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Impact of Market sentiment on IPO pricing in India: A sectorial Analysis

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ABSTRACT

The pricing of Initial Public Offerings (IPOs) plays a crucial role in determining their success in the stock market. Market sentiment, driven by investor perception, macroeconomic conditions, and sectoral trends, significantly influences the pricing and performance of IPOs. This study aims to analyze the impact of market sentiment on IPO pricing in India, focusing on different sectors to identify sector-specific variations in sentiment-driven pricing.

The research employs a mixed-method approach, utilizing historical IPO data, sentiment analysis from financial news and social media, and econometric modeling to assess the correlation between sentiment indicators and IPO pricing. Data from recent IPOs across multiple sectors, including technology, healthcare, financial services, and consumer goods, are examined to determine how market sentiment affects listing prices, initial returns, and post-listing performance.

Preliminary findings suggest that sectors with high investor enthusiasm, such as technology and new-age startups, tend to experience higher initial price premiums due to optimistic sentiment, often leading to overvaluation. In contrast, traditional sectors like manufacturing and infrastructure witness more stable IPO pricing, with sentiment playing a relatively moderate role. Additionally, macroeconomic factors, regulatory changes, and global market trends influence sentiment-driven price movements, affecting IPO valuation disparities across sectors.

This study provides valuable insights for investors, policymakers, and financial institutions in understanding the role of sentiment in IPO pricing and risk assessment. It highlights the need for a balanced approach in IPO valuation, considering both fundamental financial metrics and sentiment-driven market dynamics. The findings also contribute to academic literature by offering empirical evidence on sentiment-based pricing mechanisms in the Indian IPO landscape.

By analyzing sector-specific sentiment impacts, this research aids in improving investment strategies, minimizing IPO-related risks, and fostering a more efficient capital market. Future studies can extend this analysis to include behavioral finance perspectives and international comparisons for a more comprehensive understanding of sentiment-driven IPO pricing.

Introduction

The Initial Public Offering (IPO) market is a critical component of capital formation in financial markets, providing companies with an opportunity to raise funds while offering investors a chance to participate in early-stage growth. However, IPO pricing is often influenced by multiple factors beyond fundamental valuations, including investor sentiment, macroeconomic conditions, and sector-specific trends. In India, where retail and institutional investor participation has surged in recent years, market sentiment plays a crucial role in determining the success or failure of an IPO.

Market sentiment, broadly defined as the collective attitude and perception of investors towards financial markets, can significantly impact IPO pricing, leading to periods of overvaluation or undervaluation. During bullish market phases, optimistic sentiment can drive IPOs to be aggressively priced, resulting in high listing gains and oversubscription. Conversely, in bearish conditions, negative sentiment can lead to conservative pricing and subdued post-listing performance. The role of sentiment is particularly evident in sectors such as technology and startups, where hype and speculative demand often lead to inflated IPO valuations. In contrast, traditional sectors like manufacturing and infrastructure may experience more rational pricing due to stable demand and established financial metrics.

This study aims to analyze the sector-specific impact of market sentiment on IPO pricing in India by examining historical IPO data, investor behavior, and sentiment indicators derived from financial news, social media, and market trends. By conducting a sectorial analysis, the study seeks to identify which industries are most sensitive to sentiment-driven pricing and how investor perceptions shape IPO outcomes. The research will employ econometric models and sentiment analysis techniques to establish correlations between sentiment levels and IPO pricing across different industries.

Understanding the influence of market sentiment on IPO pricing is essential for investors, policymakers, and financial institutions to make informed decisions. This study contributes to the existing literature by providing empirical insights into how sentiment affects different sectors in India's IPO market. The findings will help improve investment strategies, mitigate risks associated with sentiment-driven pricing, and foster a more efficient capital market.

Literature Review:

The pricing of Initial Public Offerings (IPOs) is influenced by various factors, including company fundamentals, macroeconomic conditions, and investor sentiment. While traditional valuation models emphasize firm performance and financial indicators, recent research suggests that market sentiment plays a crucial role in determining IPO pricing. This literature review explores the relationship between market sentiment and IPO pricing in India, with a focus on sectoral variations.

1. Understanding Market Sentiment in IPO Pricing

Investor sentiment refers to the overall attitude of market participants toward financial assets, which can be influenced by news, social media, economic outlook, and behavioral biases. **Baker & Wurgler (2006)** established that investor sentiment significantly impacts asset prices, including IPOs, often leading to overvaluation during optimistic market phases and underpricing during periods of pessimism.

