UNLOCKING IPO AWARENESS: RISKS, REGULATIONS, AND INVESTOR PERCEPTIONS IN THE INDIAN SECURITIES MARKET

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Abstract

The issuance of an Initial Public Offering (IPO) is a crucial step for companies in India to access capital markets and drive growth. However, the increasing incidence of IPO fraud poses significant risks to investors, potentially deterring participation. Despite the importance of understanding these risks, there is limited research on the awareness and perceptions of retail investors in India regarding IPO investments. This study aims to fill this gap by exploring three key objectives: assessing investor awareness of IPOs, understanding the regulations mandated by the Securities and Exchange Board of India (SEBI), and analyzing investor perceptions of risk associated with IPO investments. Primary data was collected from 100 individual investors through a structured questionnaire, with the results analyzed using a one-sample t-test. The findings indicate that investors are generally aware of IPOs and the risks involved. However, there is a pressing need for stricter regulations and more robust legal frameworks to increase transparency and protect investors from fraud. This study highlights the critical role of regulatory oversight in ensuring a secure environment for IPO investments, thereby enhancing investor confidence and participation in the Indian securities market.

Keywords:- IPOs, Financial frauds, Securities market, Risk, Capitalisation.

An IPO enables a company's listing on the securities market, offering a pathway to raise capital but also presenting inherent risks, similar to other market instruments, due to the volatility of market conditions (Partners, 2013). The history of IPOs in India can be traced back to the British period in the 16th century, and with the advent of globalization, the Indian market experienced a significant increase in IPO issuances (Sarin & Sidana, 2018; Filipovic, 2018).

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IPOs are recognized as an effective means for companies to enhance their capitalization, and many Indian companies have successfully leveraged this opportunity (Agus &Zaenal, 2018). However, the market has also seen a number of IPO fraud cases, resulting in substantial financial losses for investors. These incidents highlight the risks associated with IPO investments, which can deter investors, particularly when new and upcoming companies view IPOs as a crucial mode of gaining capital (Das et al., 2013). Various factors include past frauds and market dynamics, influence investor behavior and attitudes toward IPO investments. (Cacheche et al., 2015).

Review of Literature

T. Das, S. Das, and Dr. R. Upadhyaya (2013) argued that many IPO frauds in India are due to the failure of regulatory authorities to enforce laws effectively. They cited high-profile cases such as Ramalinga Raju, Harshad Mehta, Ketan Parekh, and others, emphasizing the need for stricter enforcement of capital market regulations to prevent such frauds. A. Nagtilak and N. Kulkarni (2015) discussed the complexities of the IPO process, which involves a detailed analysis of a company's financial health, its public reputation, and the legal framework governing public offerings. This complexity underscores the challenges companies face when going public. S. Sahoo (2017) examined the role of anchor investors, a concept introduced by SEBI to improve transparency in the IPO book-building process. By analyzing data from the NSE between 2009 and 2014, Sahoo found that the presence of anchor investors can help reduce the mispricing of securities, whether through underpricing or overpricing.

Selvam (2021) highlighted the primary market's role in facilitating the transfer of financial resources from investors to companies, arguing that an increase in financial market investments can lead to more efficient use of productive resources, ultimately boosting the country's economic growth. Finally, V. Vasa and S. Bhayani (2021) conducted a study on investor awareness and confidence regarding IPOs. They found that while many investors recognize the potential returns from IPO investments, they also view these investments as particularly risky, owing to the complexities involved in the IPO issuance process.

Statement of the Problem

As being a mode of entering into the securities market or as a prominent security market instrument, the variabilities and factors of risk that exist in the securities market are squarely applicable to IPOs. The number and volume of IPO issues are increasing in the market. The reliability and profitability of such shares cannot be predicted. The risks and threats behind such investments may put off investors from putting their money into them. There may be several factors which influence the investor's behaviour and perspective towards investments in IPOs. The study aimed to understand the Indian IPO market and the scams involved in IPOs. Furthermore, it aimed to understand the common investors' perspective towards the elements of risk in IPO investment and to know the existing regulation regarding IPO issues mandated by the Securities Exchange Board of India (SEBI).

Research Objectives

- To check whether the investors are aware or not the IPOs.
- To understand the regulations regarding IPOs mandated by SEBI.
- To understand the investor's perception of risk in IPO investments.

Hypotheses

- H01- There is no significant difference in the awareness of investors about the IPOs.
- H02- There is no significant difference in the opinion of investors is that the IPO investments are risky.

