

Retail Investor Decision Making in SME IPOs in Indian Capital Market: A Qualitative Analysis

Sachin Prakash Srivastava

Junior Research Fellow
Department of Management
Dayalbagh Educational Institute
Agra, Uttar Pradesh, India

Prof. Sunita Kumari Malhotra

Professor
Department of Management
Dayalbagh Educational Institute
Agra, Uttar Pradesh, India

Prof. K. Santi. Swarup

Professor
Department of Management
Dayalbagh Educational Institute
Agra, Uttar Pradesh, India

Abstract

With the emerging recognition that SME IPOs is utmost requirement for adequate capital mobilization for emerging start-ups that meets the criteria of listing in capital market. BSE and NSE has created separate platform for smooth listing of emerging companies. Past literature has provided ample evidence for main board IPOs subscription and investors decision making elements but it does not apply in SME IPOs as far as fundamental differences in IPO issues is concerned. Paper has investigated perception of sample concerned to SME IPOs and analysed with the help of qualitative analysis using NVivo (QSR) 12 software. A series of questions has been asked from respondent with the help of questionnaire and Tele-interviews and analysis revealed that apart from risk and return criteria, investors and issue-based characteristics affect the subscription decision of investors in SME IPOs. Due to software limitation, sentiment analysis has not been done and it paves the way for future research work along with responses from social networking sites.

Keywords: SME IPOs, Retail Investors, Initial Public Offering, Qualitative Analysis.

JEL Classification: G02, G11

Introduction

With the emerging recognition that SME IPOs is utmost requirement for adequate capital mobilization for emerging start-ups that meets the criteria of listing in capital market. BSE and NSE has created separate platform for smooth listing of emerging companies. Securities exchange board of India (SEBI) had first proposed a framework for SME listing in 2008 and framework was based on the recommendation of Prime Minister task force, 2010. Later, BSE created BSE SME platform and NSE has created NSE EMERGE. Public listing not only provides wide finance access but also stringent corporate governance and exit option for existing investors. Due to the advent of high technological development pace, digitalization and conducive environment for start-ups, there was an urgent need to relax the criteria of listing in Indian scenario as new start-ups are related to internet based technology, e-

commerce and banking and financial services which is based on asset light business model (ALM) where start-ups carries fast rate of growth that eventually shorten the financing time of private equities and angel investors and requires democratic widely held shareholding from public listing.

Differences due to fundamental characteristics between main board IPOs and SME IPOs asserted that factors which influence main board IPOs may not comply with SME

IPOs. Issue size, gross proceed, use of funds, firm size, Age of firm and capital structure parameters affect the IPO performance in short run as well as long run (Durkan Banu, 2002). In SME IPOs, almost all exchanges of the world have relaxed the criteria norm for SME listing that leads to less robust parameters of IPO issue and it may not be the robust parameter to judge SME IPOs as growth prospect needs to be analysed before investing in SME IPOs. SEBI has proposed the criteria difference between main board IPOs and SME IPOs on the basis of issue characteristics.

Table 1: Difference between Main board and SME criteria

(Sangeeta Lakhi and Sulakshna Sinha, 2019, ET Times)

Parameters	Main board IPOs	SME Platform
Post Issue Paid Up Capital	Not less than Rs. 100,000,000	Less than Rs. 2,500,000
Underwriting	Compulsory, except where 75% is allotted to QIBs	100% underwritten
Minimum Application Value	Rs. 100,000	Between Rs. 10,000 to Rs.14000.
Minimum Allotees	1000	50
Market Making	NA	Compulsory for 3 Years
Offer Document	SEBI	Stock Exchanges

Paper has investigated cognitive decision-making framework of respondent with respect to risk and return criteria of IPO issue and sought the reasons behind riskiness and probability of fetching stag profit in IPOs. Composition of paper as follows; introduction followed by literature review and theoretical framework, it followed by data collection and data analysis and eventually findings and conclusion and limitations which pave the way for future work of research.

