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Influence of Corporate Governance on Post-IPO Performance Across Diverse Firms

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INTRODUCTION

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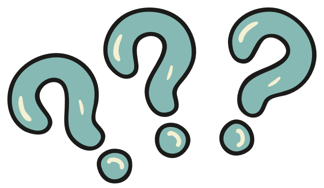
- Corporate governance refers to the systems and processes by which companies are directed and controlled, playing a crucial role in a firm's health and long-term success.
- Effective governance is particularly significant for firms post-IPO, as it helps in stabilizing the company during its transition into public ownership and ensures accountability and transparency to new shareholders.
- This study is timely and relevant given the growing trends of IPOs in emerging markets, particularly in India, where market dynamics are rapidly evolving.

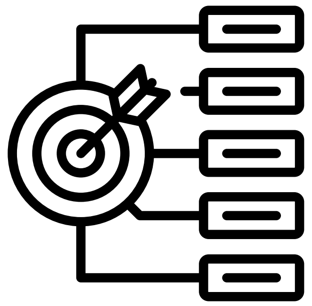
KEY QUESTIONS ADDRESSED

- How do different elements of corporate governance affect the performance of firms after their Initial Public Offering (IPO)?
- What relationships exist between corporate governance structures like founder’s retained ownership, board diversity, and post-IPO firm performance?



OBJECTIVES OF THE RESEARCH

- The primary aim of this thesis is to dissect the impact of various corporate governance mechanisms on the performance of firms after they go public. This includes examining aspects such as the independence of board members, the roles of audit committees, and the influence of founder-CEO duality.



REVIEW OF LITERATURE

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Hermalin and Weisbach (1991) which examine the effects of board composition on firm performance, suggesting mixed results regarding the impact of outside directors on financial outcomes.

Brickley et al. (1994) find a positive relation between the proportion of outside directors and the stock market reaction to poison pill adoptions. I

Baysinger and Butler (1985), which show that market rewards firms for appointing outside directors.

Agrawal and Vyas (2020) address the significant gap in studies concerning the Indian market by evaluating the impacts of board characteristics and ownership structures on long-term market performance of IPOs. Their findings suggest that smaller board sizes and greater independence are linked with improved performance outcomes

Chatterjee et al. (2024) investigates the influence of corporate governance structures on the post-IPO performance of Research and Development-intensive newly public firms, , highlighting that while retained ownership by promoters positively impacts firm performance, their involvement in management could have adverse effects.

Research Gaps

- Significant gap concerning long-term studies of post-IPO performance linked to various governance factors in emerging markets like India.
- The need for advanced methodological approaches to handle endogeneity issues, which this study addresses using the GMM model.

