

# EFFECT OF FOUNDER OWNERSHIP ON INITIAL RETURNS: EVIDENCE FROM INDIAN IPOs

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## ABSTRACT

*IPO under pricing has been a challenging area of IPO research which has generated explanations from various theories and underlying principles. Signaling has been advocated as an important explanation to under pricing whereby issuers communicate their credibility to potential investors using a variety of tools. The study explores the relationship between the founder-promoter ownership in the firms at the time when they go public with the IPO's initial returns. It investigates ownership as a signal in Indian firms which are characterized by concentrated patterns of ownership in the hands of founding families. Analyzing 379 IPOs issued between the years 2002-2012, the study confirms the credibility of retained ownership as a signal which does garner attention of investing public in arriving at an investment decision.*

**Keywords:** Underpricing, Initial Public Offering, Signaling, Promoter Ownership, India

## 1. Introduction

An IPO is the first and one of the most important strategic actions by a public firm, and has significant effects on the firm's governance and structure in return for the large infusion of cash (Bruton *et al.*, 2010; Nelson, 2003). Under pricing of initial public offerings (IPOs) has been confirmed by researchers in different countries and empirically established to be existent in varying degrees. Factors influencing this under pricing of IPOs have been an interesting area for researchers (e.g. Bruton *et al.*, 2010; Chahine *et al.*, 2012; Poulsen, 2013). A substantial body of literature investigates the theoretical and empirical underpinnings of the consistent short-run under pricing of IPOs drawing explanations from myriad theories. One of the convincing explanations to this under pricing anomaly comes from the signaling hypothesis wherein issuing firm send signals to these investors to indicate firm quality and to enhance the acceptability of its issue, thereby improving IPO performance. These signals are expected to give positive indications to investing public and induce them to participate in the investing process. Vast variety of signals have been adopted by issuing firms to communicate company's potential and credibility to potential investors in order to garner support for the issue. Amongst these, retained ownership by the insiders has also been identified as one of the signals adopted by high quality firms to communicate their potential and credibility to investing public.



An initial public offering produces considerable consequences on a firm's ownership structure, control and management. At the time of IPO, the ownership structure faces important changes in terms of concentration and identity of main shareholders which in turn may implement significant changes in terms of management and control. These important changes in firm ownership during an IPO also generate considerable interest among IPO researchers. Ownership structure plays a very eminent role in economies, more so in case of developing and emerging economies. Characterized by significant control of owners in the firms they own and promote, underdeveloped market structure leads to high degrees of information asymmetry. This information asymmetry results in influential owners and managers resulting in operationalization of managerial alignment and entrenchment effects. On one hand, the existence of significant managerial ownership mitigates agency costs (Jensen and Meckling, 1976) where a higher degree of information asymmetry between managers and outside shareholders in an emerging market results in a greater alignment of managerial interests with shareholder interests. On the other hand, in a market with high information asymmetry, it may be easier for entrenched manager-owners to expropriate wealth from outside shareholders.

Hence, an important but understudied issue is the association of IPO under pricing with insider ownership in emerging markets like India. Promoter ownership is an essential ingredient of corporate governance which has hogged ample limelight in the scam driven scenario prevalent in India. Indian markets also present an interesting area of study being established as markets where ownership structure is highly concentrated in the hands of family members and their relatives. When much fortune is concentrated in the hand of so few people, it definitely has implications on decision making exercise and draws immediate attention. As Indian stock market is expanding in terms of volume of trading and market capitalization, these questions need to be addressed. Therefore, it is imperative to study the implications of founder ownership on IPO and its returns as this relationship is expected to have wide implications for all concerned.

## 2. Theoretical Framework

The ownership structure of a firm is documented to be influential to its firm performance. All the theoretical and empirical research on the relationship between equity ownership and performance are influenced by the separation thesis of Berle and Means (1932). In their transition from private to public ownership the firms have to dilute their insider ownership which leads to agency costs. Jensen and Meckling (1976) formulate the agency problem that arises when managers own only parts of the ownership of the firm. The partial ownership causes the manager to exploit the outside ownership of the firm to their own advantage. Hence, the partial ownership decreases the value of the firm. Once they gain controlling authority in the firm,

they can entrench themselves or pursue non-value maximizing activities. As per entrenchment hypothesis, more equity ownership by manager/insider may lead to lower financial performance. The reason being, with larger ownership stake they may be so powerful that they do not have to consider other stakeholders interest. Being wealthy due to large amounts of holding, they no longer need to maximize profit rather try to maximize their personal utility (like building personal empire, increasing market share or consume at office). This negative effect of ownership on performance has been established in many prior efforts. Jensen and Rubuck (1983) indicate that managerial entrenchment implies that the higher the managerial ownership the lower the value of the firm. With respect to corporate control theory, the managerial ownership will hurt the wealth of outside shareholders and decrease the value of the firm. Stulz (1988) argues that the incumbents are typically against hostile takeover. If managerial ownership is raised to be high enough to get rid of hostile takeover, the firm value decreases. Israel (1992) and Stulz, Walking and Song (1990) also indicate that the high enough managerial ownership will decrease the possibility of a tender offer by raiders.

