



# A STUDY ON INCREASING INTEREST OF RETAIL INVESTORS IN INITIAL PUBLIC OFFERS IN INDIA

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**Abstract:** Stock market is one of the most lucrative investment avenues in India. People invest in the stock market because it has the potential to generate handsome returns in a small span of time. Investors trade in the stock market either through the primary market or through the secondary market. In an Initial Public Offering (IPO) to raise money, the offer is usually geared towards institutional investors. They have always been the dominant force, many a times even getting to dictate the terms and conditions on their sheer clout. But, with a huge influx of retail investors, things seem to be changing now. Retail investors are becoming a force that no one can ignore now. In fact, their clout has risen so much that merchant bankers are focusing more on them in this fund raising exercise. Retail demand for recent IPOs has been on a rise. This paper makes an attempt to investigate the factors contributing to the increased interest of retail investors in initial public offerings.

**Index Terms** - IPO, retail investors, stock markets, listing

## 1.1 INTRODUCTION

Stock market is one of the most lucrative investment avenues in India. People invest in the stock market because it has the potential to generate handsome returns in a small span of time. Investors trade in the stock market either through the primary market or through the secondary market. The primary market involves investing in the stock market by applying to the Initial Public Offering (IPO) of a company while the secondary market involves purchasing and selling shares directly from the stock exchange. In an Initial Public Offering (IPO) to raise money, the offer is usually geared towards institutional investors. They have always been the dominant force, many a times even getting to dictate the terms and conditions on their sheer clout. But, with a huge influx of retail investors, things seem to be changing now. Retail investors are becoming a force that no one can ignore now. In fact, their clout has risen so much that merchant bankers are focusing more on them in this fund raising exercise. Retail demand for recent IPOs has been on a rise. The lure of stellar listing gains has been attracting many first time investors. Retail investors have poured more money than total issue sizes in many cases. That means the companies could have reserved all the shares for retail investors and still sailed through! In the last six (fiscal) years, the market share of individual investors has risen sharply by 12 percentage points from 33 per cent in FY16 to 45 per cent in FY21, rising sharply this financial year, offsetting a decline in the share of FIIs and public and private companies during the same period. NSE has registered 51.3 lakh new investors in just four months of this financial year. An influx of retail investors has added more money to the market, often leading to hysterical behaviour, especially when people were chasing quick returns. Many see this retail exuberance for IPOs as a telltale sign of the market peaking. But merchant bankers are not complaining. They have priced their client's IPOs aggressively, with price to earnings reaching up to 90 times in some cases. The fact remains that retail investors have tasted blood in the IPO mart, with listing gains consistently reaching up to 100 per cent. As long as they are making money, their love for IPOs

may not be lost. And, IPO managers will continue to exploit this new breed of hungry investors.

## 1.2 OBJECTIVES OF THE STUDY

1. To understand the development of Initial Public Offerings in India.
2. To understand the types and advantages of Initial Public Offerings.
3. To probe the factors influencing increasing retail investors interests Initial Public Offerings.

## 1.3 RESEARCH METHODOLOGY

The present study is descriptive in nature and uses secondary data collected from journals, magazines newspapers etc.

## 1.4 THE INITIAL PUBLIC OFFER (IPO) MARKET

### *Definition of IPO:*

An initial public offering (IPO) refers to the process of offering shares of a private corporation to the public in a new stock issuance. An IPO allows a company to raise capital from public investors. The transition from a private to a public company can be an important time for private investors to fully realize gains from their investment as it typically includes a share premium for current private investors. Meanwhile, it also allows public investors to participate in the offering.

### **Definition of Retail Investor:**

A retail investor is a non-professional investor who cannot apply or bid for shares worth more than ₹ 2 lakh. Given their low purchasing power, these investors often trade in lower amounts compared with institutional investors. They often have to pay a higher fee for their transactions. An initial public offering (IPO) is a key milestone in a firm's life cycle. A healthy IPO market is important for many reasons. IPOs give entrepreneurs liquidity for their investments, so a vibrant IPO market can stimulate the flow of pre-IPO investments and help develop new ventures. An IPO brings in new investors to a firm, which facilitates the firm's access to future growth capital. Being public also reduces the costs of raising future capital by stimulating the supply of information from the investment community. IPOs are significant as they are regarded as the barometer of the health of the capital market. A single bad IPO can create considerable market disruptions and stall the plans of other firms that want to go public. Relatedly, an important reason for ensuring a smoothly functioning IPO market is to manage investor frenzy. IPOs are closely watched by investors and the media. Overheated IPO markets could result in cascades in which enthusiastic investors overbid for IPOs, create bubbles, and ride them out. The subsequent correction of bubbles and the distorted real investments induced by wrong price signals could create negative externalities for the real economy.