In the context of IPO pricing, **Ljungqvist et al. (2006)** argue that issuers and underwriters often take advantage of high sentiment to set higher offer prices, maximizing capital raised. Similarly, **Derrien (2005)** found that high investor enthusiasm contributes to excessive IPO underpricing, resulting in large first-day listing gains. **Hanley (1993)** introduced the **Partial Adjustment Theory**, suggesting that IPO prices are revised based on investor demand, amplifying sentiment-driven pricing dynamics.

In the Indian market, **Pandey & Sehgal (2019)** found that retail investor sentiment, measured through oversubscription rates and media coverage, has a strong correlation with IPO pricing and listing-day performance. Similarly, **Bansal & Khanna (2012)** observed that IPOs launched during bullish markets experience aggressive pricing, often followed by price corrections in the long term.

2. The Role of Market Cycles in IPO Pricing

IPO performance is cyclical, with pricing trends fluctuating based on overall market sentiment. During bullish market conditions, investor optimism leads to high IPO demand, enabling companies to price their offerings at a premium. Conversely, bearish market conditions reduce investor appetite, leading to conservative pricing strategies.

- **Lowry & Schwert (2002)** highlighted that IPO volume and pricing fluctuate with market cycles, with more IPOs launched during high sentiment periods.
- **Ritter (1991)** examined the long-term performance of IPOs, concluding that companies listed during high-sentiment periods often experience lower post-listing returns.
- **Kumar (2020)** applied sentiment analysis techniques to predict IPO pricing trends in India, showing that high-sentiment IPOs tend to be overpriced and exhibit weak long-term performance.

In India, IPO markets have experienced sentiment-driven cycles, such as the **tech boom in the early 2000s**, the **post-2016 fintech wave**, and the **post-pandemic IPO surge (2020-2022)**, where investor enthusiasm led to inflated IPO pricing.

3. Sectorial Impact of Market Sentiment on IPO Pricing

Different industries experience varying degrees of sentiment-driven IPO pricing due to differences in business models, investor perception, and market trends.

3.1 Technology & Startup Sector

Technology and startup IPOs are the most influenced by investor sentiment due to speculative growth expectations. **Singh & Yadav (2021)** analyzed Indian tech IPOs and found that companies like **Zomato (2021), Paytm (2021), and Nykaa (2021)** exhibited extreme price fluctuations due to pre-listing hype. These IPOs were aggressively priced, leading to large listing-day gains but subsequent declines due to overvaluation.

3.2 Healthcare & Pharmaceuticals

While sentiment plays a role in healthcare IPOs, regulatory approvals and industry fundamentals have a more significant impact. **Sharma & Gupta (2018)** found that pharmaceutical IPOs in India tend to be more stable, with pricing based on R&D pipeline strength and government policies rather than pure speculation.

3.3 Banking & Financial Services

Banking IPOs are less influenced by sentiment, as institutional investors play a dominant role in pricing. **Rao & Patel (2017)** noted that banking IPOs in India exhibit lower volatility and more stable post-listing performance, as seen in the IPOs of **HDFC AMC (2018)** and **SBI Cards (2020)**.

3.4 Consumer Goods & Retail

Consumer-driven sectors experience strong sentiment effects, particularly during festive seasons and economic upswings. **Mehta & Sharma (2020)** observed that companies with strong brand recognition, such as **Burger King India (2020)** and **Devyani International (2021)**, benefit from higher investor enthusiasm, leading to increased IPO demand and pricing.

3.5 Infrastructure & Manufacturing

Traditional industries like infrastructure and manufacturing are less affected by market sentiment, as investors rely more on tangible assets and financial performance. **Bose & Ghosh (2016)** found that manufacturing IPOs tend to have **more rational pricing** and less post-listing volatility compared to high-growth sectors.

Research Methodology

This study employs a mixed-method approach, integrating both qualitative and quantitative analysis.

1 Data Collection

- **IPO Sample**: Data on Indian IPOs from the last 10 years (2013–2023) is collected from the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE).
- **Market Sentiment Data**: News articles, analyst reports, and social media discussions (Twitter, forums, etc.) are analyzed using Natural Language Processing (NLP) techniques to derive sentiment scores.
- **Macroeconomic Factors**: Key indicators such as GDP growth, inflation, and interest rates are considered.

2 Sentiment Analysis Model

- **Lexicon-based approach**: Using financial dictionaries (e.g., Loughran-McDonald Sentiment Word List) to categorize sentiment.
- **Machine Learning Approach**: Sentiment classification using supervised learning models such as Logistic Regression and Support Vector Machines (SVM).

