

Initial Public Offering Investment: The General Investors' Perspective

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Abstract

This study aims to explore the views of general investors on their IPO investments in the primary market. Using a judgemental sampling, the views of 109 general investors who actively participated in the primary market has been employed in the study from Pokhara City. The study revealed that banking and finance followed by hydropower are the most preferred sectors of buying common stocks in the primary market with the expectation of long term returns. There is a significant different perception on both risk and return from IPO investment between male and female investors. The study also found that government's policy announcements followed by the size of the firm that issues IPOs are the major determinants of IPO return and risk among investors. Increasing paid up capital for business expansion is the important reason for issuing IPOs by the companies while creating exit route for existing shareholders is the least.

Keywords: IPO, investment, return, risk, general investors

Background

An investment is the current commitment of money or other resources in the expectation of reaping future benefits (Bodie et al., 2011). Investors invest in financial assets like shares, debentures, options, etc. and they generally aim at long term gain in terms of regular income or return for consumption as well as appreciation in their wealth at the minimum risk. Utility theory explains that investors are predominantly risk averse (Pandey, 2010), and their investment strategies are purely based on the risk-return consideration. In other words, investors always try to make proper trade-off between expected return and the risk in their investments. Generally the investors have opportunity to invest in financial assets or securities at the time of public issue, which is referred to initial public offering (IPO).

Initial Public Offerings (IPOs) are defined as the original sale of a company's securities to the wider public for the first time in the primary market (Brealey & Myer, 2003). An IPO offers a fresh source of capital that is vital to the growth of the company and provides the company and existing shareholders a liquid market for their shares. Primary market also provides a forum for the subsequent sale of new securities called seasoned new issues, by the companies

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that are already public (Gitman & Joehnk, 2012). Mainly the companies that are small and fast growing and require more capital to their expansion, they go for public with prospectus. On the other hand, an IPO renders investors an opportunity to share in the rewards of the growth of the company. Among various alternatives, investment in common stock is considered as one of the options with high risk-return. It is an opportunity for risk-seeking investors for their investment wishing to take greater risk for higher return. Moreover, Zingales (1995) argues that an IPO is a first step in the owner's exit strategy and liquidity to the investors. The risk-averse investors on the other hand would seek to invest on securities like debentures and preference shares issued by companies and bonds by government which would provide fixed return over a period of time with very little on their investment. However, initial public offerings are almost always remain quite risky (Ibbotson, Sindelar & Ritter, 1988).

The history of initial public offerings in Nepal dates back to 1936 in which year the shares of Biratnagar Jute Mills Ltd. were floated. HMG Nepal introduced the Company Act in 1964 and the first issue of government bonds made in the same year through Nepal Rastra Bank to collect the development funds for the government. HMG Nepal announced the Industrial Policy in 1974 and under this policy an institution named Securities Marketing Center (SMC) was established to deal in government securities -development bonds, national savings bonds, and corporate securities of few companies. Then, Securities Exchange Center (SEC) was established in 1976 with an objective of facilitating and promoting the growth of capital market. Due to the world whim of economic liberalization, privatization and globalization, the operation of SEC was felt to change and HMG Nepal brought about change in its structure by dividing it into two distinct entities -Securities Board of Nepal (SEBON), an apex capital market regulator and Nepal Stock Exchange Limited (NEPSE), as a platform for secondary trading of securities in 1993. Since then equity issuance in the primary market formed a significant portion of total issue, which is considered as a viable opportunity for risk-seeking investors wishing to take greater risk for higher return (Vaidya & Parajuli, 2004). The Company Act, 2063, section 34, has made a provision that the public company are able to issue debentures with a complete work plan regarding the proceedings. Consequently, Nepal Rastra Bank has been compelling bank and financial institutions to increase their capital base issuing debentures in recent years.