The other argument, however, professes that with higher ownership the interests of insiders are better aligned with the interests of the firm. They themselves will have to bear significant loss for each penny forgone in value reducing activities. Convergence of interest sets in with this argument relating to ownership in the firm. It may be noted that, incentive effects operate positively for performance of the firm. Each increment in shareholding induces the promoter/insider to perform. Oswald and Jahera (1991), Makhija and Spiro (2000) and Cole and Mehran (1998) find evidence to support the positive relation between share value and managerial ownership. Chen and Steiner (1999) and Lee, Rosenstein, Rangan and Davidson (1992) find that increased managerial ownership decreases manager-shareholder agency costs resulting in better firm performance.

Therefore, convergence-of-interest or monitoring hypothesis predicts a positive relationship between ownership concentration and firm performance; at the same time entrenchment hypothesis proposes a negative one. Some authors argue that both the effects, emanating from separation of ownership and management, operate at different level of shareholding thus resulting in a non-linear relationship between insider ownership level and performance.

Another argument which links the founder ownership to performance and more specifically IPO performance stems from information asymmetry and is built on signaling model suggested in the seminal work of Leland and Pyle (1977). Leland and Pyle (1977) show that the managerial ownership is a signal to convey the information of firm value to the outsiders. The basic premise of their model is that the more shares held or retained by the entrepreneur, the higher the valuation of the firm at IPO. In effect, the "willingness of the



person(s) with inside information to invest in the project of firm...lenders will place a value on the project that reflects the information transferred by the signal" (Leland & Pyle, 1977, p 371). Basically, the agency theory and signaling hypothesis argue that the higher the managerial ownership, the higher the value of the firm. From the signaling theory perspective, under pricing measures the information asymmetry between insiders and the broader market of general investors who purchase shares after the stock starts trading on the open market. The issuers try to bridge these gaps through a variety of signals to reassure the investors of the credibility of their investment. Leland and Pyle (1977) suggest that one costly signal for IPO firm is for the initial owners to maintain an ownership position in the firm after the issue. This is expected to reduce the pervasive information asymmetry and it is expected that initial day under pricing would be lower for firms with high ownership by initial owners.

An alternative explanation comes from the argument where under pricing is treated as a signal adopted by high quality firms whereby it is believed that high quality firms will exhibit more under pricing to receive favorable reaction to their further offerings (Allen and Faulhaber, 1989; Grinblatt and Hwang, 1989; Welch, 1989 and Chemmanur, 1993). If under pricing and quality share a direct relationship, it is expected that firms with high ownership would experience higher levels of initial returns and thus more under pricing than firms with low ownership in the hands of initial owners. This theory, also does not establish the direction of relationship expected between the two variables.

The purpose of this paper is to examine the relation between ownership positions of founders and the pricing irregularity found in Indian IPOs supported by these arguments in Indian context which presents a good case of information asymmetry and patterns of concentrated ownership.

### 3. Data, Variables and Descriptive

#### 3.1 Sample and Data

The present study is aimed at exploring the signaling role of retained ownership of founders of the company as reflected in its initial returns. Sample for the study comprises of Indian IPOs issued between the years 2001-2012 and those which have been listed on BSE. The period of study has been finalized in the backdrop of SEBI's specification of principles of corporate governance and in the listing agreement of stock exchanges which was to be adopted by listed firms with effect from 2001. The final sample after adjusting for the missing information on account of prospectuses and information disclosed on account of post-IPO ownership is 379 companies. The sample does not consider the IPOs listed on exchanges other than BSE, the issues of securities other than those of common stock, further public offerings or rights issues and the delisted or defaulting companies.

Data for study has been collected from secondary sources. The data on ownership variables has been extracted from the

prospectus submitted by companies at the time of IPO. These prospectuses have been procured from websites of SEBI, BSE and of respective companies. Issue-related data including data for issue price, gross proceeds raised from the issue and over subscription have been taken from IPO prospectus and ACEEQUITY database which is a commercial agency engaged in monitoring and compilation of information on all listed companies in India. For firm specific variables, Capitaline, ACE EQUITY and Prowess Databases have been relied upon.

