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**PRE-IPO CHARACTERISTICS AND POST-IPO OPERATING
PERFORMANCE IN MALAYSIA**54

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Abstract

The performance of Initial Public Offerings (IPO) has been investigated in numerous studies but little attention has been paid to shed more light on the factors that influence the success of these IPOs. This paper investigates the relation between pre-IPO characteristics and post-IPO operating performances. The objective of this study is to identify the determinants of post IPO operating performance. The pre-IPO factors include pre-IPO profitability, dilution of ownership, age and size of firm. The post-IPO operating performances include: return on asset, return on sales and asset turnover. Using newly public-listed companies on the Main Board of Bursa Malaysia from 2000 to 2004, findings confirmed that pre-IPO profitability and firm size are the key predictors of post-IPO performance. The results obtained provide useful information and caution for prospective investors in new issues.

Keywords: Pre-IPO Characteristics, post-IPO operating performance, Malaysia

Introduction

When a company lists its shares on the stock exchange for the first time through an Initial Public Offering (IPO), the general public has the opportunity to become shareholders of the company and share their risks and profits. Fund paid by investors for the newly-issued shares goes directly to the company. An IPO therefore allows a company to tap a wider pool of investors to provide a larger volume of capital for future growth. The company is never required to repay the capital, but instead new shareholders have a right to future profits distributed by the company. It is believed that these capital investments make shareholdings more valuable in absolute terms and once a company is listed, it will be able to further issue shares via rights or bonus issues, thereby providing it with capital for expansion without incurring additional debt. The ability to raise large amount of capital from the general market, rather than having to seek and negotiate with individual investors or financial institutions, is a key incentive for many companies seeking public listing.

There are several advantages to a company by listing in the stock exchange. Firstly, it is an effective way to gain confidence of investors because a company must meet the stringent regulations of an exchange prior to listing. It automatically gains credibility that projects confidence to investors. Secondly, public listed companies provide liquidity to their investors through an efficient valuation system which enable investors to dispose of their shares in the stock market at a market determined value at anytime. A listed company that is well managed and displays strong responsibility



towards its shareholders also has the potential to raise more funds from existing shareholders via rights issues or loan stocks. In addition, due to the publicity and recognition gained through market activities, listed companies are in a better position to expand their operations locally and globally as well as diversify their operations. Nevertheless, there are also disadvantages of going public where the profits made have to be shared with other shareholders. All shareholders are entitled to share profits and losses after an IPO. Besides, public companies must continuously file reports with the Securities Commission (SC) and the exchange where they are listed and comply with all securities laws and exchange guidelines. This process would result in higher overall costs and also information disclosed could provide advantages to competitors. In summary, firms go public in order to increase publicity, satisfy the desire to raise capital and to create a public equity market where shareholders can liquidate their wealth (Ritter and Welch, 2002). Investors on the other hand, are most concern whether IPOs present an opportunity for them to invest in high growth potential firms thereby acquiring higher return.

Table 1: Bursa Malaysia IPO Listing Statistics

Year	Main Board	Second Board	MESDAQ	Total
2007	15	8	3	26
2006	10	8	22	40
2005	16	17	46	79
2004	15	26	31	72
2003	16	22	20	58
2002	22	22	8	51
2001	6	14	-	20
2000	12	26	-	38
1999	10	11	-	21
1998	6	22	-	28
1997	25	63	-	88
1996	40	52	-	92
1995	18	33	-	51
1994	19	47	-	66
1993	12	32	-	44
1992	25	20	-	45
1991	21	18	-	39
1990	19	12	-	31
1989	11	2	-	13
1988	6	-	-	6
1987	5	-	-	5
1986	5	-	-	5
1985	4	-	-	4
1984	14	-	-	14
1983	10	-	-	10
1982	8	-	-	8
1981	5	-	-	5
1980	-	-	-	-
1979	5	-	-	5
1978	3	-	-	3
1977	4	-	-	4
1976	6	-	-	6
1975	4	-	-	4
1974	8	-	-	8