The main objective of this paper is to explore the reasons for IPO investments especially common stocks among the general investors in Pokhara. This paper presents the important issues that need to consider for IPO investments in terms of returns, risks, firm related variables like firm size, age of the firm, issue size of IPOs, subscription rates along with market return and government policies. Further, the study explores the investors' opinion about the firms' motive to issue equity IPOs in the primary market. Thus, this paper would contribute a lot to those who are interested to invest in IPOs of firms. It will also help future researchers to explore different avenues of research on IPO investments in Nepal.

Review of Literature

Numerous studies have been found in corporate finance about the initial public offerings using various methods. Baker and Haslem (1973) contended that dividends, expected returns and the firm's financial stability are critical investment considerations for individual investors. Potter (1971) identified six factors: dividends, rapid growth, and investment for saving purposes, quick profits through trading, professional investment management and long-term growth that affect individual investors' attitudes towards their IPO investment decisions. Baker et al. (1977) found that there is a positive association between risk and expected rate of return; and the risk-capital appreciation, while the risk and dividend relationship appears negative in initial issues of stocks. Cohn et al. (1975) provided tentative evidence that risk aversion decreases as the investor's wealth increases, while Riley and Chow (1992) showed that risk aversion decreases not only as wealth increases, but also as age, income and education increase. Pokharel (2018) found that the most important factors of investment in company shares is market value of stocks while the book value is the least. Similarly, majority of the investors consider capital gain as the main reason for investment in IPOs followed by dividend purpose.

Verma (2008) documented that mutual funds were popular amongst professionals, students and the self-employed while the graduates and above in qualification preferred to invest in equity shares as well as mutual funds. Sireesha and Laxmi (2015) found that gender, age and friends are mostly influencing the investment decisions of the investors since they are conservative in nature and show less concern for money multiplication and liquidity. Patel and Modi (2017) found that investment decisions are majorly influenced by risk, return, market trends, and past performance. Further, male and female are significantly different in risk taking ability. Nagy and Obenberger (1994) reported that wealth-maximization criteria were found significant among investors while the effect of recommendations of individual stock brokers, family members and co-workers were identified as insignificant.

Studies showed that the firm size is the main determinant of the IPO returns. They explained that since larger firms are perceived as more stable that tends to reduce the amount of risk investors are exposed to (Afza et al. 2013; and Li, Fowler & Naughton, 2008). This phenomenon is in accordance with winner's curse hypothesis, which associates lower underpricing with lower exposed risk. Studies by Clark (2002), Gidici and Roosenboom (2006), and Islam et al. (2010) used company's age prior to the IPOs and found its positive impact on IPO returns. It implies that longer the age of the company prior to its IPO, investors perceive the company with an established and proven track record entity while younger firms have higher risk. In Nepalese context, the relationship between age of the firm and IPO return seems not to be statistically significant (Subedi, 2012).

Ibbotson, Sindelar and Ritter (1988), and Islam et al. (2010) reported that there is a negative relation between initial return and issue size of IPOs. Subscription rates measures the number of times an IPO has been over or undersubscribed. Studies found that higher the subscription rate, better the IPO return that investors' perceived (Omran, 2005; Marisetty & Subrahmanyam,

2008; and Pradhan & Shrestha, 2016). This indicates that subscription rates are one of the important variables that have impact on return of IPOs. Aussenegg (2006) and Dahal (2007) found that there is a positive relationship between market return and IPO return implying that higher the market return higher will be the IPO returns in the primary market.

The above discussion reveals that there are numerous studies concerning IPO return and risk as well as factors influencing associated with it where there is some inconsistencies in findings. Thus, this study has been undertaken to explore some issues for discussion in regard to IPO investment from the viewpoints of general investors especially in Pokhara.