CORPORATE GOVERNANCE CONNECTIDNESS

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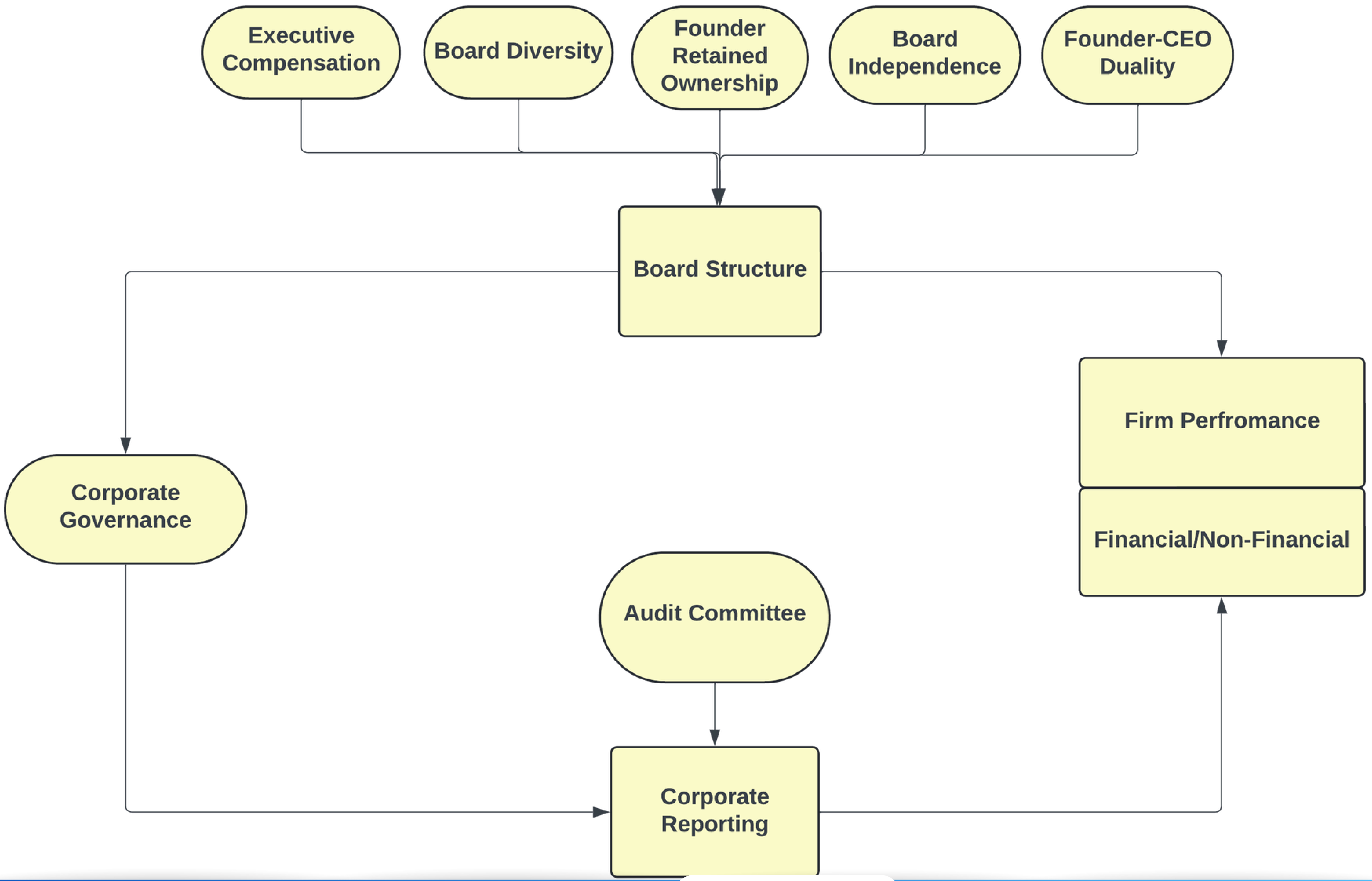

DATA COLLECTION

- **Six years** of post-IPO trading data for firms that went public between **April 2015** and **March 2017**.
- Initially collected data from **86** newly public firms but note that firms with incomplete data over the subsequent five years were excluded to maintain the integrity of the analysis
- A final sample of **25** newly public firms was established, forming a longitudinal panel dataset consisting of **125** firm-year observations.

- **Primary Sources of Data:** Prowess CMIE database, Chittorgarh Portal, BSE and NSE websites, IPO prospectus from the SEBI website, company websites, Annual reports, and Exchange filings.

RESEARCH METHODOLOGY

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DEPENDENT VARIABLE

- **Financial Performance**: Assessed through Return on Equity (**ROE**), measuring profitability relative to shareholders' equity.
- **Market Performance:** Evaluated using the Annual Percentage Return (**AAPR**) on stock, indicating the variation in stock price over time.

INDEPENDENT VARIABLE

- **Founder's Retained Ownership**: Impact of founders retaining ownership post-IPO.
- **Founder-CEO Duality**: Influence of a founder also serving as CEO.
- **Board Independence**: Role of independent and diverse board compositions.
- **Audit Committee Independence:** Significance of an autonomous audit committee.
- **Institutional Ownership:** Effect of shares held by institutional investors.
- **Executive Compensation**: Connection between compensation structures and firm performance.
- **Board Diversity:** Percentage of female members on the board.

