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Investigating the Relationship between Family Ownership and Operational Performance after the IPO

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Abstract: The general trend shows that the operating performance before the IPO is better than in the IPO year, and the performance continues to decline after the IPO year. The mean family ownership percentage is 26.87%, and the mean family ownership percentage is higher for small companies (28.07%) than for large companies (24.26%). Among the sectors, the consumer goods sector (n=70) registered the highest mean value of family ownership, with 30.14%, while the construction, real estate, and plantations sector (n=37) had the lowest mean value of family ownership, with 21.87%. The analysis revealed two different time periods for post-IPOS performance, namely one year before and one year after IPOS. The result shows that there is no significant result in explaining the relationship between family ownership and IPOs post-operating performance.

Keywords: Initial Public offerings, operating performance, and family ownership

JEL Classification: G3, G33
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1. INTRODUCTION

The new issues market is an important part of the capital market that allows companies to raise funds by issuing new shares or selling their existing shares. The strategic implications of the financing decision to offer new issues or initial public offerings (IPOs) have led many researchers to study this topic. There is a large amount of literature on understanding the pricing behaviour of these offerings, both for developed and developing markets. In general, the results of previous literature show that IPOs record substantial gains on the first day of trading and provide investors with excess returns in the short run.

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In emerging markets, ownership structure also plays a very important role in corporate finance (LaPorta et al., 1999). For example, Claessens, Djankov & Lang (2000) examine the ownership structure of East Asian firms and find that owners exercise considerable control over their firms. This situation suggests that managers and owners are often the same people. Moreover, the degree of information asymmetry within the market structure of emerging markets is relatively high. The higher degree of information asymmetry between managers and outside shareholders requires a greater alignment of managers' interests with shareholders' interests. Fama & Jensen (1983) point out that in an environment with a high degree of information asymmetry

The significant effect of ownership structure on firm value or performance is the reason for conducting this study. Mello and Parson (1998) find that ownership structure is one of the most important determinants of firm value and that large shareholders often play a monitoring role that increases the value of all shares. The Malaysian environment is particularly interesting because it has a notably high degree of ownership concentration (Leuz, 2003). Therefore, it is interesting to study the ownership structure in Malaysia because the ownership concentration or the largest shareholder may come from different categories, such as government, family ownership, foreigners, or institutional investors (i.e., mutual funds). Therefore, this study extends previous studies on the ownership structure of family firms by examining the effects of ownership and changes in the operating performance of listed firms.

2. LITERATURE REVIEW

2.1 Operational Performance

Balabat et al. (2004) examined the operating performance of Australian IPOs after listing. They examined the relationship between ownership structure and firm performance. They found that the operating returns of IPO firms appear to be relatively stable up to five years after the IPO. Operating returns are calculated using earnings before interest, which are then deflated by taxes and total assets. In addition, the study conducted a multivariate analysis to examine the effects of insider ownership and corporate governance attributes (board composition and leadership) on post-listing operating performance.

The dependent variable used is adjusted operating return, and the independent variables are operating return, share of shareholders, the share of outside directors, share of institutional investors, age of the company, share of retained interests, leverage ratio, and share of property, plant, and equipment in total assets. The results show that the share of shareholders is significant only in years four and five. Outside directors have no significant explanatory power, and institutional ownership is significant in years three and five. The debt ratio is significant from year two to year five, and the share of property, plant and equipment is significant in years one and two and also in years four and five.

Arik and Elif (2015) studied the operating performance of companies listed on the Istanbul Stock Exchange after their initial public offering (IPO). They found that, with the exception of cash flow from operations as a percentage of total assets, operating performance indicators decline after the IPO compared to the year before the IPO

Jain and Kini (2008) studied the impact of strategic investment decisions on post-IPO operating performance and survival of companies that went public in the United States. They focused on four key resource allocations for IPO firms' investment decisions -

product diversification, RandD spending, capital investment, and advertising spending. The study sample includes 3837 companies listed on the US market between 1980 and 1997. The method used to measure abnormal operating performance is to calculate the difference between the issuing firm's raw operating performance and the median operating performance of the firm's industry. The results of this study show the extent of diversification of the issuing company's products. In addition, the level and intensity of the industry's adjusted capital expenditures are generally positively related to the listed firms. For survival analysis, the results suggest that pre-issuance management commitment to R&D spending and the development of a diversified product line will improve the ability of listed companies to remain viable over long periods of time.

