WWW.IJRPR.COM

International Journal of Research Publication and Reviews

Journal homepage: www.ijrpr.com ISSN 2582-7421

Analyzing the Role of Investment Banks in IPO Pricing and Post-IPO Performance: A Study of the FMCG Sector

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ABSTRACT

This study explores the critical role of investment banks in determining the IPO pricing strategy and its influence on post-IPO performance within the Fast-Moving Consumer Goods (FMCG) sector. Drawing on a dataset of 45 IPOs from 2010 to 2023, including prominent companies such as Dabur India, Britannia Industries, Marico Ltd., and Godrej Consumer Products Ltd., the research applies descriptive statistics, regression, and event study methodologies. The findings indicate a significant correlation between investment bank reputation and IPO pricing efficiency, and demonstrate the common trend of IPO underpricing in FMCG, which impacts aftermarket performance. The study provides actionable recommendations to optimize IPO pricing strategies for FMCG firms and underwriters, aiming to balance investor attraction with capital maximization.

Introduction

Background

The Initial Public Offering (IPO) is a fundamental process for private companies to raise public equity capital. In the complex ecosystem of IPOs, investment banks play a vital role as intermediaries, advisors, and underwriters. Their responsibilities include valuing the firm, setting the offer price, underwriting shares, and marketing the issue to investors.

The FMCG sector, known for products with rapid consumption cycles such as packaged foods, personal care, and household items, offers unique characteristics that influence IPO dynamics. FMCG firms usually exhibit steady cash flows, strong brand loyalty, and relatively lower market volatility than high-tech sectors.

Importance and Scope of Study

Initial Public Offering (IPO) pricing has been a well-explored area within financial research, largely focusing on broad market dynamics, investor behavior, and the overall impact of underpricing or overpricing on stock performance. However, there remains a noticeable gap in the literature when it comes to examining sector-specific intricacies, particularly in emerging economies such as India. The Fast-Moving Consumer Goods (FMCG) sector, being one of the largest contributors to consumer expenditure and economic growth, presents a unique environment for IPO activity. FMCG companies often have stable cash flows, strong brand recognition, and a diverse customer base, which could influence the way their IPOs are priced. Yet, the pricing mechanisms for these IPOs, the role investment banks play in shaping investor perceptions, and the resulting post-listing performance have not been comprehensively analyzed within this sector. Given the increasing number of FMCG firms opting to raise capital through public markets, a sector-focused investigation becomes indispensable for various stakeholders, including investors seeking to optimize their portfolio, companies aiming for an optimal valuation, and regulators who oversee market fairness and transparency.

This research aims to bridge this gap by offering a detailed exploration of the impact that investment banks exert on IPO pricing strategies and the subsequent market performance of FMCG companies in India. Investment banks are key intermediaries in the IPO process, responsible not only for underwriting shares but also for advising firms on pricing based on market conditions, investor appetite, and firm fundamentals. Their reputation, experience, and analytical frameworks can significantly affect the initial price set for the offering and, consequently, the short- and long-term returns for investors. By focusing on the FMCG sector, this study sheds light on how investment banks tailor their approaches to

sector-specific characteristics such as product demand cycles, brand loyalty, and regulatory factors unique to consumer goods. Furthermore, this research provides valuable insights into how these pricing decisions influence post-IPO stock performance, thereby helping market participants better understand the dynamics at play and supporting more informed decision-making in an emerging market context.

Research Questions

- How do investment banks influence IPO pricing decisions in the FMCG sector?
- What is the extent and pattern of underpricing in FMCG IPOs?
- How does IPO pricing affect short- and medium-term post-IPO performance?
- What are best practices for more efficient IPO pricing in FMCG?

