

IPO Puzzle in India: An Integrated View of Firm, Issue, and Ownership Drivers

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ABSTRACT

Initial Public Offerings (IPOs) continue to present a persistent puzzle in capital markets, characterized by significant short-term underpricing and weak long-term performance. While IPOs are undertaken to raise capital, enhance corporate visibility, and support expansion, empirical evidence suggests that listing-day gains often do not translate into sustainable shareholder value. In the Indian context, despite SEBI's regulatory reforms to enhance transparency and reduce information asymmetry, IPO outcomes remain influenced by multiple structural and behavioural factors. This study provides an integrated review of IPO performance in India by synthesizing theoretical and empirical literature across five major dimensions: theoretical foundations, company-specific determinants, issue-specific characteristics, ownership structure, and long-term post-listing performance. The review highlights the role of firm size, age, profitability, industry profile, issue size, price band width, underwriter reputation, promoter shareholding, governance quality, and market timing in shaping IPO outcomes. By consolidating fragmented evidence into a unified framework, this study contributes to a deeper understanding of the "IPO Puzzle" in India. It identifies key areas for future empirical research on sustainable value creation in emerging capital markets.

Keywords: Initial Public Offerings (IPOs), Underpricing, Long-term Performance, Firm-specific Factors, Issue Characteristics, Promoter Shareholding.

Introduction

The phenomenon of Initial Public Offerings (IPOs) has attracted sustained academic attention due to its paradoxical behaviour in capital markets. Despite being strategic financing decisions aimed at growth, expansion, and enhanced market visibility, IPOs frequently exhibit two persistent anomalies: short-term underpricing and long-term underperformance. These patterns have been consistently documented across developed economies such as the United States and Europe, as well as emerging markets including India (Beatty & Ritter, 1986; Loughran & Ritter, 1995; Kooli & Suret, 2004). The coexistence of significant listing-day gains with disappointing post-listing returns forms the core of what is often described as the "IPO Puzzle."

The theoretical foundations explaining IPO performance have evolved around information asymmetry, signalling mechanisms, agency conflicts, behavioural finance, and institutional frameworks. Early studies grounded in information asymmetry theory argue that issuers deliberately underprice IPOs to compensate uninformed investors for valuation uncertainty (Beatty & Ritter, 1986). Subsequently, signalling models suggested that high-quality firms intentionally leave money on the table to differentiate themselves and build reputation in capital markets (Loughran & Ritter, 1995). Behavioural perspectives further enriched this debate by emphasizing investor sentiment, herd behaviour, and market

overreaction, particularly in emerging economies where informational inefficiencies are more pronounced (Kooli & Suret, 2004).

In the Indian context, the regulatory environment, shaped by the Securities and Exchange Board of India (SEBI), has played a critical role in shaping IPO pricing, transparency, and investor confidence. Initiatives such as IPO grading, disclosure norms, and promoter lock-in requirements have attempted to reduce information asymmetry and strengthen governance standards (Deb & Marisetty, 2010). Nevertheless, empirical evidence suggests that structural, firm-level, and ownership-related factors continue to influence IPO outcomes in India significantly.

The literature on IPO performance can be broadly categorized into five interrelated streams. First, theoretical models explain the underlying causes of underpricing and long-run anomalies. Second, firm-specific determinants such as size, age, profitability, and industry characteristics are examined as drivers of IPO success. Third, issue-specific factors, including offer size, price bands, and underwriter reputation, are studied for their impact on listing-day returns and subscription levels. Fourth, ownership structure, particularly promoter shareholding, has emerged as a key governance variable influencing post-listing performance. Finally, long-term market-adjusted returns are analysed to determine whether IPOs create sustainable shareholder value.

While global evidence on IPO performance is extensive, Indian studies have gained momentum only in the past two decades, especially after market liberalization and regulatory strengthening. However, findings remain fragmented across different determinants and time horizons. Moreover, the growing relevance of emerging sectors, evolving investor participation, and changing institutional mechanisms necessitate a consolidated understanding of IPO behaviour in India.

Accordingly, this review synthesises existing theoretical and empirical research on IPO performance by organising the discussion into five major dimensions: theoretical background, company-specific determinants, issue-specific characteristics, ownership structure and promoter influence, and long-term post-listing performance. By integrating these perspectives, the review aims to provide a comprehensive foundation for examining the drivers of IPO performance in the Indian capital market and identifying research gaps for future empirical investigation.