Most studies have focused on investigating the after-market and long-run stock performance of IPOs instead of examining the post IPO operating performances (Loughran and Ritter, 1995). Little attention has been paid to the study of pre-IPO factors that determine the post-IPO operating performances of companies (Lamba and Otchere, 2001). Moreover, performance of IPOs is not only sensitive to different measures and methodology but also different sample periods. It is believed that not all firms achieved superior operating performance after listing therefore it is vital to understand factors that can provide indication of higher potential return. This study therefore aims to investigate the relation between pre-IPO characteristics and post-IPO operating performances so as to assist investors in their investment decisions. In addition, investors would be able to better understand and evaluate the performances of newly listed firms. There have been less IPO activities in the early 2000 relative to the previous decade in Malaysia. Table 1 provides a summary of the all the IPO activities on Bursa Malaysia from 1974-2007. This research attempts to examine the significant relationship between post-IPO operating performance and pre-IPO factors of age of firm, size of firm, dilution of ownership and pre-IPO profitability. This study includes only IPOs on the Main Board of Bursa Malaysia from 2000 to 2004. A total of seventy-one companies were newly listed during this period. Data series from 1998 to 2007 are collected in order to compile the 3-year pre-listing and 3-year post listing average performance.

Financial information of these companies is collected from DataStream, Bursa Malaysia and individual companies' annual reports. In order to determine the impact, average three-year pre-IPO (-3, -2 and -1) and three-year post-IPO (0, 1 and 2) operating performances are computed. The age of firm is measured from the date of incorporation of the firm to the date of IPO; the company size is measured by the net assets of the company in the year before listing; the percentage of equity issued for the dilution of ownership at the year of offering provide the extent of original shareholders' ownership dilution due to the offering; and lastly, the pre-IPO profitability of the firm is computed by the 3-year average operating income to total asset ratio. The 3 years post-IPO operating performance is measured by: operating return on assets (ROA), return on sale (ROS) and assets turnover (ATO). A list of all the companies included in the study is in Appendix A.

Literature on IPO Performance

Various theoretical deductions have been made to shed light on post-IPO performances of firms. The majority of them stems from the inherent conflict of interest between original owners and new shareholders reflected in higher agency costs, size and age of firms, and timing of the issue during bull or bear periods. There are also numerous theories on the underpricing of IPOs which concentrates on information asymmetry (Ritter, 1991). This study concentrates on the three most common issues of size, age of firms and ownership structure. Ahmad and Lim (2001) examined the relationship between post-IPO operating performance and pre-IPO factors of 162 IPOs from various industries and their results indicated that age of firm; multi-nationality and dilution of ownership were not significant in determining the post-IPO operating performance. Size of firm has significant negative relationship on post-IPO operating performance



when ROA and ATO are used as measures of operating performance. They also found that there is significant negative relationship between pre-IPO firms' profitability and post-IPO operating performance when measured by ROA and ROS. Khurshed, Mudambi and Goergen (1999) proposed that the long-run performance of IPOs is a function of pre-IPO factors, including managerial decisions and the firm's performance prior to going public. Using U.K. data set, they found that the percentage of equity issued and the degree of multi-nationality are key predictors of IPO performance. Long-run performance is also positively related to the degree of multi-nationality of a firm. They also found negative relation between profitability before flotation and long-run performance. In addition, they concluded that the larger the size of the firm the better the long-run performance. Similarly, Chi and Padgett (2006) also found that pre-IPO profitability is positively related to post-IPO performance.

Age, Size and Ownership

David (2002) found statistically significant positive relationship between age of the firm at IPO and aftermarket performance. He observed that the age-return relationship is different for technology and non-technology companies, where the former shows negative relation while the latter shows positive relationship. Carpenter and Rondi (2003) used large longitudinal datasets to compare the behaviour of U.S. and Italian firms. They found that Italian IPOs are larger in size than U.S., but they raise fewer funds from the IPO and the fund grows slower. Employment growth is also much smaller for Italian firms' post-IPO. Italian firms going public in the 1990s display features that are more similar to US IPOs than in the 1980s. They describe changes to the Italian economy and financial markets being responsible for the change. Grouping IPOs by size, they found that small firms going public appear to achieve faster growth rate. This is similar to Chi and Padgett (2006) whose analysis confirmed that smaller firms enjoy higher IPO returns. Ahmad and Lim (2001) used net assets as a measure for size of firm and it is found to be negatively related to return on asset (ROA) and asset turnover (ATO). Their result showed that the larger the firm, the lower the post operating performance. This result is consistent with Wu (1993) who examined the long-term price performance of 70 IPOs listed in Malaysia from 1974 to 1989 and found that small companies tend to outperform big companies in both short and long-term. This is contrary to Khurshed, Mudambi and Goergen (1999) who found positive relation between size of a firm and its long-run performances.