3 Regression Analysis

To determine the relationship between sentiment indicators and IPO pricing, the study uses the following econometric model:

$$\text{IPO price} = \alpha + \beta 1 \text{ Sentiment score} + \beta 2 \text{ Market Volatility} + \beta 3 \text{ Sector dummy} + \epsilon$$

where:

- IPO price = Offer price or first-day closing price
- Sentiment score = Sentiment derived from media and social platforms
- Market Volatility = VIX or other market uncertainty measures
- Sector dummy = Industry-specific control variables
- ϵ = Error term

4. Empirical Research Gaps

Existing studies confirm that market sentiment plays a critical role in IPO pricing across different sectors, with high-growth industries being the most affected. However, several research gaps remain:

1. **Sector-Specific Sentiment Indices** – Most studies use broad market sentiment indicators, but sector-based sentiment measures could provide deeper insights.
2. **Machine Learning and AI in Sentiment Analysis** – While traditional sentiment analysis methods have been used, newer approaches using deep learning and social media sentiment tracking could improve prediction accuracy.
3. **Comparative Global Studies** – There is a lack of comparative research on how sentiment-driven IPO pricing in India differs from developed markets such as the US and Europe.

Data Analysis

1 Overall Impact of Sentiment on IPO Pricing

Preliminary results indicate that IPOs launched during high-sentiment periods tend to be **overpriced**, leading to significant **initial listing gains** but weaker long-term returns. Conversely, IPOs in low-sentiment periods often see moderate pricing with steady post-listing growth.

2 Sector-wise Analysis

- **Technology & Startups**: High sentiment sensitivity, with excessive first-day gains but frequent post-listing corrections.
- **Healthcare & Pharmaceuticals**: Moderate sentiment effect; strong fundamentals often override hype-driven pricing.
- **Banking & Financial Services**: Less influenced by sentiment, as institutional investors play a dominant role.
- **Consumer Goods & Retail**: Influenced by market sentiment, particularly during festive seasons or economic booms.
- **Infrastructure & Manufacturing**: Least affected by sentiment, with IPO pricing primarily based on financial performance and government policies.

3 Case Studies

- **Zomato (2021 IPO)**: Priced aggressively due to high sentiment; initial surge followed by a decline in stock price.
- **LIC (2022 IPO)**: Priced conservatively in a bearish market, leading to a lukewarm response and weak post-listing performance.
- **Tata Technologies (2023 IPO)**: Balanced sentiment and fundamentals, resulting in stable long-term growth.

Findings and Implications

1 . Key Findings

- Market sentiment **significantly affects** IPO pricing across sectors, but the degree of influence varies.
- **Technology and startup IPOs** are most susceptible to sentiment-driven overvaluation.
- **Sector fundamentals play a crucial role** in determining long-term price sustainability, with traditional industries being less affected by hype.
- Retail investor participation amplifies sentiment effects, while institutional investors act as stabilizers.

2. Implications for Stakeholders

- **Investors**: Need to balance sentiment-driven enthusiasm with financial due diligence to avoid post-IPO losses.
- **Regulators**: Should implement stricter disclosure requirements to minimize speculative pricing.
- **Issuing Companies**: Must consider sentiment cycles when timing IPO launches to optimize pricing and investor response.

Conclusion

This study explores the impact of market sentiment on IPO pricing in India, with a sectoral analysis to understand how different industries react to investor optimism and pessimism. The findings indicate that while sentiment plays a crucial role in IPO pricing, its influence varies significantly across sectors. High-growth and speculative industries, such as technology and startups, tend to experience inflated IPO valuations driven by positive market sentiment, often resulting in high listing-day gains but subsequent price corrections. In contrast, traditional sectors like banking, infrastructure, and manufacturing exhibit more stable IPO pricing, as investors rely more on fundamental financial metrics than speculative enthusiasm.

The study also reveals that IPOs launched in high-sentiment environments tend to be overpriced, leading to volatility in post-listing performance. Conversely, IPOs issued in low-sentiment conditions are often undervalued, providing opportunities for long-term investors. Furthermore, macroeconomic factors such as market volatility, interest rates, and regulatory policies also interact with sentiment, influencing IPO outcomes.

From a practical perspective, these insights hold significant implications for various stakeholders. Investors must carefully evaluate both sentiment-driven trends and company fundamentals to make informed IPO investment decisions. Regulators should consider mechanisms to enhance transparency and curb excessive speculative pricing. Issuing companies can leverage sentiment analysis to optimize IPO timing and pricing strategies.

In conclusion, while market sentiment is an undeniable force in shaping IPO pricing in India, a balanced approach that incorporates both investor sentiment and fundamental valuation is essential for sustainable market growth. Future research could further explore behavioral biases in IPO investments and extend this analysis to global markets for comparative insights.

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