Objective of the Study

To develop an integrated framework to examine how firm-specific, issue-specific, and ownership-related factors influence short-term underpricing and long-term performance of IPOs in the Indian capital market.

Review of Literature

• Theoretical Background of IPO Performance

Financial research widely studies initial public Offering (IPO) performance. IPOs often show unusual behaviour, such as being priced below their true value on the day of listing (underpricing) or performing poorly in the long run. These patterns have been observed in developed and emerging markets, including India.

The information asymmetry theory is one of the earliest explanations for IPO underpricing. This theory holds that companies know more about their value than investors do. Because of this knowledge gap, companies often price their IPOs lower to attract investors and reduce the perceived risks (Beatty & Ritter, 1986). Having a well-known underwriter also helps reduce this information gap. Investors trust established underwriters, leading to better subscription rates and less underpricing (Carter & Manaster, 1990). Another explanation comes from signalling theory, which suggests that companies use underpricing as a signal of strength. By offering investors a strong initial return, companies signal confidence in their long-term performance (Loughran & Ritter, 1995). The relevance of signalling theory becomes particularly evident in markets like India, where investors may not have easy access to reliable company information.

The role of investor behaviour is also critical. Sometimes investors decide based on market hype, recent trends, or emotions rather than facts. Such behaviour leads to overreaction, herd behaviour, and mispricing (Kooli & Suret, 2004). These behavioural aspects are especially strong in emerging markets.

Researchers have also studied how regulatory frameworks and institutional conditions affect IPOs. For example, the Securities and Exchange Board of India (SEBI) introduced IPO grading to

improve transparency in India. Such institutional tools shape investors' perception of IPOs (Deb & Marisetty, 2010). Many factors influence IPO performance.

- **Company-Specific Determinants of IPO Outcomes**

Firm-specific factors play a major role in determining IPO success. Researchers have explored several characteristics, including firm size, age, financial performance, and industry type. Firm size and age are both important indicators of company stability. Firm size is one of the most studied variables. Larger companies are considered safer because they usually have more resources, a longer track record, and are better known to the public. These characteristics reduce investors' risk, leading to lower underpricing and better listing-day performance (Cabral & Kumar, 2023). In contrast, smaller firms are often riskier and can show high volatility in their stock prices after listing (Sahoo & Rajib, 2010). Firm age is another important factor. Older firms are assumed to be more stable and better managed. They are also more likely to have consistent revenues and profits, which makes investors feel safer about buying their shares (Mangala & Dhanda, 2022). However, younger firms often perform well in IPOs in industries like technology and digital services because investors expect rapid growth, even if the firm is new (An & Chan, 2008).

A firm's profitability is also a key indicator. Companies with good profit margins, return on assets (ROA), or return on equity (ROE) tend to do better in IPOs. Investors are more confident when they see healthy financials (Chatterjee et al., 2024). Strong financial performance also helps firms receive better IPO grading scores. Industry type also matters. Some industries are more attractive to investors. For example, firms in renewable energy, healthcare, or fintech often receive higher investor interest than those in traditional manufacturing or textile industries (Wei, 2024). These trends affect how IPOs across industries are priced and how they perform after listing (Dhankar & Malik, 2017).

- **Issue-Specific Factors Influencing IPO Performance**

Besides company characteristics, the structure of an IPO also affects its market performance. Key structural elements include issue size, offer price range, underwriter reputation, and grading. Issue size and price bands are key structural elements that signal investor confidence and expected demand. Issue size is important because it shows how much capital the company wants to raise. A bigger issue size usually means the company is confident about investor demand. Large issues often get more attention and are considered safer, leading to more stable prices on the listing day (Deb & Banerjee, 2024). However, if market conditions are poor, large issues may fail to attract sufficient investors and perform poorly (Murthy & Kumar, 2025). Price bands (minimum and maximum prices for IPO shares) also give important signals. Narrow bands show the company's confidence in its valuation, while wide bands may indicate uncertainty. Wider bands often lead to more price swings after listing (Guner et al., 2004).