Wang, Xu and Zhu (2001) explored the effects of public listing in China and found that public listing as a means to reform state-owned enterprises (SOEs) have not worked well: company performances in the post-listing years are sharply lower than their levels in both the pre-listing and initial public offering years. They used a panel data set that contains both pre- and post listing financial and ownership information on publicly listed firms in Shanghai and Shenzhen Stock Exchanges. The effects of public listing on performances are not significantly affected by the percentage of state shares or total shares held by top shareholders, but are positively correlated with a more balanced ownership structure among these shareholders. Jain and Kini (1994) investigated the relation between long-run performance and ownership and found significant positive relation between post-IPO operating performance and equity



retention by the original shareholders. Khurshed, Mudambi and Goergen (1999) found that the higher the proportion of equity sold at the time of offering (the higher the dilution of original shareholdings) the worse is the long-run performance. The result is also stronger for large firms. Huang and Song (2002) found that company performance deteriorates after going public due to: principal-agent problem and earnings management. The conflict between managers and shareholders increases agency cost because principal entrepreneurs' ownership decline and becomes more dispersed after IPOs. These companies may even have overstated their profit before listing. Although there are some benefits of listing, overall effect of IPOs on company performance is negative. Mikkelson, Partch and Shah (1997) also found that in general, the long-run performance both within one year of offering and during the first ten years of public trading is unrelated to the ownership structure. This is consistent with Ahmad and Lim (2001) where they found no significant relationship between dilution of ownership and post-IPO operating performance.

Pre-IPO profitability

Khurshed, Mudambi and Goergen (1999) found negative relationship between the profitability of a firm prior to going public and its long-run performance especially for large firms. The more profitable a firm is prior to going public the worse is its long-run performance. Firms generally go public at the height of their performance thus seizing the window of opportunity. Companies which made profit in the last three years prior to listing showed underperformance after listing compared to firms that were running losses before listing. Companies with pre-IPO net liabilities performed worse than companies with pre-IPO net assets and companies with large turnover in the year before listing perform better than smaller turnover company. Consistently, Mikkelson, Partch and Shah (1997) found that there were reversals in operating performance pre- and post-IPOs, whereby firms failed to sustain pre-listing level of profitability. Teoh, Wong and Rao (1994) investigated earnings management related to firm performance and found significant negative association between abnormal accruals during the year of offer and stock returns over a three-year post-IPO period. These are inconsistent with Ahmad and Lim (2001) where they found that two out of its three operating performance proxies, ROA and ROS have shown significant positive relationship with pre-IPO firm's profitability. This positive relation between pre-IPO firm profitability and post-IPO operating performance may imply that earnings management was not practised by their sample firms before listing. This inconsistency is supported by Bhabra and Pettway (2003) who examined 242 IPOs in Canada from 1987 to 1991 and documented that firms with a history of profitable operations are expected to have lower levels of uncertainty and risk compared to those firm with negative earnings.

Data and Methodology

The financial data from the newly listed companies are collected from DataStream, Bursa Malaysia as well as individual company's financial reports from 1998-2007. The set of variables investigated and their respective proxies which are the ratios used in the analyses are listed in Table 2. This study hypothesize that there should be positive relation between pre-IPO profitability, age, size of firms and post-IPO performance.



The firms are expected to perform as well or better after listing. Investors also expect those firms with longer historical background and are more established to perform better than smaller, newer firms. Multiple least square analyses on this set of cross-sectional data are used to assess the overall impact of the pre-IPO factors (age of firm, size of firm, ownership dilution and pre-IPO profitability) on post-IPO operating performances (ROA, ROS, ATO). Analyses are based on a number of crucial assumptions where the error term is normally distributed, has zero expected mean and has constant variance in each time period. All values of independent variables in one period of time is unrelated to its value in any other period. Out of the total seventy-one companies that were listed during the study period, only thirty-eight companies are included in the tests due to data unavailability of some of these companies.

