ICCMCT-2018
SEP- 2018
Special Issue

ISSN: 2455-3085 (Online)
RESEARCH REVIEW International Journal of Multidisciplinary
www.rrjournals.com [UGC Listed Journal]

# Validity of Winner's Curse Hypothesis: Evidence from Initial Public Offerings in the Indian Insurance Industry

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**ARTICLE DETAILS**

**Article History**
*Published Online:* 29 Sep 2018

**Keywords**
Initial Public Offerings, Insurance Industry, Market Performance, Winner's Curse Hypothesis

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**ABSTRACT**

The insurance industry is one of the prominent industries in India and it plays an important role in the nation building process and social security enhancement. It is growing at 15-20 % and it contributes nearly 4% of the GDP. It includes 57 companies, out of which 24 are life insurance companies, 31 general insurance companies and two are re-insurance companies. However, only seven are listed on the stock exchanges including LIC. In 2016, ICICI Prudential Life Insurance Ltd. became the first player to go public from the insurance industry after LIC. A large number of investors are attracted to insurance sector IPOs including institutional investors and retail investors as leading insurance companies go on public issue after 16 years of liberalization of LIC. In the two preceding years, the Indian stock market has witnessed the Initial Public Offerings of leading insurance companies. This occurred mainly due to the moderation of capital raising norms by the Insurance Regulatory and Development Authority of India (IRDAI). The present study analyses the short run secondary market performance of the recent Initial Public Offerings (IPOs) of insurance industry in India. Further, the study tests the validity of Winner's Curse Hypothesis with regard to Insurance IPOs.

## 1. Introduction

Initial public offering (IPO) denotes an offer of shares of an unlisted issuer to the public for subscription. The IPO is a prominent corporate event that provides companies a unique opportunity to raise capital, broaden their investor base, and increase the liquidity of their shares (Hong, Hyun A et al. 2013). An IPO improves a company's public profile, visibility and recognition of its products and services. In India, IPOs are governed by the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009. Through the process of floating, underwriters make arrangements for the shares to be listed and as a result, a private company is converted into a public company. This brings the path for listing and trading of shares. The research studies show that IPOs diversify investor's portfolios and bring both domestic and foreign capital into the market and thereby expand the market.

According to the Ministry of Commerce and Industry, Government of India, Indian insurance industry is expected to quadruple from its current size of $ 60 billion. Further, the population of the country is expected to touch 750 million by the end of this decade. Life expectancy is also showing an increasing trend and now it is 74 years. With this rate of growth, the industry cannot stay away from the public issue of shares as IPOs provide more funds from the public and liquidity to the existing shareholders. This will provide more funds for operations and increase the disclosure compliances of insurance companies. Understanding this, Insurance Regulatory and Development Authority of India (IRDAI) had issued guidelines for IPOs in 2011 itself but, insurance companies stayed from public issues because of bad market conditions. In 2016, ICICI Prudential Life Insurance Ltd. became the first insurance company to go public from the insurance industry after LIC.

The insurance industry is one of the prominent industries in India. It has become an indispensable pillar in the economic prosperity of the country by channelizing savings into productive investments. It is growing at 15-20 % and it contributes nearly 4% of the GDP. The sector includes 57 companies, out of which 24 are life insurance companies, 31 general insurance companies and two are re-insurance companies. However, only seven are listed on the stock exchanges including LIC. In the two preceding years Indian stock market witnessed the IPOs of leading insurance companies. A large number of investors are attracted to insurance sector IPOs including institutional investors and retail investors as leading insurance companies go on public issue after 16 years of liberalization of LIC. This occurred mainly due to the moderation of capital raising norms by the Insurance Regulatory and Development Authority of India (IRDAI). The present study analyses the short run secondary market performance of the recent Initial Public Offerings (IPOs) of insurance industry in India. Further, the study tests the validity of Winner's Curse Hypothesis with regard to Insurance IPOs.

## 2. IPO Underpricing and Winner's Curse Hypothesis

There have been many research studies done in the area of market performance of IPOs. The Underpricing phenomenon is very common in the IPO market. The underpricing of initial public offerings (IPOs) is referred to in the literature as one of the anomalies observed in primary markets all over the world. The extent of it, however, varies from country to country. IPOs are said to be underpriced if the listing price is more than the issue price. Similarly, if the issue price is higher than the listing price, the IPO is overpriced. It is evident from the literature that most of the prior IPOs in different sectors in India are underpriced.