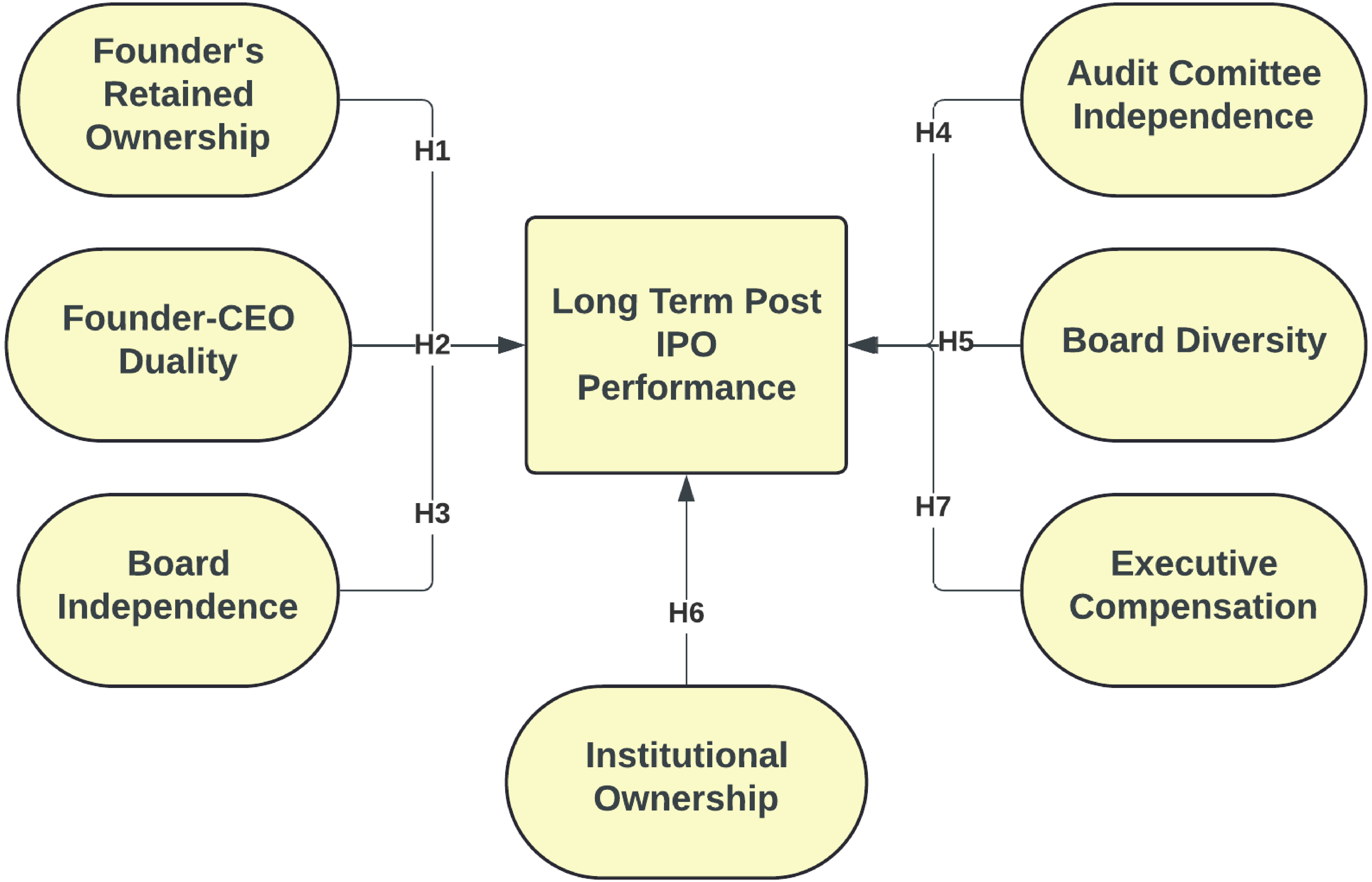
CONTROL VARIABLE

- **Firm Size**: Logarithm of total assets.
- **Firm Age:** Years since establishment.
- **Firm Leverage:** Debt-to-equity ratio.

METHODOLOGICAL APPROACH

- Use of the **SYSTEM GMM estimator** to handle data peculiarities such as serial correlation, stationarity, and multicollinearity, ensuring robust estimation.
- **Sargan-Hansen J test**: For over-identification restrictions.
- **Arellano-Bond tests**: For autocorrelation checks.