Table 2: List of Variables and Measurement

Variable	Measurement
Return on Asset (ROA)	Net Income / Total Assets
Return on Sales (ROS)	Operating Income / Net Sales
Asset Turnover (ATO)	Net Sales / Total Assets
Pre-IPO Profitability	Operating income / Total Assets
Dilution of Ownership	Shareholder Equity / Total Assets
Size of Firm	Log of Net Assets
Age of Firm	Log of Date of Incorporation in Malaysia to Date of IPO

In summary, the analysis on the pre-IPO determinants of the post-IPO performances are carried out by estimating the three models as follows:

Model 1: Post-IPO Performance of ROA

$$ROA = a_0 + a_1Age + a_2Size + a_3Dilution\ of\ Ownership + a_4PreIPO\ Profitability + \varepsilon_1$$

Model 2: Post-IPO Performance of ROS

$$ROS = b_0 + b_1Age + b_2Size + b_3Dilution\ of\ Ownership + b_4PreIPO\ Profitability + \varepsilon_2$$

Model 3: Post-IPO Performance of ATO

$$ATO = c_0 + c_1Age + c_2Size + c_3Dilution\ of\ Ownership + c_4PreIPO\ Profitability + \varepsilon_3$$

Descriptive Statistics, Correlation and Unit Root Tests

Table 3 reports the descriptive statistics for each of the variable utilized in the study. The minimum column represents the minimum range of number while maximum column represents the maximum range of number. The minimum range for ROA is -30.12% and the maximum is 25.35%. On the other hand, the mean column describes as an average value while the standard deviation column describes as the variability of the value. We compare the mean with standard deviation to determine high and low level of dispersion. The mean for dilution of ownership is 60.9 and the standard deviation is 20.6. Dilution of ownership has the highest and widest range between both mean and standard deviation relative to the others. Multicollinearity refers to the correlation among independent variables, which reduces any single independent variable's predictive power by the extent to which it is associated with another independent variable. It can be detected using Variance Inflation Factor (VIF), an estimator of the



extent of inflation of this problem as explained by Hair *et al.* (1998). Variables with larger VIF values or low tolerance level can thus be excluded by reference to the VIF. Alternatively highly collinear variables may be grouped together by some form of transformation of the affected series. Correlations of the variables are also investigated and results for the analysis are presented in Table 4. There is no significant correlation between Pre-IPO factors and ROA but age is significantly correlated with ROS while size is significantly correlated to ATO. Unit root tests on the variables according to Table 5 show that the series are stationary and further tests can be carried out.

Table 3: Descriptive Statistics

Variable	Mean	Std Dev	Minimum	Maximum
ROA	0.064224	0.0797518	-0.3012	0.2535
ROS	0.176190	0.2073641	-0.1150	1.1701
ATO	0.764245	0.3981265	0.1025	1.8404
Pre-IPO Profitability	0.143529	0.3456954	-1.8637	0.7365
Dilution of Ownership	60.900460	20.601292	-22.0058	94.1004
Age	2.168536	0.5065478	1.3863	3.4965
Size	4.466168	1.7064838	0.9555	8.7164

Table 4: Correlation Analyses

Variables	ROA	ROS	ATO	Pre-IPO Profit	Dilution of Ownership	Size	Age
ROA	1	0.345*	0.302	0.094	-0.083	-0.196	-0.080
ROS	0.345*	1	-0.305*	0.136	0.098	0.201	0.333*
ATO	0.302	-0.305*	1	0.155	-0.081	-0.504**	0.176
Pre-IPO Profitability	0.094	0.136	0.155	1	0.534**	-0.248	-0.050
Dilution of Ownership	-0.083	0.098	-0.081	0.534**	1	0.053	-0.084
Size	-0.196	0.201	-0.504**	-0.248	0.053	1	-0.148
Age	-0.080	-0.333*	0.176	-0.050	-0.084	-0.148	1

Note: Correlation is significant at the 0.05 level* and 0.01 level**.