The researchers have formulated many hypothesis to explain the initial abnormal returns for the IPOs. The most well-known hypothesis is called Winners' Curse Hypothesis. The idea of winner's curse model is based on the mechanism of auctions. In competitive bidding, it is quite usual that some prospective buyers will overestimate the value of the object under auction and some others will do the reverse. Therefore, there is a high chance that the "winner" paid too much for the object by winning the auction. This concept can be applied in IPO's case also. This is to say, in the case of IPOs, getting an allotment of shares for an individual less-expert investor may indicate that the stock is overpriced. To put it simply, if it is not overpriced, knowledgeable buyers would have subscribed the entire issue. As a result, uninformed buyers are likely to purchase only a small portion of the cheap issues compared to institutional investors and a large portion of the expensive issue. This is a serious issue as it strikes at the informational efficiency of the market. Therefore, it is very relevant to analyze the market performance of insurance companies that undergo public issue and the study looks into the following research questions.

- Whether the issues are undersubscribed or oversubscribed?
- Whether the underpricing phenomenon exists in the case of insurance company IPOs or not?
- How is insurance sector IPOs performed in the short run?
- Whether the insurance company IPOs validate Winners' Curse hypothesis?

## 3. Research Methodology

The study is analytical and descriptive in nature. The study uses secondary data for the purpose of analysis. This study considers all the recent IPOs occurred in the insurance sector. Following public issues are considered in the work.

**Table -1**
**IPOs in the Insurance Sector**

| Name of the Company | Opening and Closing Dates |
|---|---|
| HDFC Standard Life Insurance Company Ltd | 07-09, September 2017 |
| New India Assurance Company Ltd | 01-03, November 2017 |
| General Insurance Corporation of India | 11-13, October 2017 |
| SBI Life Insurance Company Ltd | 20-22,September 2017 |
| ICICI Lombard General Insurance Company Ltd | 15-19,September 2017 |
| ICICI Prudential Life Insurance Company Ltd | 19-21,September 2016 |

*Source: NSE Website*

The data collected from the websites of National Stock Exchange of India, annual reports of Insurance companies, websites of IRDAI, RBI and various journals and academic publications. The study uses Returns and Market Adjusted Returns to calculate abnormal returns.

## 4. IPO Details

Table 2 shows the details of IPOs of Insurance companies in the year 2016 and 2017.The Initial Public Offering of ICICI Prudential Life Insurance Company Ltd. came in the year 2016 and the other companies in 2017. All the issues were 100% book built issue.

**Table 2**
**IPO Details**

| Company | Issue Size (Rs in Crores) | Issue Price Band Rs/share | Market Lot | EPS |
|---|---|---|---|---|
| HDFC Standard Life Insurance Company Ltd | 29.82 | 275-290 | 50 | 1.03 |
| New India Assurance Company Ltd | 12 | 770-800 | 18 | 7.58 |
| General Insurance Corporation of India | 12.47 | 855-912 | 16 | 7.71 |
| SBI Life Insurance Company Ltd | 12 | 685-700 | 21 | 2.3 |
| ICICI Lombard General Insurance Company Ltd | 8.6 | 651-661 | 22 | 5.11 |
| ICICI Prudential Life Insurance Company Ltd | 18.13 | 300-334 | 44 | 2.84 |

*Source: National Stock Exchange of India and Annual Reports of Insurance Companies*

The offer price ranges from Rs. 275 to Rs. 912 and the size of the offerings ranges between Rs. 8 crores to Rs. 30 crores. HDFC Standard Life Insurance Company Ltd. has the highest issue size of Rs. 29.82 crores and the lowest was ICICI Lombard General Insurance Company Ltd with an issue size of Rs. 8.6 crores. General Insurance Corporation offered shares at the highest price brand and its Earning Per Share (EPS) is also the highest one. While HDFC Standard Life Insurance Company Ltd has the lowest offer price band and it's EPS is also low.

Table 3 indicates the response of IPO investors for subscribing the IPOs. All the issues were oversubscribed by the investors. The following table shows the issue size of each companies and the number of times oversubscribed.