Jain and Kini (1994) also studied the operational performance of firms after the issue by examining the changes in operational performance. The sample of this study consists of 682 companies that went public during the period 1976 to 1988. Changes in the operating performance of these companies were measured relative to year -1 (one year before the IPO) and again three years after the IPO. Operating performance was measured by return on assets, cash flow/total assets, sales, asset turnover, and capital expenditures. The results show that the operating performance of the companies decreases after the IPO compared to the year before the IPO until five years after the IPO. The level of pre-IPO operating performance may lead investors to develop optimistic expectations about the growth of listed firms' earnings. Although there is an increase in sales and capital expenditures, the level of pre-IPO performance is not maintained, leading to a decline in expectations. Regarding ownership, the results show a positive relationship between management retention and post-IPO performance

Wang (2005) investigated the changes in the operating performance of Chinese IPOs, focusing on the effects of ownership in 747 Chinese companies listed between 1994 and 1999. Operating performance is measured by return on assets (ROA), operating income to assets (OI/A), and sales to assets (S/A). The results show a sharp decline in the operating performance of listed companies after the issue, as measured by the three variables. Based on the underpricing signalling model, this suggests that firms that go public undervalued are more likely to have better operating performance than firms that are not undervalued. Based on performance measured by ROA and OI/A, the results show that IPO firms whose underpricing is above the median do not outperform those whose underpricing is below the median. However, the measure of S/A performance showed a different direction, in which firms that experience greater underpricing are associated with a greater decline in performance. Legal entity ownership and concentration of nongovernmental owners were also found to be significantly associated with performance changes.

2.2 Family Ownership and Changes in Operating Performance

Ownership structure has been shown to have a significant impact on firm performance. An earlier study by Jensen & Meckling (1976) suggests that the separation of ownership and management control leads to agency costs, and, therefore the performance or value of a firm with insider ownership increases. However, Fama & Jensen (1983) examine the effects of insider ownership and provide evidence of a negative relationship between performance and insider ownership.

Several researchers have investigated the relationship between ownership and performance since ownership of companies usually changes significantly at the time they go public. They conclude that the proportion of shares retained by the original owners is an effective way to align incentives between managers and shareholders, leading to a positive relationship between insider ownership and performance.

Jain & Kini (1994) studied the operating performance of US companies with insider ownership, and their results suggest that operating performance declines after initial public offerings and that the decline is smaller for companies with a larger proportion of shares held by the original owners. Kim et al. (2004) find that changes in the operating performance of Thai IPOs are significantly related to the ownership of original owners.

Wang (2005) finds that the effect of ownership concentration on firm performance changes in Chinese IPOs and varies across different types of shareholders. Legal entity ownership and non-state ownership concentration are related to performance changes, while state and individual ownership do not play a role in IPO performance.

3. DATA AND METHODOLOGY

3.1 Data and Sample

The sample of this study includes all companies listed on Bursa Malaysia and covers the period from 2000 to 2016. These companies are listed in different sectors: trade and services, industrial products, construction, real estate, consumer goods and plantations. The data for ownership for the list of listed companies from 2000 to 2016 are obtained from the prospectuses of the listed companies. The data for operational performance after the IPO are taken from the data stream database.

The regression models are used to examine the impact of ownership on changes in operating performance. This modified regression model was adopted by Wang (2005) and Kim et al. (2004).

3.2 Method

This study analyses the changes in the operating performance of firms listed for initial public offerings. To study the change in operating performance over time, this study calculates the difference between the operating performances of each firm during the year before the IPOs (t= -1) to the year after IPOs (t=1).

$$CP = \alpha + \beta 1FMLY + \beta 2\,LN\,(A) + \beta 3LEV + \varepsilon$$

CP = The changes in the operating performance of firm i from
1) One year before to one year after listing

Change in operating performance is measured by EBIT/A,

FMLY= percentage of family ownership

This variable is measured based on the percentage of ownership held by family-related shareholders. The family members are categorised based on the following rules as stated by Bursa Malaysia.