Table 5: Unit Root Tests

Variables	ADF Test		KPSS Test
	t-stats	Model (lag)	KPSS statistic
ROA	-6.23***	C(0)	0.14
ROS	-7.27***	C(0)	0.24
ATO	-6.20***	C(0)	0.10
PREIPO	-5.76***	C(0)	0.16
DO	-5.45***	C(1)	0.14
LNSIZEN	-1.89	C(9)	0.17
LNAGE	-7.26***	C(0)	0.12

Note : Significant at 10% significance level *, 5% significance level **, 1% significance level ***



Findings for Post-IPO Performances

The results for the three models for the determinants of pre-IPO factors on post-IPO performances are shown in Table 6. Similar to Ahmad and Lim (2001), there is significant positive relationship between pre-IPO profitability and post-IPO performances when return on asset is used as the measure for post-IPO performance in this study. This model can explain approximately 12 percent of the changes in post-IPO performance with the overall model being significant according to the F-statistics. There is also a negative relation between age and size of the firm with post-IPO performance but it is not statistically significant. In Model 2 with return on sales (ROS) as the measure for post-IPO performance, age of the firm is found to be marginally significant in determining the post-IPO performance but the other variables are not found to be significant in the model. There is negative relation between age and return on sales. However, the adjusted R-squared is only 0.06 and the F-statistics indicates that the overall model is not significant. Using asset turnover (ATO) as the post-IPO performance indicator in Model 3, it is found that size of firm before listing is negatively significant in determining post-IPO performance. Comparable results are confirmed by Chi and Padgett (2006), Ahmad and Lim (2001) and Wu (1993). The other variables are found not to be significant in affecting post-IPO performance. The model can explain about 27 percent of changes in post-IPO profitability with the overall model being significant. The variance inflation factor (VIF) for all variables in these models are all below 2 indicating that there is no multicollinearity problem. It is also interesting to note that dilution of ownership is not found to be significant in affecting post-IPO performances in all the models investigated.

Table 6: Pre-IPO Characteristics and Post-IPO Performances

Variables	Model 1: ROA	Model 2: ROS	Model 3: ATO
Pre-IPO Profitability	0.153 (0.053)*	0.168 (0.583)	-0.439 (0.377)
Dilution of Ownership	0.001 (0.238)	-0.001 (0.861)	-0.006 (0.120)
Age	-0.001 (0.954)	-0.127 (0.094)*	-0.038 (0.751)
Size	-0.005 (0.587)	0.038 (0.268)	-0.193 (0.001)***
Adjusted R-Squared	0.122	0.061	0.268
F-significance	0.081	0.196	0.006

Note: P-value in parentheses and significant at 10% level*, significant at 5% level** and significant at 1% level***.

Conclusion and Recommendation

Does investing in IPOs provide an opportunity to invest in forward-looking firms with potential for high growth? Many studies have investigated short and long-run price performance of firms after they have been listed. Relatively fewer studies have examined the factors that determine operating performance after they went public. Using a sample of thirty-eight firms that were listed on the Main Board of Bursa Malaysia between 2000-2004 with return data from 1998-2007, this study significant relationship between pre-IPO profitability and ROA as an indicator of operating



performance. Secondly, the size of a firm is statistically significant when ATO is used as an indicator of the operating performance. This is consistent with a previous study by Ahmad and Lim (2001) where they found that the two variables are also significant in determining post-IPO operating performance. On the other hand, Khursed, Mudambi and Goergen (1999) have found that dilution of ownership is also significant in affecting post-IPO operating performance besides pre-IPO profitability and firm size. This may be due to the data set they have used from the U.K. Booth and Chua (1996) found that the level of insider and institutional shareholders do not affect the performance of firms. This is consistent with the result of this study where dilution of ownership is not significant in affecting operating performance as measured by ROA, ROS, and ATO. This study did not find any significant relation between the age of firms and ROA and ATO. This is consistent with Ahmad and Lim (2001) where they also found that age of firm is not significant in affecting operating performance. However, this result differs with Schultz (1993) who found that older firm perform better after IPO. In summary, this study provides significant implications that pre-IPO profitability is positively related to post-IPO performance and investors should be wary of the performance of a Malaysian firm before going public as a portfolio selection criterion. In addition, smaller size Malaysian firms tend to perform better after IPO relative to larger firms and older established firms may not perform better than newer unknown firms after IPO in Malaysia. Findings would be more complete if more factors are included as variables in determining post-IPO performance. Some of these factors include managerial decision, investor demand (Agarwal, Liu and Rhee, 2008) and multi-nationality of a firm. The lack of data availability disabled other factors to be incorporated into the models. In addition, other operating performance proxies can also be included. More precise results should also be found if a larger sample is included.