Data and Methodology

The data used in this study has been completely quantitative in nature. It has used mainly primary data to achieve the desired study objectives. A well-structured set of questionnaire has been employed to obtain the response of investors. The questionnaire includes two major parts – respondents profile and basic questions on initial public offerings. The later part of the questionnaire consists of responses based on dichotomous questions and ranking scale items. The population of the study was all the IPO investors who actively participated in the primary market in Pokhara City. Altogether 155 sets of questionnaire have been distributed to those who actively involved in the IPO market using judgmental sampling but only 109 usable responses (i.e. response rate = 70.32 percent) were collected for the study. Table 1 shows the respondents' demographic and professional profile.

Table 1: Profile of respondents/investors

Investors' Character	Number	Percentage
Gender		
Male	75	68.8
Female	34	31.2
Academic Status		
School education	14	12.8
University education	95	87.2
Occupation		
Teaching	69	63.3
Non-teaching	40	36.7

Source: Questionnaire survey 2019

Descriptive research design has been employed in the study focusing to describe research issues thoroughly related to IPO. Since Pokhara City is one of the major cities of Nepal with high density of population, where a large scale share market activities have been undertaken and hence the researcher has selected the city as a prominent city for the study.

The data have been analyzed in different ways. Frequency distribution table of respondents/investors' profile has been used to arrive at simple description of characters of investors. Analysis of data has been carried based on the different categories of personal characteristics of investors with the aim of identifying and analyzing the differences in views on the basis of gender, academic status, and occupation. Under this, percentage, cross-tabulation has been used to record the number of responses under each category of personal characteristics. Similarly, chi-square statistics has been employed to test the association between attributes of personal characteristics with respect to the responses on return, and risk. Similarly, for ranking scale type of data, overall mean rank and standard deviation has been used to identify the most and least preferred factors influencing IPO return and risk and evaluating the opinion on firms' motive in IPO as perceived by the general investors.

This study has some limitations. The study analyzes the general investors' perspective on IPO investments in Pokhara City only. Views of non-investors have been entirely ignored in the study. Sample size is also small. Primary data has only been used in the study. Therefore, the reliability of the findings depends upon the accuracy of the information provided by the respondents/investors.

Results and Discussion

Investment is regarded as the sacrifice of certain present value for the uncertain future reward. IPO investors, thus, require to consider various indicators before investing. The present study found that most of the investors consider projected return (37.6 percent) followed by company image (32.1 percent), management team (22.9 percent) and rest considers the projected risk before investing in IPOs. This implies that risk associated with IPO investment is weakly evaluated by the investors in Nepal.

A great majority of the investors (64.2 percent) would like to hold IPO shares for longer periods i.e. more than one year. A very few investors buy and hold their IPOs for up to the time of trading starts in the secondary market. It implies that Nepali IPO investors are still unaware about the capital gain from IPO investments at the time of trading starts because of underpricing. Subedi (2012) and Gurung (2019) reported that there is a 503.40 percent and 276.87 percent underpricing respectively of IPOs in Nepal. Higher underpricing of IPOs is the opportunity for capital gain among the general investors whereas it is the wealth loss to the existing shareholders.

Table 2: Opinion on IPO investment preference

Sector	Ranking of preference (1=Most preferred; 4 least preferred)				Weighted Mean	Std. Deviation	Overall Rank
	1	2	3	4			
Banks and finance	55.0%	35.8%	7.3%	1.8%	1.56	0.71	I
Insurance	13.8%	38.5%	47.7%	0.0%	2.34	0.71	III
Hydropower	29.4%	24.8%	34.9%	11.0%	2.28	1.01	II
Others	2.8%	0.9%	9.2%	87.2%	3.81	0.58	IV
Total	100%	100%	100%	100%			

Source: Questionnaire survey 2019

Table 2 showed that 'banks and finance' appears the most preferred sector for IPO investors. Similarly 'hydropower' sector is ranked number two as another important area of IPO investment. The weighted mean ranking statistic shows that 'insurance' is also important sector for investment in IPOs in Nepal. 'Others' sector that includes hotels, trading, manufacturing and processing; is found to be least preferred sector for investors in Nepal.