From a policy perspective, the key issue in ensuring a healthy IPO market is how to enable an environment where IPOs can be reasonably priced. Fair pricing ensures that firms sell instruments at acceptable prices, and investors get appropriate risk-adjusted returns. Fair pricing for IPOs is, however, challenging. IPO firms face the markets for the first time. Relatively little is known about an IPO firm's future prospects, governance quality, and other parameters that are relevant for valuation. These information gaps could result in issues being underpriced or being valued at substantial discounts relative to fair value. Thus, a main focus of IPO regulations is to mitigate information gaps between firms and investors. Regulator Stock Markets in India Securities Exchange Board of India (SEBI) facilitates this through policies to increase the quality of pre-IPO disclosures and by specifying mechanisms by which firms can make IPOs.

### 1.5 INITIAL PUBLIC OFFERING (IPO) PROCESS OVERVIEW:

1. A private company decides to raise capital through an IPO.
2. The company contracts an underwriter, usually a consortium of investment banks which assess the company's financial needs and decide the price/price band of shares, number of shares to be offered etc.
3. The underwriter then participates in the drafting of the application (to SEBI) for approval with details of the company's past financial records including profits, debts/liabilities, assets and net worth. Also, the draft mentions how the funds to be raised will be used.
4. SEBI carefully scrutinizes the application and after making sure that all eligibility norms are fulfilled, it gives the company the go ahead to release the 'red herring prospectus'.
5. The 'red herring' prospectus is a document released by the company mentioning the number of shares and the issue price/price band (price of one share) to be offered in the IPO. It also has details of the company's past performance.
6. In a 'Road show', executives travel to meet with and woo potential investors to buy their company's shares.
7. An IPO opens and can last for 3-21 days, though it is usually open for 5 days.
8. During this time, retail investors can bid for stocks through their banks/brokerages via the Internet.
9. Investors need to have a demat account to participate in an IPO, and a PAN card.
10. If the stocks bid for are allotted, they'll be credited to investors demat account. If not, money is returned back.

### 1.6 METHODS OF IPOs:

1. **Book Building Route:** It is a type of process that an underwriter uses to figure out at what price should an IPO be sold. Fund managers submit the number of shares they wish to purchase and at what price. This helps the underwriters determine the value & initial share price of the IPO.
2. **Underwriting:** An underwriter is the one (or a group of investment banks) who assesses a company's financial needs and decides the price/price range of shares, number of shares etc. They also participate in the drafting of an IPO's application to SEBI. Finally, after the IPO comes to an end, the new public stock is listed on a stock exchange. From then on, trade can take place in the publicly held shares on the stock market.

### 1.7 ADVANTAGES OF IPO:

There are certainly some advantages of investing in IPOs. Here are some of these unique IPO advantages

1. **Access to top quality unlisted stocks:** There are a number of marquee companies that have come into the stock markets through the IPO route. Here are some stand-out examples. L&T Infotech is a 9-bagger since its IPO in July 2016. Team lease is a 5-bagger since January 2016. Dixon Technologies has been 12-bagger since September 2017 while CDSL has been a 10- bagger since June 2017. In an IPO, the merchant bankers and the issuers try to attract maximum buying interest. Hence, the endeavour is to leave something on the table for investors. That is where the biggest benefit comes from the IPO. While one can buy these stocks in the secondary market, the price would be much steeper
2. **IPOs give access to quality PSU stocks:** The PSU stocks may not be the darling of the markets but some of them have done really well. For example, this year, two major divestment issues of BPCL and LIC are expected to hit the market. In the last few years, the primary markets gave access to the shares of high quality companies like Hindustan Aeronautics and Cochin Shipyards. Of course, Coal India in 2010 still remains the largest IPO ever. Divestments were a lot more aggressive in the pre-2007 period and one of the classic examples has been the divestment of Maruti in 2002, which went on to become a 100-bagger over time. These IPOs give access to such quality paper of top class PSU companies.
3. **IPO norms favour small investors:** If you are a retail investor, then you have a huge benefit in that the allotment process is designed to ensure that maximum number of applicants get allotment. This normally works in favour of the small investor. There are quite a few such measures favouring retail investors. In most PSU IPOs, retail investors are eligible to get a discount over the issue price applicable to HNIs and institutions. Secondly, even within the retail quota, small investors get higher allotments since the focus of SEBI is on broadening the retail ownerships.
4. **SEBI's streamlined IPO regulation and IPO processes:** If there is one area where SEBI has placed a lot of accent in fine tuning processes and ensuring safety, it is in primary markets. Crunching the time to allotment and listing has impelled companies and investment bankers to fine tune processes. They also follow higher standards of disclosure and transparency. This has made IPO markets more professional and safer for the retail investors. In the secondary