Literature Review

Gumanti and Lestari (2017) examined the effect of risk factors, use of proceeds for investment, size of issue and ownership level on performance of IPOs on the basis of initial returns and found that these factors are positively correlated to positive initial return of Indonesian IPOs except level of ownership retention level. Another finding revealed that those firms which has the motive of expansion and innovation was less underpriced as compared to those

firm which has operative motives. Findings indicated that investors preferring growth prospect rather than settlement of dues to stabilise the firm. According to the guidelines of Securities exchange board of India, every issuer needs to disclose certain risk factors in red herring prospectus. With the help of these mentioned factors, investors can evaluate valuation of IPOs, various studies Clarkson and Merkely (1994), Henseler (1997), Niagara (2006) and Yatim (2011) advocated that these factors have significant relationship with initial returns of IPOs. Risk is one aspect which investor strives to decode to get exact valuation of IPOs. It would be of higher importance in SME IPOs as it has less robust fundamentals as compared to main board IPOs.

Brau and Carpenter (2013) highlighted the difference between main board IPOs and SB IPOs (western nomenclature, SME in India) and tested the three anomalies to see if small firms differ from main board firms along these dimensions. Findings revealed that they differ along

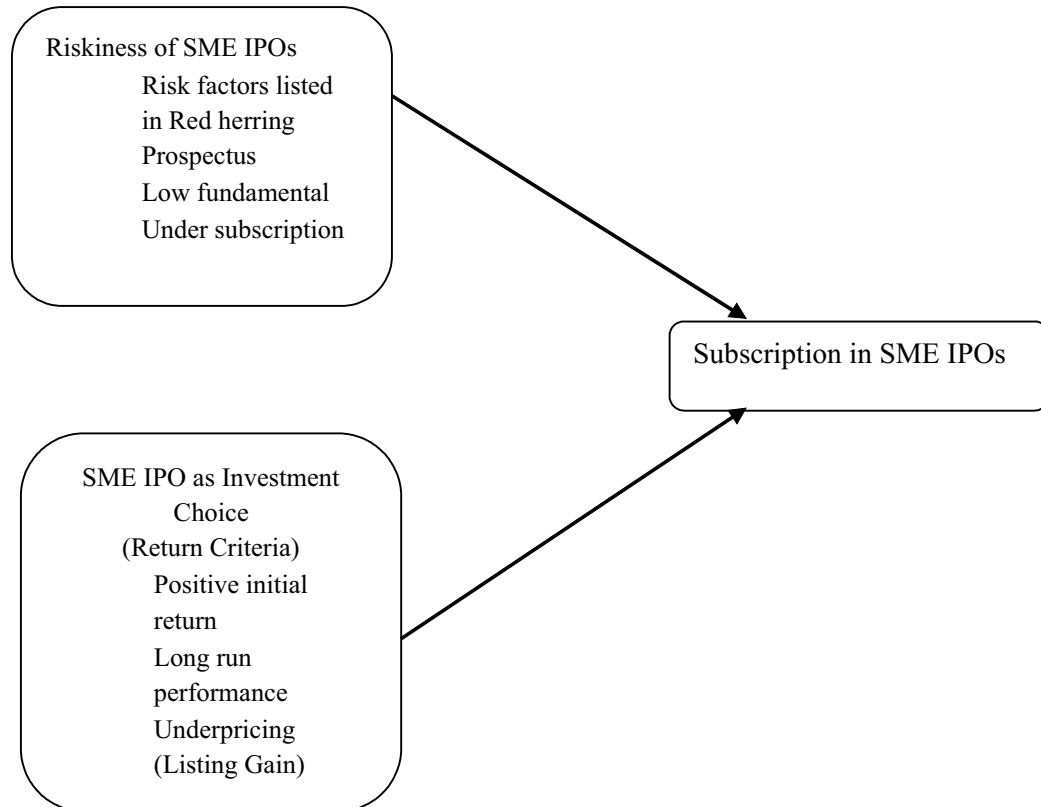
with these dimensions but in desperate ways than mainline IPOs do and it supported small firm uniqueness hypothesis but SB-2 firms have less underpricing than S-1 firms and SB-2 firms outperformed the S-1 firms' performance. It again indicated that investors emphasized on growth aspect in spite of knowing that small firms have high risk factors and uncertainty in returns and it is supporting the argument that higher risk fetch higher gain. Brau and Osteryoung (2001), Brau and Gee (2010) both studies micro IPOs whereas Cooney, Jordan and Dolvin (2006) studies penny stock IPOs. Brau (2001) also emphasized that exchange has made the system less stringent for smooth listing of small firms and it is evident throughout the world that exchanges trying very hard to develop their market by listing more firms and previous studies as carpenter (2013) revealed that small firms has less volatility and potential to provide equal returns as compared to S-1 firms.