Scope of the Study

This study evaluates the awareness and perceptions of retail investors in India regarding Initial Public Offerings (IPOs). It examines investor knowledge about IPOs, the regulatory framework by the Securities and Exchange Board of India (SEBI), and perceived investment risks. Based on primary data from 100 individual investors, the study provides insights into their understanding and experiences with IPO investments, covering key aspects of investor behavior, regulatory awareness, and risk perception in the Indian securities market.

Significance of the Study

This study explores investor awareness and perception of IPO risks in the Indian financial market, a critical yet under-researched area. With rising IPO-related frauds, understanding investor knowledge and risk perception is crucial for protecting retail investors. The study assesses awareness, identifies knowledge gaps, and provides insights for policymakers, regulators, and financial institutions. Its findings can help develop effective regulatory frameworks and educational initiatives to enhance transparency, reduce fraud, and create a more secure investment environment in India.

Research Methodology

Research Design: The study is descriptive and exploratory in nature.

Sample Size: The sample size is fixed at 100 individual investors. Convenient sampling method is adopted to select the sample.

Source of Data: Both primary data and secondary data were employed here. People who have investments in securities market are taken as the target population to collect the primary data. The primary data for the study have been collected through a structured questionnaire in the form of Google forms. The Secondary data have been collected from various articles and previous and related studies in the field.

Tools used for analysis: The sample size is fixed at 100 so that one sample t-test is undertaken to check the validity of the hypotheses. Normal percentage analysis is also done to distinguish the personal profile of population.

Factors of Risk in IPOs

- *Inconsistent Share Allocation*: Investing in an IPO does not guarantee share allocation. Despite investing with the expectation of high returns, investors may not receive any shares (Falato & Scharfstein, 2016).

- *Price Disparity*: The offering price, set by the issuer, may differ from the initial trading price in the secondary market due to fluctuating market conditions, potentially leading to investor losses (Gambhir, 2010; Liu & Fan, 2022).
- *External Influences*: Social, legal, economic, and political factors can significantly impact the market, potentially decreasing the value of an IPO (Liu & Fan, 2022).
- *IPO Underperformance*: High liquidity and rising market indices can lead to overvalued IPOs, which may underperform once listed, discouraging ordinary investors (Paramati& Gupta, 2011).
- *Information Asymmetry*: Predicting a company's future performance or share behavior post-IPO is challenging, leading to potential investment risks (Jianu & Jianu, 2021).
- *Cornering*: Market participants may manipulate the IPO price by acquiring a large portion of the shares, reducing availability for other investors and distorting the share price at listing (Byrd, 1979).

The legal framework for IPOs

The Securities and Exchange Board of India (SEBI) oversees and regulates IPO processes in accordance with legal provisions (Bose, 2005). In response to the IPO surge of 2021, SEBI introduced several regulations to protect retail and non-institutional investors (Personal & Archive, 2007).

1. *Inorganic Growth Funding*: Companies must clearly specify acquisition or investment targets. If not, funds allocated for these purposes cannot exceed 25 per cent of the total amount raised.
2. *Enhanced Scrutiny*: SEBI established a forensic accounting unit for audit scrutiny, mandated the reporting of merchant bankers' track records, and introduced listing-day circuit filters to control price volatility.
3. *Anchor Investor Lock-In*: After the initial 30-day lock-in, only 50 per cent of anchor investors' shares can be sold; the rest must be held for 90 days, to reduce sharp post-lock-in price declines.
4. *Shareholder Sale Restrictions*: Pre-IPO shareholders with over 20 per cent holdings cannot sell more than 50 per cent, and those with less than 20 per cent cannot sell more than 10 per cent during the IPO. This addresses concerns that some companies were using IPOs for cashing out rather than raising business funds, often at high valuations (Summary, 2016).
5. *Price Discovery*: SEBI aimed to improve price discovery, as many IPOs were previously allocated at the upper price band, even when listed at a discount (Goyal, 2006).

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6. *Monitoring Agencies*: Only SEBI-registered credit rating agencies, not Scheduled Commercial Banks or Public Financial Institutions, can serve as monitoring agencies. Funds raised for general corporate purposes will be monitored until fully utilized to prevent misuse (Regulation and Supervision of Financial Market Infrastructures Regulated by Reserve Bank of India, n.d.).

Data Analysis and Interpretation

Out of the 100 samples taken, most of the investors are male investors (72 per cent). The majority of them (94 per cent) are between the age group of 20-30, having an educational qualification of post-Graduation (73 per cent). The majority (57 per cent) of the population has an average monthly income of between 10000- 20000. Most of the population (45 per cent) resides in Semi-Urban areas.