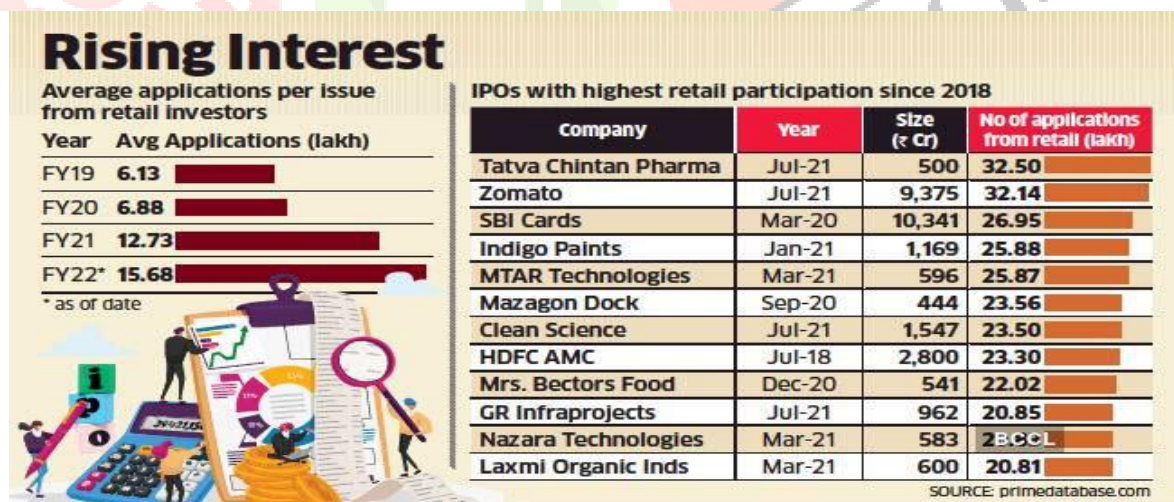
markets there tends to more of information and noise but limited insights. IPOs manage to squeeze all the intelligence pertaining to the company into the prospectus.

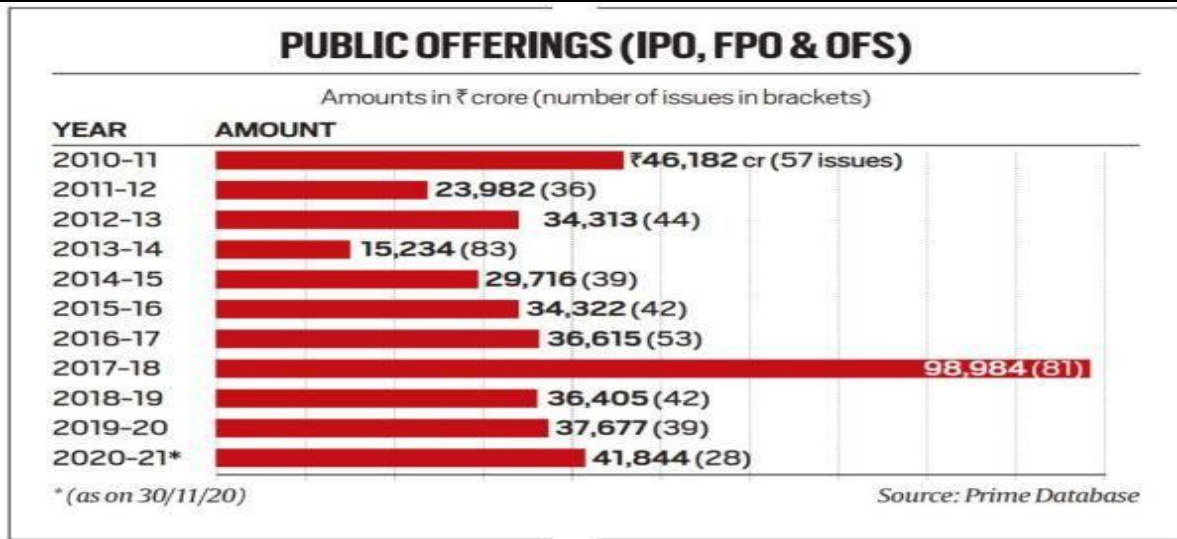
- Information Symmetry:** Most secondary market stocks are tracked by institutional investors, analysts and insiders. Some are even over-tracked. These institutions and analysts have an edge in terms of information access. IPOs are not tracked by analysts so the only source of information is the IPO prospectus. Therefore, in terms of information symmetry, retail investors are at par with analysts and institutions. This is unique to IPOs.