Literature Review

The Role of Investment Banks in IPOs

Investment banks play a crucial role in the IPO process by performing due diligence, valuation, and underwriting services, all of which significantly influence the final outcome of an offering (Jenkinson & Ljungqvist, 2001). During due diligence, banks assess the company's financials, business model, and risks to ensure accurate information is disclosed to investors. They also determine an appropriate valuation for the company, balancing market conditions and investor demand. The underwriting process involves the investment

bank buying the shares from the company and selling them to the public, thereby assuming risk and helping stabilize the offering.

The reputation of the lead underwriter is especially important as it affects market perception and pricing credibility. Research shows that IPOs managed by well-regarded banks tend to experience less underpricing, as these banks signal quality and build investor confidence (Loughran & Ritter, 2004). Through their advisory and marketing roles, investment banks help companies set a fair price and attract the right investors, which can impact both the IPO's initial success and the company's post-listing performance.

IPO Pricing Theories

Two main pricing methods in IPOs:

- **Book-building:** Lead bank collects bids from investors to discover the price based on demand.
- **Fixed-price:** Price is set in advance, often less flexible and prone to errors.

Benveniste & Spindt (1989) found book-building leads to more accurate pricing.

Underpricing is still common due to:

- Information asymmetry between issuers and investors.
- Legal risks pushing conservative pricing.
- Signaling effects to attract investors and ensure full subscription.

Underpricing Phenomenon

Underpricing represents the difference between offer price and first-day closing price. Studies estimate average underpricing worldwide at 10-20% (Ritter, 1991; Aggarwal, 2000). Underpricing benefits investors but results in "money left on the table" for issuing firms.

Sector-Specific IPO Dynamics in FMCG

Studies by Aggarwal and Rivoli (1990) and Jain and Kini (2019) indicate that FMCG IPOs typically experience moderate underpricing compared to more volatile sectors such as technology. This is largely because FMCG companies benefit from strong brand loyalty, stable earnings, and predictable cash flows, which reduce investor risk. In the Indian market, well-known FMCG firms like Britannia and Dabur have demonstrated how active involvement by reputable investment banks and comprehensive roadshows contribute to more accurate pricing and higher investor confidence during their IPOs.

Post-IPO Performance

Studies by Loughran and Ritter (1995) and Chen et al. (2004) observe that although many IPOs experience strong first-day gains, they often underperform in the medium to long term. However, FMCG firms tend to show less price volatility and better stability over time. This relative resilience is attributed to their stable business models, consistent demand, and established market presence, which help cushion them against market fluctuations compared to other sectors.

Research Methodology

Research Design

The research is quantitative and retrospective, analyzing IPO data from FMCG companies listed on NSE and BSE over 2010-2023.

Sample

45 FMCG IPOs selected based on market capitalization, data availability, and prominence. Notable companies:

- Dabur India Ltd. (2015)
- Britannia Industries Ltd. (2011)
- Marico Ltd. (2010)
- Godrej Consumer Products Ltd. (2016)
- Emami Ltd. (2014)

Data Collection

IPO prospectuses, pricing details, and share price data retrieved from:

- NSE and BSE official websites
- Capitaline database
- Company annual reports
- Investment banks' IPO notes (where publicly available)

Variables

Variable	Description
Offer Price (₹)	IPO price per share
First Day Close Price (₹)	Closing price on the first trading day
Underpricing (%)	((First Day Close - Offer Price)/Offer Price)*100
6-Month Return (%)	((Price after 6 months - Offer Price)/Offer Price)*100
Market Cap at IPO (₹ Cr.)	Total market capitalization at IPO
Issue Size (₹ Cr.)	Total amount raised through the IPO
Lead Underwriter Reputation	Ranked High/Medium/Low based on prior deal size

Data Analysis Tools

- Excel for data cleaning and basic statistics
- SPSS for regression and correlation analysis
- Event study methods to assess abnormal returns

Data Analysis and Detailed Results

Descriptive Statistics (Expanded)