Out of the 100 samples taken, majority (85 per cent) of the investors are aware about the Initial Public Offerings in the primary securities market. In which, 65 per cent of them are well aware and a 20 per cent of investors were somewhat aware about it. On the other hand, a 15 per cent of the respondents were not aware about the IPO issues.

Hypothesis- 1

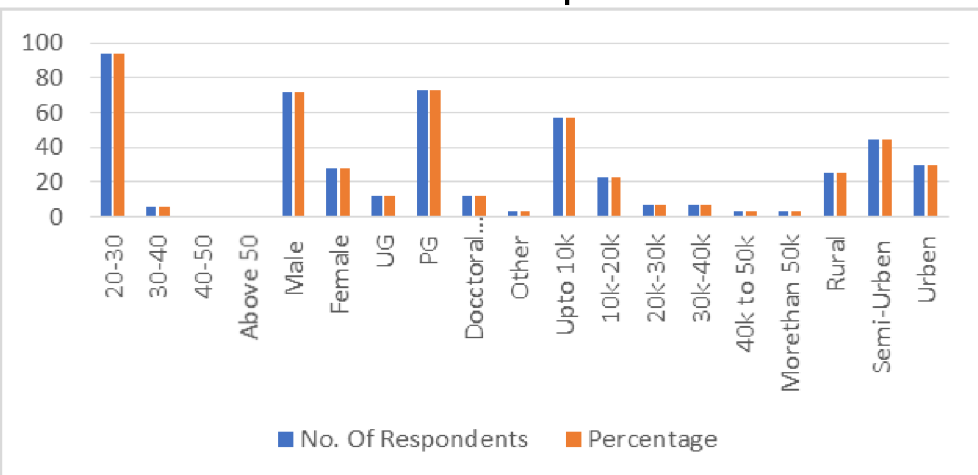
H01- There is no significant difference in the awareness of Investors about the IPOs.

The variable for the test is ***Investor's awareness***.

Based on the statistical analysis, we reject the null hypothesis. Experimentally, with a test value of 2 and a computed significance level below the confidence level of 0.05, the null hypothesis is rejected. This implies that investors are indeed aware of IPOs.

Figure 1

Profile of Sample



Source: Primary data

Hypothesis- 2

H02- There is no significant difference in the opinion of investors is that the IPO investments are risky.

The variables for the test are: ***Risk in reward, Understanding of company's performance, Variability in return, External influences***.

Level of Significance: 0.05, Test value fixed to be –> 3

Based on the statistical analysis, the null hypothesis is rejected. Experimentally, with a test value of 3 and a significance level below 0.05, the null hypothesis is also rejected. This suggests that investors perceive IPO investments as risky.

Findings based on theoretical framework and primary data analysis:

1. *Investor Awareness of IPOs*: The study reveals that investors are generally well-informed about Initial Public Offerings (IPOs). Most respondents demonstrated a sound understanding of what IPOs entail, indicating that retail investors are aware of the basic concepts and processes involved in IPO investments.
2. *Liquidity Benefits*: One of the significant findings is that IPO investments offer investors a higher rate of liquidity. By participating in IPOs, investors can buy shares at the offering price and sell them in the secondary market, often benefiting from substantial liquidity as shares become publicly traded.
3. *Portfolio Diversification*: IPOs provide a valuable opportunity for portfolio diversification. Many investors view IPOs as a strategic way to diversify their investment portfolios, allowing

Table 1

Investor's Awareness on IPO

Investor's Opinion	No. of Respondents	Percentage
Yes, Well Aware	65	65
Somewhat Aware	20	20
No, Not Aware	15	15
Total	**100**	**100**

Source: Primary data

Table 2

One – Sample T test results Hypothesis – 1

Awareness							Test Value=3	
	Mean	SD	t	Df	Sig.(2-tailed)	Mean Difference	95% Confidence Interval	
							Lower	Upper
	2.52	0.731	7.11	99	0	0.52	0.37	0.67

Level of Significance: 0.05 and the Test value fixed to be – 2

Source: Calculated values from primary data using IBM SPSS Statistic 23 software

Table 3

One – Sample T test results Hypothesis - 2

Variables	Mean	SD	t	Df	Sig.(2-tailed)	Mean Difference	Test Value=3	
							95% Confidence Interval	
							Lower	Upper
The IPO investment is a high -risk reward investment	2.66	0.9972	-3.41	99	0.001	-0.34	-0.538	-0.142
A sound understanding of the company's performance is essential before investing in IPO	2.09	1.3787	-6.6	99	0	-0.91	-1.184	-0.636
There is higher probability to getting less than the offered rate	2.67	0.9853	-3.349	99	0.001	-0.33	-0.526	-0.134
The external influences can affect the share price	2.24	1.147	-6.626	99	0	-0.76	-0.988	-0.532

Source: Calculated values from primary data using IBM SPSS Statistic 23 software

them to spread risk across different sectors and companies, which can lead to improved risk-adjusted returns.