RESEARCH METHODOLOGY



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DESCRIPTIVE STATISTICS

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Dependent variable	Variable name	Construct
Operating performance	ROE	Return On Equity
Market performance	AAPR	Average Annual Percentage Returns
Independent Variable	**Variable name**	**Construct**
Founder's retained ownership	FOUNDER_OWNRSH	Percentage of founder's shareholding
Founder-CEO duality	FOUNDER_CEO	If the duality is present, the dummy code is 1, otherwise it is 0.
Board independence	BOARD_IND	Ratio of number independent members to total number of members in the board
Audit Committee Independence	AUDIT_IND	If there are no relatives or family members of the promoter group on the audit committee, the dummy code is 1, and if there are, it is 0.
Board Diversity	BOARD_DIVERSITY	Percentage of female members on the board
Institutional Ownership	INSTI_OWNRSH	Percentage of a company's stock held by institutional investors
Executive Compensation	EXECUTIVE_COMP	Dummy coding of 1 if compensation is stock-based, 0 otherwise
Control Variable	**Variable name**	**Construct**
Firm age	AGE	Firm age; adjusted based on year of establishment
Firm size	SIZE	Firm size as log value of total assets
Firm leverage	LEVERAGE	Debt to equity ratio

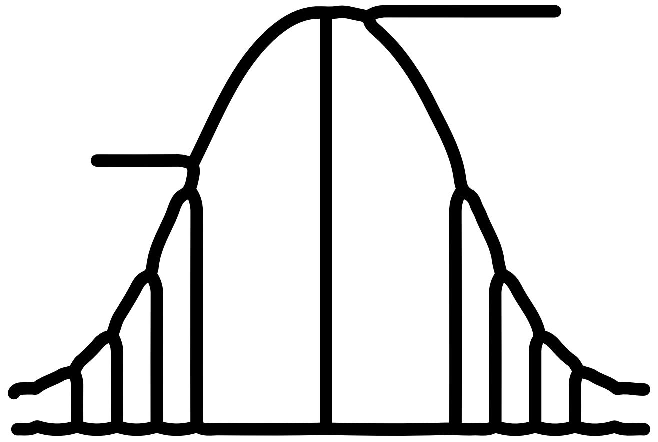
Table 2.2: Details of variables.

Variable name	Mean	Median	Min	Max	Std Deviation	Skewness	Kurtosis
ROE	0.169	0.18	-0.05	0.35	0.054	0.94	3.32
AAPR	0.183	0.14	-0.081	0.331	0.87	0.67	6.78
FOUNDER_OWNRSH	0.412	0.46	0.056	0.898	0.2614	-0.35	2.89
BOARD_IND	0.42	0.30	0.00	0.60	0.13	0.15	3.71
AUDIT_IND	0.53	0.50	0	1	0.13	-0.27	2.36
BOARD_DIVERSITY	0.45	0	0	1	0.51	-0.27	-2.65
INSTI_OWNRSH	0.53	0.50	0.0007	0.92	0.13	-0.27	2.36
EXECUTIVE_COMP	0.556	1	0	1	0.496	-0.11	-3.71
AGE	21.34	16.000	4.000	35.00	12.21	3.23	8.18
SIZE	2.89	3.78	1.85	5.66	0.78	-1.42	1.78
LEVERAGE	21.01	9.87	0.27	204.48	21.22	3.21	24.87

Table 2.3: Descriptive Statistics

GMM MODEL

- The study addresses endogeneity concerns by employing a lagged dependent variable in the estimation model, a common approach recommended in corporate governance scholarship Filatotchev and Wright (2017)
- GMM model to ensure robust handling of potential endogeneity issues and provide reliable estimates
- The dynamic panel model is estimated using the SYSTEM GMM estimator developed by Arellano and Bover (1995) and Blundell and Bond (1998), ensuring robustness to serial correlation, stationarity, and multicollinearity
- Lagged values of dependent variables are incorporated to address dynamic aspects of firm performance
- Validity of the system GMM estimator is assessed through diagnostic tests such as the Sargan–Hansen J test for over-identified restrictions and the Arellano-Bond test for second-order serial correlation in the first-differenced residual