Brav, Michaely, Roberts, Zarutskie (2009) revealed that institutional lender perceive equity issuer as risky as similar non issuer firms. Ajay Pandey (2004) also highlighted the fact that small firms generally rely more on retail investors as institutional investor does not subscribe these issues due to high risk factors. Literature clearly indicated that SME IPOs are considered as risky option as compared to main board IPOs.

Conceptual Framework

Based on literature review, two crucial criteria i.e. Riskiness of SME IPOs and SME IPO as investment choice (Return Criteria) is selected which would be analysed with the help of respondent response to find their magnitude of importance in investor's decision making in SME IPOs subscription.

Figure 1: Conceptual Framework of subscription in SME IPOs based on Risk and Return Criteria



Objectives of the Study

1. To determine the most frequent words in investor's response using word frequency and word cloud.
2. To compare the investor's view based on risk and return nodes.
3. To identify a generalisable theme of investment decision making of investors in SME IPOs using Text Analysis.

Nature of the Study

The present study is descriptive and qualitative in nature. The research is descriptive because it explores the various dimensions of SME IPOs investment. The study is qualitative because it developed a pattern-based theme of respondent cognitive process of decision making in SME IPOs. The proposed research benefits the researchers to understand the cognitive framework of investor's thinking which eventually revealed hidden aspect of decision making.

Data Collection and Data Entry

For the present study, survey had been conducted and it is based on nominal group technique where five experts of different capacities in finance domain are selected based on their expertise and classified based on gender and profession. Questionnaire had been circulated amongst the members.

Table 2: Demographic of Respondents

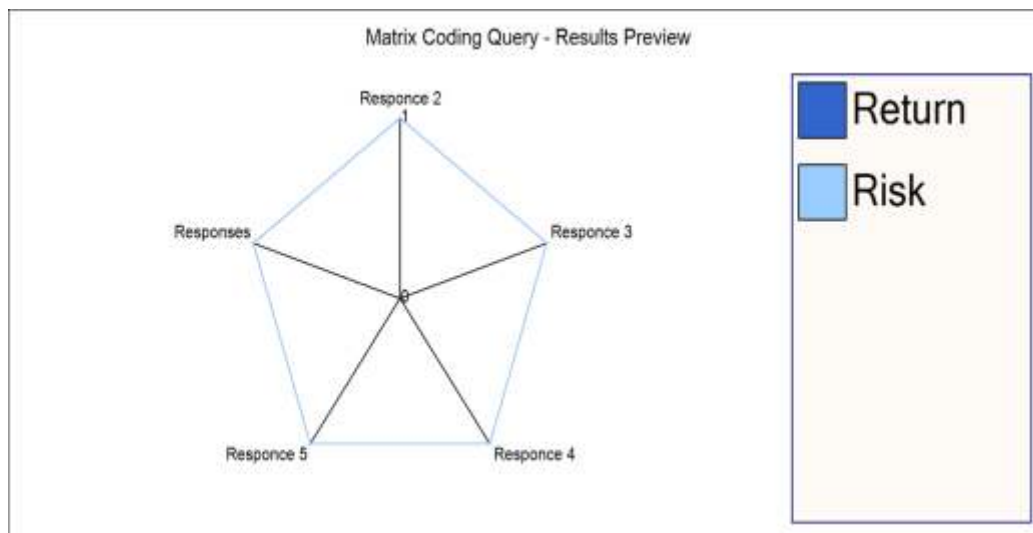
Case/Responses	Gender	Profession
Cases\\Response 2	Male	Analyst
Cases\\Response 3	Female	Journalist
Cases\\Response 4	Male	Investor
Cases\\Response 5	Male	Broker
Cases\\Response 1	Female	Professor

After collection of respondent responses, their responses has been checked whether they have successfully respond to all the necessary items based on risk and return node for further analysis. Cross tabulation and matrix coding were performed to validate the response.

Table 3: Cross tabulation table for respondents

Node	A : Response 2	B : Response 3	C : Response 4	D : Response 5	E : Response 1
1 : Return	1	1	1	1	1
2 : Risk	1	1	1	1	1

Figure 2: Matrix Coding of Response



Cross tabulation table and Matrix coding of response shows those experts has expressed their views on all items of risk and return nodes. Validation is necessary to develop word cloud, comparison diagram and text search query.

