary market situation.
- Regulatory environment.
- Lead manager’s image and expertise.

**FACTOR 3**
- Issue price of the IPO.
- Market price after listing.
- Liquidity after listing.

**FACTOR 4**
- Easy availability of margin funds.
- Revision of issue price with change in market response.
- Availing greenshoe options.
- Comparing valuation if issues with that of its listed peers.

Further covariance analysis of the selected 15 variables was carried out using the same software. This was done in order to find out the degree of correlation among the grouped factors i.e. whether the grouped factors are correlated with each other. The output of this analysis is as shown in the graph below:
Based on the above output final dominating factors were grouped into the following groups:

**FIG. 2 FURTHER DISCRIMINANT ANALYSIS OF SELECTED 15 VARIABLES**

Finally Linear Discriminant Analysis of the selected final variables was carried out using the correlation method and Euclidian Distance metric.
FIG 3: LINEAR DISCRIMINANT ANALYSIS

This test was carried out in order to analyze whether the grouping of the selected dominant factors was correct or otherwise. The output of the above test is shown in fig. 3. The linear discriminate analysis of the final observations shows that out of the final 15 factors 13 factors were correctly grouped. However, 2 factors were incorrectly assigned. Hence these two factors give independent importance along with the other groups.

DISCUSSION

Factor 1 explains about an investor’s exposure to different sources of information/analysis reports. It also tells us about the investor’s reliance on that source for making his/her investment decisions. In the absence/inadequacy of reliable data the investor does his own analysis. Before making an investment decision on a new issue, it is essential for an investor to gather as much as information about the company’s fundamentals/background. Since it is an Initial offer the easy availability of information is limited, this limitation further increase when there is no similar kind of company listed in the market. With what-all information available, if not detailed, an investor is advised to do a minimum basic personal analysis before making an investment decision. In addition to his personal analysis he can even cross check his analysis with his broker advice or the media analyst’s recommendation.
Factor 2 explains about an investor’s behavior in relation to the secondary market situation, regulatory environment and the image and expertise of the lead manager. Here, if the market is bullish and regulatory environment are favorable, the image & expertise of the lead manager are well acknowledging then he will be acting positively, else vise-versa. When it comes to investment in initial public offers external factors such as market condition, regulatory frameworks & lead manager’s image & expertise have a great influence on investor participation. The bullish/stable market condition, reputed & experienced company acting as a lead manager with favorable regulatory environment will have a positive impact on the new issue, thereby attracting more & more investor subscribing to the issue. Similarly, the volatile market / bearish market condition, non-reputed & inexperienced company acting as a lead manager with unfavorable regulatory environment will have a negative impact on the new issue thereby leading to under-subscription to an issue.

Factor 3 explains about the liquidity-promotion hypothesis, as post-listing turnover is positively related to initial under-priced. An Initial public offer to be successful the company should carry fair pricing policy. The issue price of a company’s IPO which is well above its fair value will attract less investor thereby leading to under-subscription. Moreover the issue will face the selling pressure one it gets listed on the browsers. To overcome these problems the IPO’s should always be fairly priced. Post listing price action and the liquidity in the issue has great impact on investor psychology, the rising price & good amount of liquidity will make investor feel confident and comfortable this in-turn will also create demand for the issue thus taking prices further up. The declining price & with not much of shares being traded will put investor in dilemma whether to hold the issue or sell it off, this in-turn will add to the existing supply thereby taking the prices further down. Thus the post listing price action & liquidity of an issue checks the nervous stability of individual investors.

Factor 4 explains, does an investor behavior is impacted by the availability of margin funds, IPO pricing compared to its listed peers, then the demand for the issue. The subscription to the offer also depends on the liquidity in the market. The availability of margin funds will definitely have a positive trigger to the issue’s offer. Revision of issue price with changes in market response and a greenshoe option is helps underwriter by giving him an opportunity to increase the supply in case of increased demand. If the issue price is undervalued in comparison to its listed peer then the possibilities of it being oversubscribed is more & vice versa.

CONCLUSION

The Study found that investors are not dependent on single source for information to invest their hard earned money. The market condition, regulatory frameworks, lead manager’s image & expertise form suitable or unsuitable environment for investments. For initial public offers the post listing price action & liquidity play an important role in attracting investors. Similarly, an undervalued initial public offering attracts more subscriptions.

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