Table 3: IPO return in primary market

Return from IPO investment is higher than the secondary trading of stocks.								
Variable	Attribute	Yes	No	No Idea	Total	χ^2	df	p-value
Gender	Male	53	12	10	75	10.541	2	0.005
		70.7%	16.0%	13.3%	100.0%			
	Female	13	10	11	34			
		38.2%	29.4%	32.4%	100.0%			
Academic status	School education	8	3	3	14	0.082	2	0.960
		57.1%	21.4%	21.4%	100.0%			
	College education	58	19	18	95			
		61.1%	20.0%	18.9%	100.0%			
Occupation	Teaching	40	14	15	69	0.805	2	0.669
		58.0%	20.3%	21.7%	100.0%			
	Non-teaching	26	8	6	40			
		65.0%	20.0%	15.0%	100.0%			

Source: Questionnaire survey 2019

Table 3 shows the chi-square test of independence to determine whether there is an association of respondents' demographic characters with IPO return from the primary market. A significant association was found ($X^2(2) = 10.541$, $p = 0.005$) between male and female investors that return from IPO investment in the primary market is higher than the secondary trading of stocks. Contingency table shows that male investors assumed to have higher level of return from investment in IPO while the female investors seems indifferent on the same. However, there is an insignificant association between investors of school and college level education on return from IPO investments in the primary market which contradicts with the findings of Verma (2008). Similarly, there is no significant association between teaching and non-teaching IPO investors on return from IPO stocks. Thus, only the investors of male and female attributes have different opinion on return from IPO investment in primary market.

Table 4: IPO risk in primary market

		Investment in equity IPO is risky than the secondary trading of stocks.						
Variable	Attribute	Yes	No	No Idea	Total	χ^2	df	p-value
Gender	Male	58	10	7	75	8.34	2	0.015
		77.3%	13.3%	9.3%	100.0%			
	Female	18	6	10	34			
		52.9%	17.6%	29.4%	100.0%			
Qualification	School education	8	2	4	14	2.1	2	0.350
		57.1%	14.3%	28.6%	100.0%			
	College education	68	14	13	95			
		71.6%	14.7%	13.7%	100.0%			
Occupation	Teaching	47	11	11	69	0.289	2	0.866
		68.1%	15.9%	15.9%	100.0%			
	Non-teaching	29	5	6	40			
		72.5%	12.5%	15.0%	100.0%			

Source: Questionnaire survey 2019

Table 4 reveals a chi-square test of independence is significant that male and female investors' investment in IPOs is risky than that of secondary trading of stocks which is consistent with the finding of Patel and Modi (2017). Contingency table of gender implies that male investors assumed to have high level of risk from investment in IPOs than that of female investors. The second part reveals an insignificant association between investors of school education and college level education on risks from investment in IPOs. Similarly, there is also an insignificant association between investors of teaching and non-teaching sector on risks from share investment in IPOs of primary market. These facts imply that investors of both school

and college level education attainment as well as teaching and non-teaching career have indifference in risk concerns of IPO investments.

Table 5: Opinion on influencing factors in IPO return and risk

Factors influencing IPO return/risk	Ranking of importance (1=Most important; 6=Least important)						Weighted Mean	Std. Deviation	Overall Rank
	1	2	3	4	5	6			
Firm Size	22.9%	13.8%	27.5%	16.5%	9.2%	10.1%	3.06	1.59	II
Age of the firm	4.6%	22.0%	16.5%	25.7%	20.2%	11.0%	3.68	1.42	IV
Issue size of IPO	11.9%	11.9%	15.6%	16.5%	20.2%	23.9%	3.93	1.70	V
Public subscription rate	4.6%	9.2%	18.3%	14.7%	22.9%	30.3%	4.33	1.52	VI
NEPSE return	14.7%	28.4%	17.4%	19.3%	14.7%	5.5%	3.07	1.47	III
Government policy	41.3%	14.7%	5.5%	7.3%	12.8%	18.3%	2.91	2.02	I
Total	100%	100%	100%	100%	100%	100%			