Data Analysis

To analyse the cognitive framework of investment decision making in SME IPOs, Word frequency chart and word cloud had been developed. Instruction based on twenty-five maximum words with at least five letters had been setup to run the query.

Table 4: Word Frequency Table based on Responses

Word	Length	Count	Weighted Percentage (%)
investors	9	22	1.48
companies	9	14	0.94
listing	7	14	0.94
investment	10	13	0.88
market	6	13	0.88
crore	5	12	0.81
risky	5	12	0.81
price	5	11	0.74
shares	6	11	0.74
company	7	10	0.67
issue	5	10	0.67
invest	6	9	0.61
years	5	9	0.61
gains	5	7	0.47
getting	7	7	0.47
least	5	7	0.47
mainboard	9	7	0.47
retail	6	7	0.47
stock	5	7	0.47
every	5	6	0.40
india	5	6	0.40
investing	9	6	0.40
often	5	6	0.40
platform	8	6	0.40
returns	7	6	0.40

Word frequency table indicated that experts had more emphasized on few words, Investors (1.48%), companies (0.94%), Listing (0.94%) and Investment (0.88%) followed by market (0.88%). Table also revealed that Risk and returns are relatively lower criteria which are 0.81% and 0.40% respectively. Lower rating of risk and return indicated that either they are universal in nature or risk and return are not as important as literature shown. It would be answered in nodes analysis of comparison diagram*. Investors (1.48%) indicated that they more emphasized on subscription trend during listing period of particular IPOs, in other words, investors response. It revealed the behavioural bias “Herding” in investor's decision-making process. Second most priority given to companies means issuer-based characteristics i.e. issue size, use of proceeds, capital structure parameters and age of the firm and findings are consistent with Gumanti and Lestari (2017). Listing scenario had been placed 3rd in table. Here, experts

emphasized on stag profit which comes out as listing gain after selling IPO share on first closing price. It also indicated that all experts agreed on the fact that IPOs are underpriced and provide positive initial return and underperform in long run. It is also validated from the lower rating of years (0.61%) that experts have not emphasized on holding of IPO share. This finding is consistent with Ritter (2004), Aggarwal (2002). Market has been placed on 5th position, experts had asserted that IPOs never come in bearish scenario and issuer always maximise the IPO listing by issuing in bull scenario (Rajan, Raghuram,2003), Although, healthy secondary market is necessary to provide liquidity during listing. Platform (0.40%) received lower rating and it indicated that there is no significant difference in exchanges as far as IPOs listing is concerned. Main board (0.47%) revealed that experts had not assumed that fundamentals of SME IPOs is as similar as main board IPOs. It indicated that investment decision making in SME IPOs is different than main board IPOs.

Figure 3: Word Cloud of most frequent words in responses



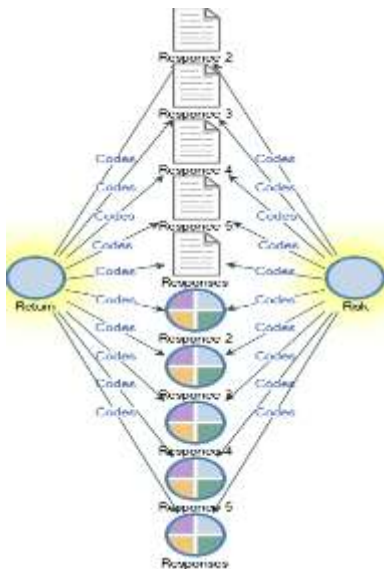
Comparisons of Risk and Return Nodes based on Responses

In word frequency table, risk and return criteria has not been validated due to lower rating in table. Due to lower rating, there were two possibilities emerged, which are as follows:

- A. They are universal in nature
- B. Risk and return are not as important as literature shown

Comparison of respondent responses are required to know the criteria of risk and return whether all expert agreed on the fact that investors should assess the inherent risk and return of any SME IPOs.