$$\begin{aligned} ROE_{it} = \beta_0 + \delta ROE_{it-1} + INDEPENDENT\_VARIABLE_{it}\beta_1 \\ + INTERACTION\_TERM_{it}\beta_2 + CONTROL\_VARIABLE_{it}\beta_3 + \varepsilon_{it} \end{aligned} \tag{3.1}$$

$$\begin{aligned} AAPR_{it} = \beta_0 + \delta AAPR_{it-1} + INDEPENDENT\_VARIABLE_{it}\beta_1 \\ + INTERACTION\_TERM_{it}\beta_2 + CONTROL\_VARIABLE_{it}\beta_3 + \varepsilon_{it} \end{aligned}$$

GMM RESULTS

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Variable	ROE (Model 1)	AAPR (Model 2)
Lagged ROE	0.221 (0.182)	-
Lagged AAPR	-	0.323 (0.068)
FOUNDER_OWNRSH	0.0003 (0.00017)	0.002 (0.0018)
BOARD_IND	0.001 (0.003)	0.345 (0.023)
AUDIT_IND	0.0007 (0.0002)	0.009 (0.0018)
BOARD_DIVERSITY	0.06 (0.008)	0.085 (0.005)
INSTL_OWNRSH	0.115 (0.09)	0.215 (0.043)

Variable	ROE (Model 1)	AAPR (Model 2)
EXECUTIVE_COMP	0.095 (0.008)	0.071 (0.003)
FOUNDER_CEO	-0.093 (0.008)	-1.25 (0.160)
AGE	0.001 (0.00009)	-0.004 (0.0026)
SIZE	0.028 (0.006)	0.235 (0.102)
LEVERAGE	0.0002 (0.0001)	-0.009 (0.0019)
Year Dummy	YES	YES
AB AR (1) test p value	0.0014	0.0032
AB AR (2) test p value	0.21	0.267
Sargan Hansen p value	0.387	0.291

RESULTS AND CONCLUSION

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RESULTS FOR DIFFERENT INDEPENDENT VARIABLES

Founder’s Retained Ownership

Firms where founders retain a significant ownership stake exhibit positive long-term performance. This suggests that founder involvement could contribute beneficially to the strategic direction and continuity of the firm.

Founder-CEO Duality

Founder-CEO duality positively impacts the post IPO performance of newly public firms was not supported. Roles of CEO and chairman might be more effective when held by different individuals in newly public firms.

Board Independence

Independence of the board positively correlates with firm performance, underscoring the role of independent directors in enhancing governance by mitigating conflicts of interest and improving oversight.

Audit Committee Independence

COMMITTEE

Interestingly, the presence of an audit committee did not show a significant impact on post-IPO performance, indicating that while audit committees are essential for compliance and oversight, their role might not directly translate into performance outcomes.

Board Diversity

Board diversity was positively correlated with improved firm performance and a risk-averse approach. This reveals that diverse boards contribute effectively to decision-making and risk assessment, supporting diversity initiatives as a strategic business advantage

Institutional Ownership

Institutional ownership was found to enhance firm performance, highlighting the stabilizing influence of institutional investors which likely leads to better management practices and strategic decisions

Executive Compensation

Executive compensation has a positive on firm performance, reinforcing the notion that well-structured compensation packages that align executives’ interests with those of shareholders can drive performance, emphasizing the need for carefully designed compensation strategies to ensure long-term value creation.

FUTURE IMPROVEMENTS

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During the COVID-19 pandemic, assessing firms' governance and its impact on performance was crucial. The crisis required rapid adaptation from governance bodies, highlighting the effectiveness of governance practices in maintaining firm viability.

Comparing firms across industries reveals how governance practices depend on industry type, offering insights into sector-specific challenges and priorities.

Adding more firms and variables can improve results by offering a broader and more detailed understanding of corporate governance. Revealing previously unnoticed patterns and trends in governance effectiveness.

The Corporate Governance Index (CGI) quantitatively measures a firm's effective governance by selecting relevant variables and assigning weights to them. This enables systematic and quantitative evaluation of governance.

ESG scores serve as indicators of a firm's commitment to sustainable practices and responsible management. Firms with more sustainable practices are expected to outperform others in the long run due to several factors

Thank You!

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