#### 3.2 Variables

**Dependent variable:** The initial price performance of IPOs on day of listing has been measured using two methods: unadjusted and adjusted returns. As a first measure, raw return (RR), has been employed wherein under pricing is measured using initial returns, calculated as closing price on the first trading day on the secondary market minus the offer price, divided by the offer price (Certo *et al.*, 2001; Arthurs *et al.*, 2008). The initial return ( $R_i$ ) has been calculated to be equal to:  $(P_1 - P_0/P_0) \times 100$  where  $P_1$  is the closing price of the security on first day of trading and  $P_0$  refers to the offer price of security

Secondly, market adjusted excess return (MAER), regarded as adjusted under pricing has been used which adjusts for market movements between the prospectus date and first trading day of IPO. It is calculated by subtracting the market return (as measured by the BSE's sensitive index) from the initial raw return. The level of under pricing has been market adjusted as proposed by Carter *et al.* (1998) and Certo *et al.* (2001b) and is calculated as the percentage increase from the offering price to the closing price on the first day of trading, i.e.  $R_i - (M_1 - M_0/M_0) \times 100$ , where  $M_1$  is BSE Sensitive Index on first day of trading and  $M_0$  is BSE Sensitive Index on offer date.

**Independent variable:** The variable of interest for the study is promoter ownership retained which has been measured through the percentage of ownership retained by individual promoters after the IPO. Promoter and family controlled firms are expected to have greater value and operating efficiency as founding family members have more incentive to improve firm performance than non-family decision makers (McConaughy *et al.*, 2001; Chahine, 2004) which in turn results in alignment of interests with those of shareholders. In contrast, the founders as controllers and decision makers may tend to favor family shareholders at the expense of the public investors (Shleifer and Vishny, 1997) giving way to the risk of non-professional managerial approach (Classens *et al.*, 2000) and thus creating conflicts of interests and a host of agency problems (Filatotchev and Bishop, 2002). Moreover, the nature of this relationship suggests existence of non-linear relationship of founders' ownership with IPO under pricing and hence, squared term of promoter ownership is also included to check the non-linearity of relationship (as in Chahine *et al.*, 2009).



Table1: Description of variables of study

Variables	Operationalization
Dependent Variable	
Under pricing on listing day	Raw return-Closing price on the first trading day on the secondary market minus offer price, divided by offer price. MAER- Raw return minus the market return as measured by the BSE's sensitive index
Independent Variable	
Promoter ownership	Percentage of shares held by board of promoters (founders) after the issue
Promoter ownership squared	Square term of the percentage of shares held by board of promoters (founders) after the issue
Control Variables (Issue and firm related)	
Issue Size	Logarithm transformation of proceeds received from issuing new shares (in crores)
Subscription ratio	Number of times the IPO has been subscribed: indicator of over or under subscription
Issue Price	The offer price of shares issued through IPO
Board size	Total number of directors on the board
Block holder ownership	Number of shareholders holding shares more than 10% of total shares to denote concentrated ownership

**Control variables:** Other than the variable of interest, other variables pertaining to IPO and ownership have been included in the model to control for their potential effect on the pricing performance of IPOs. Issue size has been included as it is regarded by as proxy for ex-ante risk. It has been included to capture the inherent and fundamental risk of an IPO so as to provide for its plausible influence on performance of the issue in line with related prior works. Its logarithmic transformation has been incorporated in the model for putting all IPOs on a comparative front. Subscription ratio reflects the rate at which the issue has been subscribed with a higher ratio reflecting more demand for the new issue and vice versa and also can provide for possible influences of demand pressures on IPO stock's value. The price at which one unit of new equity shares are offered to public is the issue price and has also been included as a control variable. In Indian context over a long time period, inverse of issue price has been found to be positively related to long run performance of IPOs (Sehgal and Singh, 2009). Board size is a central issue in corporate governance and has been included to capture its effect on performance. In spite of many attempts to explore this variable and its effect, the relation of board size to under pricing has not been unequivocally established till date. From the ownership perspective, one more measure which holds more relevance in typical Indian markets which stand out for concentrated levels of ownership have been included. The ownership concentration examined is expressed through block holders. It represents the number of shareholders owning more than 10 percent of total shares to reflect the concentration tendencies, lower the number of block holders higher the

ownership concentration and vice versa. Concentrated ownership where on one side can work for aligning the interests of management and shareholders and thereby enhance firm value (Li and Simerly, 1998), can also lead to extraction of private benefits by these controlling shareholders leading to additional costs for minority shareholders (Shleifer and Vishny, 1997).