Figure 4: Comparison diagram of Respondent Responses

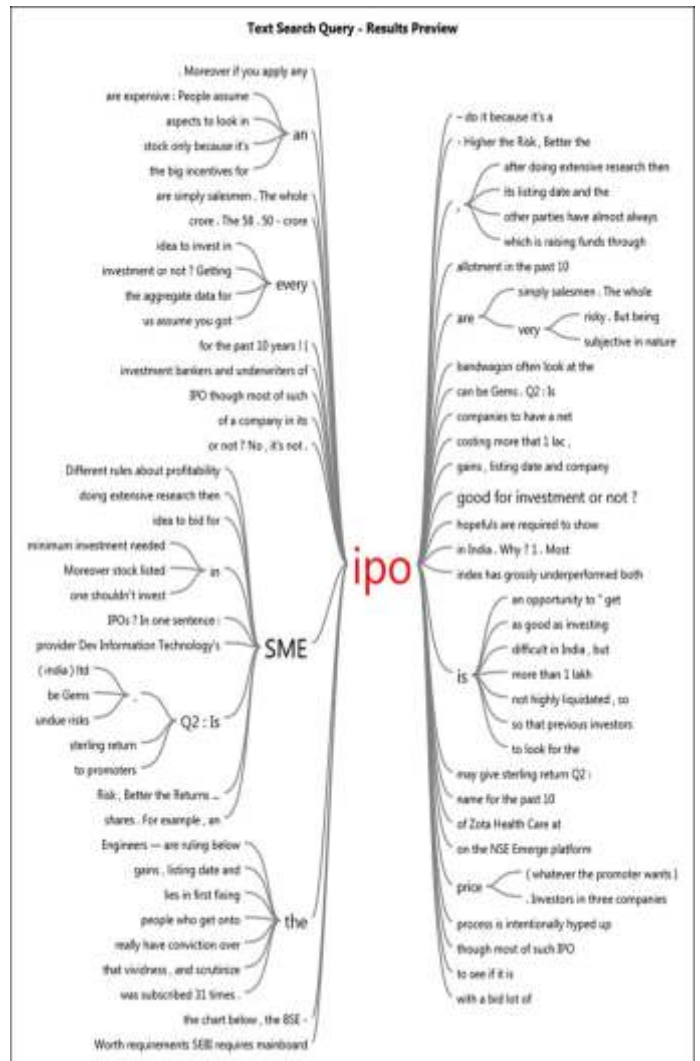


Comparison shows that the entire respondent had emphasized on risk and return criteria as here, all the arrows comes out from risk and return nodes positioned to the entire respondent individually. Comparisons of respondents were not possible as we cannot compare more than two respondents at same time.

Text Search Query for Theme Generation

Generation of investment decision making theme in SME IPOs creates a cognitive framework for better understanding of decision making.

Figure 5: Text Search Query Results (Text search query reading starts from left to right)



Conclusion

With the emerging recognition that SME IPOs is utmost requirement for adequate capital mobilization for emerging start-ups that meets the criteria of listing in capital market. SME IPO platform would not develop without continuous participation of all class of investors. Soit was prudent to research on hidden insights of investment decision making in SME IPOs. Investment decision making process is termed as cognitive process and qualitative analysis has better reach than quantitative analysis for the study of any cognitive phenomena. Word frequency chart had provided the top most contributors and investors had 1.48% contribution which highlighted the Herding behaviour of investor. Listing scenario had been placed 3rd in table. Here, experts emphasized on stag profit which comes out as listing gain after selling IPO share on first closing price. It also indicated that all experts agreed on the fact that IPOs are underpriced and provide positive initial return and underperform in long run. Comparison of nodes indicated that entire set of respondents had emphasized on both risk and return criteria.

Limitations of the Study

Advance thematic analysis requires advance version of NVivo software. In our version of NVivo, auto coding was not possible which is why we had not performed sentiment analysis. Because of the chosen research approach, the research results may lack generalisability. Therefore, researchers are encouraged to test the proposed propositions further.

Implication of the Research

Generally, retail investors not considered as smart investors, they find difficulties in quantitative analysis of any investment; it is also the case for researcher as well who wants to do research in investment decision making domain. Qualitative analysis backed paper can provide cognitive mapping of any investor and can present the entire findings in simplified manner which can be understand easily.

Scope for further Research

Future research can further extend the concept of proposed thematic analysis in context of sentiment analysis where we

would identify themes and whole sentiment of data set. Future research can be the thematic analysis of social networking sites i.e. twitters to predict the investment outcome. In future, Researcher can employ more than one technique for prediction like machine learning, customized algorithms. Then researcher can compare the prediction of future stock value emerged out from all these employed techniques.

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