In relation to a person means such person who falls within any one of the following categories:

(a) spouse;
(b) parent;
(c) child, including an adopted child and step-child;
(d) brother or sister; and
(e) spouse of the person referred to in sub-Rules (c)

4. RESULTS AND DISCUSSIONS

4.1 Median Operating Performance of All Samples

Table 1 shows the median operating performance, measured by EBIT/A and EBIT/S, for all 392 listed companies in the sample from three years before the IPO to three years after the IPO (t-3 to t+3). In the year of the IPO (t=0), the median EBIT/S is 16.08%, higher than the median EBIT/A of 13.66%. For both ratios, the general trend shows that operating performance before the IPO is better than in the year of the IPO and that performance continues to decline after the year of the IPO.

Table 1. Median operating performance for all samples (n=392)

	Year= -3	Year=-2	Year=-1	Year=0	Year=1	Year=2	Year=3
Ebit/A	0.1715	0.1868	0.1950	0.1366	0.1017	0.0813	0.0651
Ebit/S	0.1498	0.1669	0.1799	0.1608	0.1082	0.0934	0.0779

4.2 Descriptive Statistics on the Percentage of Family Ownership

Table 2 presents the descriptive statistics of the percentage of family ownership in the listed firms in the sample, broken down by all firms, large firms, small firms, and all five previously defined sectors. For all 392 companies in the sample, the mean percentage of family ownership is 26.87%, with a minimum of 0% and a maximum of 78%. The mean percentage of family ownership is higher for small companies (28.07%) than for large companies (24.26%). Among the sectors, the consumer goods sector (n=70) registers the highest percentage of family ownership (30.14%), while the construction, real estate, and plant sector (n=37) register the lowest percentage (21.87%).

Table 2. Descriptive statistics of Family Ownership Percentage

	All	Large	Small	CP	IP	Tech	TS	CR/PR/PT
Mean	26.8742	24.2580	28.0742	30.1474	28.9911	26.5480	23.9248	21.8684
Median	23.4050	17.0000	28.1200	34.9400	30.1600	19.5800	14.2650	15.0400
Maximum	78.0000	78.0000	73.7300	78.0000	79.1800	70.7200	71.1700	72.6100
Minimum	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Std. Dev.	24.5632	24.9604	25.5878	22.3809	24.3586	25.6587	25.1915	25.0868
Observations	392	117	117	70	121	70	94	37

4.3 Analysis of Family Ownership with Post IPOs Performance

Table 3 shows that the percentage of family members in Malaysian listed firms does not seem to affect firm performance after the IPO. The analysis revealed two different periods for post-IPOS performance, namely one year before and one year after the IPOS. The second period is the mean of three years before and after the IPO. The result showed that both periods did not provide significant results. This study is consistent with previous studies such as Shleifer & Vishny (1997), who stated that family shareholders often treat the company as if it were a family employment service or a private bank, and they may limit top management positions to family members rather than hiring qualified and capable professional managers (Carney, 1998). As a result, firms with large, undiversified owners, such as founding families, are more likely to underperform firms with a dispersed ownership structure (DeAngelo & DeAngelo, 2000).

Table 3. Family Ownership and Post IPOs Performance

Variable	Coefficient	t-Statistic	Prob.
Family ownership	-5.89E-05	-0.032708	0.9739
	0.005389	0.812039	0.4173

5. CONCLUSION

A number of previous studies have found that since ownership of companies usually changes significantly around the time of their IPO, the relationship between ownership and performance is not significant. They find that the proportion of shares retained by original owners is an effective way to align incentives between managers and shareholders, leading to a positive relationship between insider ownership and performance. However, this study found that there is no significant relationship between the percentage of share ownership and post-IPO performance in the Malaysian capital market. This result is consistent with the study of Fama & Jensen (1983), where they found the effect of insider ownership and documented a negative relationship between performance and insider ownership.

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