**Table 3**
**Times over Subscribed and Issue Size**

| Company Name | Times Over Subscribed | Issue Size ( Rs. In Crores) |
|---|---|---|
| HDFC Standard Life Insurance Company Ltd | 4.89 | 29.98 |
| New India Assurance Company Ltd | 1.19 | 12 |
| General Insurance Corporation of India | 1.38 | 12.47 |
| SBI Life Insurance Company Ltd | 3.53 | 12 |
| ICICI Prudential Life Insurance Company Ltd | 10.48 | 18.13 |
| ICICI Lombard General Insurance Company Ltd | 2.98 | 8.6 |
| Average | 4.075 | 15.53 |

*Source: National Stock Exchange of India and Annual Reports of Insurance Companies*

Average Issue size and times oversubscribed are 15.53 and 4.075 respectively. It indicates that IPOs from insurance sector got good response from the market. Among these, ICICI Prudential has high over subscription rate of 10.48 times and The New India Assurance Company has the low over subscription rate of 1.19 times. Table 3 also shows that IPOs of Life Insurance Companies got much better response than IPOs of General Insurance Companies. It may be because of the high issue price of General Insurance Companies. Average oversubscription rate of Life Insurance Companies and General Insurance Companies are 6.3 and 1.85 respectively. Among Life Insurance Companies, SBI Life Insurance Company's oversubscription rate is also low. This is also because of the high issue price band of SBI Life Insurance Company.

## 5. IPO Underpricing

The pricing of an initial public offering (IPO) below its market value, when the offer price is lower than the price of the first trade, the stock is considered to be underpriced. A stock is usually underpriced temporarily because the supply and demand will drive it towards its intrinsic value. Overpricing is calculated as the difference between the offer or opening price for the IPO's stock and its closing price after the first day of trading scaled by the offer price. When the opening price exceeds the closing price, the IPO is said to be overpriced. Table 4 shows whether the IPOs are underpriced or overpriced. IPOs are said to be underpriced if the listing price is more than the issue price. Similarly, if the issue price is higher than the listing price, the IPO is overpriced. The issue price of an IPO is the price at which the company is selling shares to investors. The listing price is basically the opening price of the stock on the first trading session.

**Table 4**

**IPO Underpricing in Insurance Sector**

| Company Name | Issue Price | Listing Price | Method | Result |
|---|---|---|---|---|
| ICICI Prudential Life Insurance Company Ltd | 334 | 297.4 | BB | Overpriced |
| ICICI Lombard General Insurance Company Ltd | 661 | 651.1 | BB | Overpriced |
| SBI Life Insurance Company Ltd | 700 | 735 | BB | Underpriced |
| General Insurance Corporation of India | 912 | 850 | BB | Overpriced |
| New India Assurance Company Ltd | 800 | 722 | BB | Overpriced |
| HDFC Standard Life Insurance Company Ltd | 290 | 310 | BB | Underpriced |

*Note: BB = Book Built Issue.*

Here, it is clear that two companies viz; SBI Life Insurance Company Ltd and HDFC Standard Life Insurance Company Ltd. got underpriced, as their listing price is more than the issue price. While the other companies such as ICICI Prudential Life Insurance Company Ltd, ICICI Lombard General Insurance Company Ltd, General Insurance Corporation of India and New India Assurance Company Ltd. are overpriced, as their listing price is less than the issue price. It is noticeable that, the companies that are under-priced are major life insurance companies and their EPS are very lower than the overpriced companies.

## 6. Initial Market Performance

The initial market performance of insurance companies is analyzed by taking the return. Return is the actual difference between closing and opening prices and shown in percentage of opening price.

**Table 5**

**Average Return of Insurance IPO Companies**

| Name of the Company | 1st Day | 1st Week | 2nd Week | 4th Week | 8th Week | 12th Week |
|---|---|---|---|---|---|---|
| New India Assurance Company Ltd | -2.89 | -7.74 | -11.82 | -19.93 | -12.5 | -7.29 |
| ICICI Lombard General Insurance Company Ltd | 4.62 | 4.69 | 5.58 | 4.9 | 7.6 | 19.06 |
| HDFC Standard Life Insurance Company Ltd | 11.2 | 19.58 | 20.24 | 23.03 | 47.08 | 41.79 |
| SBI Life Insurance Company Ltd | -3.74 | -4.76 | -8.43 | -9.92 | -11.1 | -4.53 |
| General Insurance Corporation of India | 2.86 | -1.44 | -6.89 | -6.56 | -8.16 | -6.73 |
| ICICI Prudential Life Insurance Company Ltd | 4.32 | 6.67 | 10.07 | 3.76 | 2.07 | 1.09 |
| **Average Return** | **2.73** | **2.83** | **1.46** | **-0.79** | **4.17** | **7.23** |

*Source: Author's Calculation*

The Average Return of all the Insurance IPOs goes on decreasing till forth week and experienced a negative rate of return on the fourth week. Thereafter, the sector witnessed a positive movement in the average return. From the above analysis, it is evident that Life Insurance Companies performed better than General Insurance Companies in the market in the post IPO time frames.