Source: Questionnaire survey 2019

Table 5 displays the results of survey which indicates that the 'government's policy announcements especially monetary and fiscal, appears the most important factor influencing IPO return and risk. This reason accounts for 41.3 percent of the responses ranked number one. Of the responses ranked number two in importance is 'size of the firm' indicating larger the firm size higher will be the return from IPO investment which is consistent with the findings of Clark (2002), Gidici and Roosenboom (2006), and Islam et al. (2010) but contradicts with Subedi (2012). Similarly, market returns of NEPSE stocks ranked number three implying higher the market return higher will be the IPO return and is similar to the study findings of Aussenegg (2006) and Dahal (2007). Inspection of the weighted mean ranking, 'public subscription rate' of IPOs is found to be the least important factors influencing IPO return and risk among investors in the primary market which contradicts the findings of Omran (2005), Marisetty and Subrahmanyam (2008), Subedi (2012) and Pradhan and Shrestha (2016). They found that the public subscription rate of IPOs is the major variable that significantly influence the IPO return and risk.

Table 6: Opinion on firms' motive in IPO

Motivating factors	Ranking of importance (1=Most important; 6=Least important)						Weighted Mean	Std. Dev.	Overall Rank
	1	2	3	4	5	6			
To increase paid up capital	57.8%	26.6%	6.4%	3.7%	2.8%	2.8%	1.75	1.20	I
Need for business expansion	23.9%	49.5%	14.7%	2.8%	5.5%	3.7%	2.28	1.23	II
Desire to enhance company image	7.3%	10.1%	26.6%	24.8%	13.8%	17.4%	3.80	1.46	III
For increment of share price	3.7%	8.3%	20.2%	18.3%	25.7%	23.9%	4.26	1.42	V
To boost management and employee motivation	3.7%	4.6%	25.7%	23.9%	27.5%	14.7%	4.11	1.28	IV
To create exit route of existing shareholders	2.8%	1.8%	7.3%	26.6%	24.8%	36.7%	4.79	1.23	VI
Total	100%	100%	100%	100%	100%	100%			

Source: Questionnaire survey 2019

Table 6 presents the perception of investors about the firms' motive for going public. The results revealed that the main motive for issuing IPOs is 'to increase paid up capital' of the firms. It accounts for 57.8 percent of the responses ranked number one. Similarly, the overall rank of 'need for business expansion' (Gitman & Joehnk, 2012) is second. The investors viewed that in order to increase and boost management and employee morale, firms should go for public allowing them for subscription. However, creating exit route for existing shareholders through IPO is the least preferred reason which contradicts with the views of Zingales (1995). Similarly, share price appreciation is less preferred reason for going public which also contradicts with the findings of Nagy and Obenberger (1994) in which they reported that wealth-maximization criteria were found significant among firms issuing IPOs in the primary market. These results imply that firms go public not for increasing shareholders wealth and creating exit route to the existing shareholders, which in essence, contradicts the theories of finance, rather it seems to increase paid up capital for the expansion of business activities with profit motive.

Conclusion

The study has been conducted to analyze the general investors opinion about IPO investments especially in Pokhara City. The study concludes that general investors mostly preferred to buy shares of banking and finance followed by hydropower sectors in the primary market with

the expectation of long term returns. Among general investors, male and female investors have significantly different opinion about the risk and return from IPO investment. The study also concludes that government's policy announcements as well as the size of the firm issuing IPOs are the major determinants of IPO return and risk while the public subscription rate is the least. Investors perceived that increasing paid up capital for business expansion in order to make profit is the important reason for issuing IPOs by the companies. Shareholders wealth maximization and creating exit route for initial owners' of the firm are less concerned.

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