### 1.8 FACTORS DETERMINING INVESTORS DECISION IN IPO:

- Due Diligence:** All listed companies are bound by regulations to publicly divulge information that may affect their stock prices. But a company going for an IPO is not listed, making it difficult for investors to get information about it. Investors should make every effort to learn about a company's financial ability, past record, and promoters before applying to buy its shares.
- The Company Fundamentals:** Analyze the fundamentals of a company going to be listed on an exchange for the first time by comparing it to those leading the segment it operates in. For example: look for the medium-to-long term growth potential of the sector. Compare its potential with respect to its competitors. This will give you a fair assessment of the price of the IPO stock whether it is undervalued, overvalued, or just right.
- The Prospectus:** Every company going for an IPO has a draft red herring prospectus (DRHP). This document contains various details about the company – such as its financial standing, its performance so far, its promoters, and its competition. While this document has a lot of information about the company, it is nonetheless prepared by the company. So, verify.
- Institutional Investor Interest:** Retail buyers should always check how interested institutional investors appear in an IPO. That would give them a hint of how secure or risky the investment would be. A greater institutional buyer interest may suggest market confidence in the IPO. But retail investors are advised to make their own decisions irrespective of those whose motives are not known to them.
- Investment goals:** Ask yourself what you want to achieve with a particular investment. Once your goals are clear, you can then compare whether an IPO fulfills them or not and decide accordingly.

### 1.9 FACTORS INFLUENCING INCREASED RETAIL PARTICIPATION IN IPOs:





1. Declining saving avenues amidst the low interest rate regime has led to greater interest by individuals in the stock market.
2. With key repo rate at 4%, the FD rates vary from 2.9% to 5.4 for different tenures (SBI FD rate). Even the current small savings rate are low, varying from 7.6% on Sukanya Samridhi Yojana Account Scheme, 7.4% on Senior Citizen Savings Scheme, 7.1% on Public Provident Fund, and 6.8% on National Savings Certificate.
3. Another reason could be the significant increase in global liquidity. “The stellar performance of the recent IPOs – both in terms of listing gains and returns post-listing – will keep investor interest elevated in new offerings.
4. Additionally, the pandemic which has resulted in people spending more time in their homes might also be another reason for their tilt towards the stock market trading.
5. The stellar performance of the recent IPOs – both in terms of listing gains and returns post-listing keep investors interest elevated in the new offerings.
6. Mobile trading applications, which are easy to use, have eased the process of applying for IPOs. “Technology has dramatically reduced the barrier of entry for individual investors from participating in the primary market as now it takes just a minute to apply for an IPO. Technology plays a key role in increasing participation in new offerings beyond top-10 cities and penetrating Tier 2 and tier 3 cities now. Earlier, investors had to fill up IPO applications for each issue and the period between the time of issue and the listing was as long as a fortnight, resulting in application money getting stuck
7. ASBA makes IPO investing very economical Retail investments in IPOs are routed through ASBA. Applications Supported by Blocked Amounts (ASBA) ensures that the amount is only blocked to the extent of your application. The actual allotment amount is debited to your bank only after shares are allotted. Small investors do not lose interest on unallotted portion and so it works out more economical, although access to the funds are still restricted. . Retail investors are pumping money into equities like never before. More than two crore demat accounts have been added since April 2020.

### 1.10 CONCLUSION:

As Sensex crosses another milestone of 63K points, a large part of it is because of retail investors. Indian investors aren't just investing in stocks more, they are moving the markets now, helping IPOs sail through and cushioning the blow when big investors exit the market.

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