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Appendix A

Table A: List of Companies Listed on Bursa Malaysian from 2000 – 2004

	COMPANY	YEAR IPO ISSUED	SECTOR/INDUSTRY
1	QL RESOURCES BHD	2000	CONSUMER PRODUCTS
2	POH HUAT RESOURCES HOLDINGS BHD	2000	CONSUMER PRODUCTS
3	LII HEN INDUSTRIES BHD	2000	CONSUMER PRODUCTS
4	APEX HEALTHCARE BHD	2000	CONSUMER PRODUCTS
5	UCHI TECHNOLOGIES BHD	2000	INDUSTRIAL PRODUCTS
6	SUPERMAX CORPORATION BHD	2000	INDUSTRIAL PRODUCTS
7	GLOMAC BHD	2000	PROPERTIES
8	TIME DOT COM BHD	2001	IPC
9	BINTULU PORT HOLDINGS BHD	2001	TRADING/SERVICES
10	DEGEM BHD	2001	CONSUMER PRODUCTS
11	EDARAN DIGITAL SYSTEM BHD	2001	TRADING/SERVICES
12	PJI HOLDINGS BHD	2001	TRADING/SERVICES
13	PRICEWORTH WOOD PRODUCTS BHD	2001	INDUSTRIAL PRODUCTS
14	TSR CAPITAL BHD	2002	CONSTRUCTIONS
15	PBA HOLDINGS	2002	TRADING/SERVICES
16	MALTON BHD	2002	PROPERTIES
17	BANENG HOLDINGS BHD	2002	CONSUMER PRODUCTS
18	MAXIS COMMUNICATIONS BHD	2002	TRADING/SERVICES
19	ATIS CORPORATIONS BHD	2002	TRADING/SERVICES
20	BINAIK EQUITY BHD	2002	PROPERTIES
21	ORNAPAPER BHD	2002	INDUSTRIAL PRODUCTS
22	HIAP TECH VENTURE BHD	2003	INDUSTRIAL PRODUCTS
23	NAIM CENDERA HOLDINGS BHD	2003	PROPERTIES
24	LUSTER INDUSTRIES BHD	2003	INDUSTRIAL PRODUCTS
25	DXN HOLDINGS BHD	2003	CONSUMER PRODUCTS
	POH KONG HOLDINGS BHD	2004	CONSUMER PRODUCTS
26			
27	ESTHETICS INTERNATIONAL GROUP BHD	2004	TRADING/SERVICES
28	CYMAO HOLDINGS BHD	2004	INDUSTRIAL PRODUCTS
29	SEAL POLYMER INDUSTRIES BHD	2004	INDUSTRIAL PRODUCTS
30	APB RESOURCES BHD	2004	INDUSTRIAL PRODUCTS
31	MUDAJAYA GROUP BHD	2004	CONSTRUCTION
32	DK LEATHER CORPORATIONS BHD	2004	INDUSTRIAL PRODUCTS
33	IBRACO BHD	2004	PROPERTIES
34	MYCRON STEEL BHD	2004	INDUSTRIAL PRODUCTS
35	KLCC PROPERTY HOLDINGS BHD	2004	PROPERTIES
36	SIN CHEW MEDIA CORPORATIONS BHD	2004	TRADING/SERVICES
37	LCTH CORPORATIONS BHD	2004	INDUSTRIAL PRODUCTS
38	EKOWOOD INTERNATIONAL BHD	2004	CONSUMER PRODUCTS