### *6.1 Offer Price and Performance*

In the offer price based comparison, it was revealed that low priced IPOs posted positive return, while high priced IPOs posted negative return. In order to do this analysis, IPOs were classified into three groups namely issues having offer price below Rs. 500, between Rs. 500-750 and above Rs. 750. HDFC Standard Life Insurance Company Ltd and ICICI

Prudential Ltd are included in the below 500 category as their offer prices are 290 and 334 respectively. SBI Life Insurance Company and ICICI Lombard General Insurance are included in the second category. Offer price above 750 consists of New India Assurance and General Insurance Corporation of India.

### *6.2 Issue Size and Performance*

In order to compare the performance of IPOs having varied issue size, issues were classified into three groups namely, issue size less than Rs. 10 crores, between Rs. 10 crores and Rs. 20 crores and above 20 crores. First category includes only ICICI Lombard General Insurance Company Ltd. New India Assurance Company Ltd, General Insurance Corporation of India, SBI Life Insurance Company Ltd and ICICI Prudential Life insurance are included in the second category. The issue size of HDFC Standard life insurance company Ltd is 29.98 and thus it is included in the third category.

### *6.3 Oversubscription and Performance*

This section provides the classification of IPOs on the basis of the number of times oversubscribed along with the average rate of return. The three groups are oversubscription rate below 3, between 3 and 6 and above 6. The New India Assurance Company Ltd, General Insurance Corporation of India and ICICI Lombard General Insurance Company are included in the first category as their over subscription rate was below 3. SBI Life insurance company and HDFC Standard Life Insurance Company has the over subscription rate of 3.53 and 4.89 and thus included in the second category.. ICICI Prudential Life Insurance Company Ltd has the highest over subscription rate of 10.48 times which is included in the third category. The analysis clearly shows that companies having high subscription rate have performed better in the market than companies having low subscription rate.

## 7. Testing the Winners Curse Hypothesis

In the present study, excess return (ER) is used to check if the winner's curse hypothesis exists in the insurance IPOs in India.

ER = MAR –RF

Where,

ER = Excess Return

MAR = Market Adjusted Return

RF = Risk Free Return

Excess Return implies the excess of Market Adjusted Return over Risk Free Return. Here, Nifty and Bank Nifty are considered for the computation of Market Adjusted Return 91 Day Treasury Bill (Primary) Yield returns as risk free rate of returns. The returns on the 1$^{st}$ day, 1$^{st}$ week, 2$^{nd}$ week, 4$^{th}$ week, 8$^{th}$week and 12$^{th}$ week are used. Winners Curse Hypothesis exists in Indian insurance IPOs only if excess return is negative or zero. The logical implication of the hypothesis is that uninformed would not get a MAR that beats risk free rate. Therefore, the market-adjusted initial returns minus risk-free rate will be close to zero. The results are summarized below.

- In the case of HDFC Standard Life Insurance Company Ltd, the returns are very high and there is no winner's curse.
- In the case of New India Assurance Company Ltd, the MAR is negative in all cases and thus excess return will also be negative. Therefore, winner's curse prevails in this case.
- In the case of General Insurance Corporation of India, except the first day, all periods show negative abnormal returns and thus winner's curse is valid.
- In the case of SBI Life Insurance Company Ltd, all periods show negative abnormal returns and thus winner's curse is valid.
- In the case of ICICI Lombard General Insurance Company Ltd, except the first day, all periods show negative abnormal returns and thus winner's curse is valid.
- In the case of ICICI Prudential Life Insurance Company Ltd, except first and second week, all periods show negative abnormal returns and thus winner's curse is valid.

## 8. Conclusion

Unlike other studies on underpricing in various sectors, this study shows that underpricing issue doesn't exist in insurance sector IPOs. Only ICICI Prudential Life Insurance Co. Ltd experienced underpricing. The study also shows that winner's curse hypothesis is valid in most of the cases. It signifies the information asymmetry and lack of investor awareness in the equity market. Insurance industry is on the path of development. For the expansion and growth, more insurance companies will enter into public issue soon. Many of the companies are in the process of making their public issue. So it is advisable for the potential investors, to look into the initial market performance of the insurance companies that have already gone public. The study shows that offer price, price band, EPS, issue size etc. are important in determining the after-market performance of IPOs. Therefore, it is imperative that investors should study these variables before investing in IPOs of insurance companies.

### *Acknowledgement*

Authors are indebted to Dr. Libison K B, Assistant Professor, St. Aloysius College, Thrissur for the valuable suggestions while executing the study.

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