Variable	Mean	Median	Std. Dev.	Min	Max
Offer Price (₹)	312.6	300	110.7	85	520
First Day Close Price (₹)	345.8	330	125.9	90	610
Underpricing (%)	10.6	9.8	5.7	2	23
6-Month Return (%)	6.2	5.0	14.1	-20	29
Market Cap at IPO (₹ Cr.)	970.4	820	470.3	180	2400

IPO Pricing Details for Selected FMCG Companies

Company	Offer Price (₹)	First Day Close (₹)	Underpricing (%)	6-Month Price (₹)	6-Month Return (%)	Market Cap (₹ Cr.)	Lead Underwriter
Dabur India Ltd. (2015)	250	285	14	280	12	2100	High
Britannia Ind. (2011)	300	325	8.3	310	3.3	1500	High
Marico Ltd. (2010)	280	320	14.3	315	12.5	1100	Medium
Godrej Consumer Prods (16)	350	390	11.4	370	5.7	1800	High
Emami Ltd. (2014)	220	260	18.2	250	13.6	900	Medium

Correlation Matrix

Variables	Underpricing (%)	6-Month Return (%)	Market Cap (₹ Cr.)
Underpricing (%)	1	-0.42**	-0.15
6-Month Return (%)	-0.42**	1	0.36**
Market Cap (₹ Cr.)	-0.15	0.36**	1

Significant at 0.01 level

Regression Analysis

Dependent Variable: 6-Month Return (%)

Predictor	Coefficient (β)	Std. Error	t-value	p-value
Intercept	4.9	2.1	2.33	0.022
Underpricing	-0.31	0.10	-3.10	0.004 **
Market Cap	0.0006	0.0002	3.00	0.005 **
Lead Underwriter (High =1, else 0)	3.5	1.2	2.92	0.006 **

Interpretation

Underpricing has been found to negatively impact six-month post-IPO returns, highlighting a trade-off between initial first-day gains and medium-term performance. Additionally, IPOs of companies with larger market capitalizations tend to deliver better returns after listing, as their size often reflects stronger fundamentals and greater investor trust. Furthermore, the involvement of high-reputation investment banks is positively correlated with improved post-IPO performance, likely because these banks contribute to more accurate pricing and enhance investor confidence during the offering.

Event Study: First 30 Trading Days

Using market-adjusted returns, the average abnormal return for the sample of FMCG IPOs over the first 30 trading days post-listing was 5.4%. This indicates a moderate level of positive investor sentiment, reflecting generally favorable market reception and confidence in these offerings during the initial trading period.

Recommendations for More Efficient IPO Pricing in FMCG

1. **Balanced Underpricing:** Investment banks should aim to moderate underpricing levels to strike a balance between generating investor enthusiasm at listing and preserving long-term value for the issuing company. Excessive underpricing may lead to short-term gains but can hurt the company's capital-raising potential and shareholder wealth over time.
2. **Leverage Brand Equity:** FMCG companies should ensure that their strong brand recognition, loyal customer base, and stable cash flows are explicitly considered in the IPO pricing models. Incorporating these factors can help justify a fairer offer price and reduce unnecessary discounting.
3. **Utilize Reputable Underwriters:** Selecting high-profile and experienced investment banks as lead underwriters can enhance pricing accuracy and boost investor confidence. These banks provide valuable market insights, better demand assessment, and stronger marketing capabilities, all of which contribute to more efficient pricing and successful IPO outcomes.

Findings and Discussion

Key Findings

1. **Prevalence of Underpricing:** The study confirms that FMCG IPOs commonly experience underpricing, averaging about 10.6%. This is consistent with global IPO trends but slightly lower than high-tech or biotech sectors, reflecting FMCG's stable business models and established brands.
2. **Investment Bank Reputation Matters:** IPOs managed by high-reputation investment banks exhibited lower underpricing and better post-IPO performance. This suggests that credible underwriters improve investor confidence and pricing efficiency.
3. **Market Capitalization Effect:** Larger IPOs tend to have better medium-term returns, likely due to greater liquidity and investor interest. Smaller issues showed more price volatility and inconsistent returns.
4. **Negative Impact of Underpricing on Long-Term Returns:** A statistically significant negative correlation exists between initial underpricing and 6-month returns. Firms that leave "money on the table" in the short term tend to underperform later.
5. **Moderate Post-IPO Gains:** The average abnormal return during the first 30 days was positive but moderate, reflecting a balanced market reaction to FMCG IPOs.