4. *Benefits of Equity Shareholders:* Investors in IPOs can enjoy the benefits typically associated with equity shareholders, including voting rights, dividends, and potential capital gains. This aspect makes IPOs attractive for investors looking to participate in the growth potential of emerging companies.

5. *Rising IPO Frauds*: A concerning finding is the increasing incidence of IPO frauds. The study highlights that fraudulent activities related to IPOs are on the rise, posing significant risks to investors. This underscores the need for vigilance and stricter regulatory oversight.

6. *Fictitious Demat Accounts*: The uses of fictitious demat accounts has emerged as a tool for falsifying IPO investments. These accounts are often used to manipulate subscription figures and create a false perception of demand, leading to inflated valuations and potential losses for genuine investors.

7. *Variance in Investment and Returns:* The study found that there is a noticeable variance in the investments and returns from IPOs. While some IPOs yield high returns, others may underperform, reflecting the inherent risks and uncertainties associated with such investments.

8. *External Influences on IPO Values*: The value of IPOs can be significantly affected by external factors such as market conditions, economic indicators, and geopolitical events. These external influences can lead to fluctuations in IPO prices, affecting the overall returns for investors.

9. *Importance of Company Performance:* A key finding is the necessity for investors to have a sound understanding of a company's performance before investing in an IPO. Thorough research and analysis of the company's financial health, growth prospects, and industry position are crucial for making informed investment decisions.
10. *Perception of Risk*: The study indicates that many investors perceive IPO investments as riskier compared to other investment avenues. This perception is influenced by factors such as market volatility, the potential for fraud, and the variability in IPO performance.
11. *Role of SEBI:* SEBI is identified as the apex authority governing the rules and regulations related to IPO issuance. It plays a critical role in ensuring investor protection and maintaining the integrity of the market. Investors rely on SEBI's regulations to safeguard their interests.
12. *Need for Stricter Regulations:* The findings suggest a need for stricter regulations and more effective legal frameworks to enhance transparency in IPO transactions. Strengthening regulatory measures can help mitigate the risks of fraud and build investor confidence in the IPO process.

These findings collectively highlight the complexities and risks associated with IPO investments, also recognizing the potential benefits. The study underscores the importance of robust regulatory oversight and informed decision-making to navigate the IPO landscape effectively.

Suggestions for Improving the Present Status

- ***Enhance Investor Education*:** Conduct regular workshops and webinars to improve investor understanding of IPO risks, benefits, and the importance of due diligence.

  Strengthen SEBI Oversight**:** SEBI should increase scrutiny of IPO applications, conduct thorough background checks, and implement real-time surveillance to detect and prevent fraud.

- ***Address Fictitious Demat Accounts:*** Enforce stricter KYC norms and conduct periodic audits to prevent the manipulation of IPO subscriptions through fake accounts.

- ***Improve Transparency*:** Ensure clearer disclosure of IPO pricing and allocation processes, and require companies to provide detailed, easily understandable information about their financials and risks.

- ***Promote Risk Mitigation*:** Introduce tools like IPO insurance and options to help investors manage potential losses and volatility associated with newly listed stocks.

- ***Encourage Long-Term Investment*:** Educate investors on the benefits of a long-term approach to IPO investments, reducing the focus on short-term gains.

- ***Update Regulations Regularly*:** SEBI should regularly review and update IPO regulations to address

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new market challenges and ensure ongoing investor protection.

- ***Streamline Market Processes***: Reduce the time between IPO subscription and listing to minimize market volatility and external influences.

By implementing these suggestions, the overall transparency, fairness, and security of the IPO process in India can be significantly enhanced, leading to greater investor confidence and a more robust capital market.

Conclusion

IPOs market in India is always on a growing margin. It is a major and reliable source for increasing capitalisation. But at the same time, considering the instabilities and anomalies in the securities market, it can be said that the issuance of IPOs is also prone to market risks and financial fraud. The people who are interested in trade are aware about the IPO investments. In their view point, a sound understanding of the company's performance is essential before investing in IPO. IPO is just an offering, not a guarantee to get a particular share. There is higher chance of variability in return. There are numerous external influences, which can cause the IPO market adversely. In short, the IPO investment is a high - risk reward investment. IPO investments are riskier even though, strict regulations and effective legal frameworks over such transactions can make it more transparent. A sound understanding of the company's performance is essential before investing in IPO.

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