The reputation of underwriters also plays a big role. Underwriters are banks or institutions that manage the IPO. If a company hires a well-known underwriter, investors feel more secure and are more likely to invest (Carter & Manaster, 1990). IPOs handled by experienced underwriters in India often get better responses (Kumar Singla, 2019). To reduce information problems, SEBI introduced IPO grading in 2007. Credit agencies rate IPOs based on the company's fundamentals. Companies with higher grades usually attract more investors and perform better (Deb & Marisetty, 2010). All these factors, including issue size, pricing, underwriter quality, and grading, influence investor demand, price accuracy, and post-listing behaviour of IPOs.

- **Ownership Structure and Promoter Influence on IPOs**

Another important area in IPO performance is ownership structure, especially the role of promoters. Promoters are the original owners or founders of a company. When promoters keep a large share of the company after the IPO, it is seen as a good sign. It shows they have faith in their business and want to stay involved. Such promoter commitment builds investor trust and supports the share price (Cabral & Kumar, 2023). In India, SEBI rules also require promoters to maintain a minimum stake for a lock-in period, further enhancing investor protection. Promoter shareholding can signal confidence and control risk when promoters retain a large share. However, too much promoter control can also be risky. It may reduce transparency and limit board independence. Excessive promoter control may hurt long-term performance and governance (Arora & Singh, 2025).

Studies also show that when promoters or private equity investors sell many shares just before or after the IPO, it sends a negative message. Investors may think the insiders are exiting because they do not believe in the company's future (Venkatesh & Neupane, 2006). A balanced ownership structure is

often seen as best. It controls promoters while allowing room for investor protection and strong governance systems (Dutt & Sahoo, 2025).

- **Long-Term Market Performance of IPOs**

Most media and investors focus on how much money they can make on listing day. Nevertheless, for serious investors and researchers, the long-term performance of IPOs is more important. Both global and Indian studies show IPOs tend to underperform the market in the long run. Studies worldwide show IPOs often underperform the market after one to three years. Companies that show big gains on listing day may lose value in the long run (Kooli & Suret, 2004). Reasons include inflated pricing during the IPO, poor management, or unrealistic investor expectations. In India, long-term underperformance is also common. IPOs from unknown or small firms tend to show losses after the first year (Babu & Dsouza, 2021).

A key reason is corporate governance. Companies that build strong internal systems, such as independent boards, timely disclosures, and transparent accounting, are more likely to succeed after listing (Mangala & Dhanda, 2023). Market timing is also important. If a company launches its IPO in a bullish (rising) market, it may get high attention and pricing. Nevertheless, if performance later does not meet expectations, investors may lose confidence (Chatterjee et al., 2024). In contrast, IPOs in slower markets often show better long-term growth because they are priced more reasonably. Therefore, looking only at listing gains gives an incomplete picture. Long-term performance must be studied to understand true IPO success.

Conclusion

The literature review demonstrates that IPO performance remains a persistent puzzle in financial markets, characterised by significant short-term underpricing and weak long-term performance. Theoretical explanations, such as information asymmetry, signalling theory, agency conflicts, and behavioural finance, collectively explain why IPOs are often priced below intrinsic value and why initial listing gains may not translate into sustainable returns. These theories highlight that IPO outcomes are shaped not only by valuation uncertainty but also by investor sentiment, governance structures, and institutional mechanisms.

Empirical evidence suggests that multiple interconnected factors influence IPO performance. Firm-specific characteristics such as size, age, profitability, and industry profile affect investor confidence and pricing accuracy. Issue-specific elements, including offer size, price band width, and underwriter reputation, influence subscription levels and listing-day returns. Ownership structure, particularly promoter shareholding, plays a crucial role in the Indian context. While higher promoter retention may signal commitment and alignment of interests, excessive control can lead to entrenchment and weaker governance, potentially affecting long-term performance.

In India, regulatory reforms introduced by the Securities and Exchange Board of India (SEBI), including book-building mechanisms, IPO grading, and promoter lock-in provisions, have aimed to enhance transparency and reduce information asymmetry. However, evidence indicates that market timing, behavioural biases, and ownership concentration continue to influence IPO outcomes. Overall, the literature emphasizes the need for a comprehensive and integrated framework that simultaneously considers firm-level, issue-level, and ownership-related determinants to better understand sustainable value creation in the Indian IPO market.

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