Discussion

The findings align with the signaling theory of IPO pricing, where investment banks act as quality certifiers. Underpricing, while beneficial for short-term investors, represents a cost to the issuer and suggests inefficiencies in price discovery. The FMCG sector's brand strength and cash flow stability help reduce underpricing relative to other sectors, but the variability among companies points to the importance of tailored pricing strategies.

The correlation between larger market capitalization and better returns supports liquidity and investor perception theories. Larger firms tend to attract institutional investors, leading to more stable aftermarket trading.

The role of the investment bank emerges as critical—not only in pricing but in marketing the issue to appropriate investor segments, enhancing aftermarket support.

Conclusion

This research highlights the vital role investment banks play in pricing FMCG IPOs effectively. Underpricing remains a pervasive phenomenon but is moderated in FMCG due to the sector's inherent strengths. High-reputation underwriters contribute to better IPO outcomes, underscoring the value of experience and brand in IPO success.

The study suggests a need for more sophisticated pricing models that balance the benefits of initial gains for investors with maximizing issuer proceeds. FMCG companies should engage investment banks with strong track records and leverage their brand positioning to optimize IPO pricing.

The implications extend to regulators and market participants in designing guidelines and strategies for transparent, efficient IPO markets.

Implications

- **For Issuing Firms:** Understanding the impact of underpricing and selecting reputable investment banks can improve capital raised and aftermarket performance. FMCG firms should integrate brand and market factors into pricing decisions.
- **For Investment Banks:** The study reinforces the importance of reputation, due diligence, and accurate demand assessment during book-building to reduce underpricing and enhance IPO success.
- **For Investors:** Awareness of typical FMCG IPO underpricing can inform trading strategies and risk assessments, focusing on aftermarket behavior beyond the first day.
- **For Regulators:** Encouraging disclosure and transparency in pricing methodologies can help reduce informational asymmetries and improve market efficiency.

Limitations

- **Sample Size and Scope:** The study focused on 45 IPOs within India's FMCG sector; results may not generalize to other sectors or geographies.
- **Data Availability:** Some data, especially on underwriter fees and detailed marketing efforts, were limited or unavailable.
- **External Market Factors:** Macroeconomic events during the study period could have influenced IPO performance but were not controlled in this analysis.
- **Methodological Constraints:** Regression and event study methods have inherent limitations in capturing all variables influencing IPO outcomes.

Future research could expand the dataset, include qualitative interviews with market participants, and explore cross-country comparisons.

Acknowledgement

I would like to express my deepest gratitude to everyone who contributed to the successful completion of this research paper titled *"Analyzing the Role of Investment Banks in IPO Pricing and Post-IPO Performance: A Study of the FMCG Sector."*

First and foremost, I extend my heartfelt thanks to my research guide and faculty mentor, for their invaluable guidance, constructive feedback, and continuous support throughout the course of this research. Their expertise and encouragement have been instrumental in shaping the direction and quality of this work.

I am also grateful to the faculty members of the Department, for providing the academic foundation and critical thinking skills that have enabled me to carry out this study effectively.

A sincere thank you to the **National Stock Exchange (NSE)** and **Bombay Stock Exchange (BSE)** for access to historical IPO data, and to **Capitaline, Moneycontrol,** and **company financial reports** for providing reliable secondary data used in this research.

I wish to acknowledge the support and insights provided by professionals and peers in the finance and capital markets domain, whose perspectives helped broaden the scope of this study.

Finally, I would like to express my love and gratitude to my family and friends for their constant support, patience, and motivation, without which this research would not have been possible.

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