**3.3 Analysis Method:** For achieving the objective of the study, regression analysis has been used. The regression model for the study is

$$\text{Under pricing}_i = \alpha + \beta_1 \text{Issue size}_i + \beta_2 \text{Subscription ratio}_i + \beta_3 \text{Issue price}_i + \beta_4 \text{Board size}_i + \beta_5 \text{Promoter ownership}_i + \beta_6 \text{Promoter ownership}_i^2 + \beta_7 \text{Block shareholder}_i + \varepsilon_i$$

Before running regressions, the models have been tested to assure that they do not suffer from multi-collinearity and heteroscedasticity problems. The existence of heteroscedasticity was, however, confirmed and as a solution, White's heteroscedasticity Consistent Standard Errors have been used. For multi-collinearity arising on account of squared variable in the model, the series for variable of promoter ownership has been substituted with their standardized value which has been documented as one of the methods for handling multi-collinearity arising from including squared values of a variable together with the original variable in the model.

### 3.4 Descriptive

Table 2 presents the descriptive statistics of the variables used in the model. The average returns of the Indian IPOs during the study period are positive for both the measures of



unadjusted and adjusted returns as measured by raw returns (RR) and market adjusted excess returns (MAER). The positive returns of these IPOs (almost 24%) confirm the

existence of under pricing phenomenon which is in line with previously documented figures though it has diluted a little which can be attributed to legal and statutory requirements.

**Table 2: Descriptive of variables of study**

Variables	Mean	Median	Max	Min	Std. Dev.
Raw return (%)	24.36	12.89	323.50	-94.29	56.23
Market adjusted excess return(%)	22.99	9.70	285.44	-101.78	54.46
Issue size (in Rs. Crores)	401.47	90.00	15475.09	2.16	1313.63
Subscription Ratio (no. of times)	19.64	7.48	175.88	0.00	26.86
Issue Price (in Rs.)	176.13	115.00	1310.00	10.00	191.87
Board Size	7.80	8.00	20.00	4.00	2.28
Promoter Ownership (%)	59.06	59.51	90.00	5.06	15.14
Block shareholders	2.58	2.00	6.00	0.00	1.26

Issue size expressed in crores of rupees shows wide variation in offer size as observed through minimum value of 2.16 crores and maximum value of 15475 crores and also a high value of standard deviation. The mean value for issue size is noted as 401 crores which indicate that Indian IPOs are of reasonably big size on an average. The trend of issuing IPOs at a high premium than the face value is also very evident from mean value of issue price which stands at Rs 176 against the minimum value of 10. Indian IPOs on an average have been oversubscribed (19.64 times and minimum value of zero) reflecting the active operations in capital market in general and new issue markets specifically. The mean and median board size stands at 8 indicating the trend of moderate board size, neither too small nor too big. Sample does have firm with board as big as 20 members and on the lower size a board size of four is also observed, the variations being validated by standard deviation of 2.

Mean holdings of the promoters of the company (post-IPO) stand at a high of 59% with maximum value being as high as 90% confirming the pattern of family ownerships and control (which is further strengthened through appointment of relatives on boards). The shareholdings of all promoters have been cumulated for this purpose whose values affirm that promoter controlled IPOs is common sight in Indian markets. The average number of block shareholders (holding more than 10% of total equity) is found to be more than two (2.58) which only represents the number of controlling members and decision makers for IPO firm confirming trends of concentrated ownership levels in the IPO firm.

Descriptive statistics as explained above paint an initial rough picture of the variables under consideration though for their impact and influences on the dependent variable further investigations have been done. The results of regression analysis have been presented and explained in the next section.

#### 4. Results and Discussion

The present study performs cross sectional regression analysis to explore the impact of promoter ownership on the initial under pricing of IPOs in Indian markets the results for which have been presented in Tables 3 and Table 4. Separate regression models have been run for raw returns and market adjusted excess returns. To confirm the non-linearity of the relationship between retained ownership by the insiders and initial returns the squared term of variable of interest has also been incorporated. To take care of the problem of multicollinearity, the promoter ownership series was standardized and this standardized series with its square term were used for analysis. The final models were robust models with significant F-values and no violation of assumptions of regression especially heteroscedasticity and multicollinearity.

Regression analysis is first done using raw returns as dependent variable and the results are reported in Table 3. In regression analysis, the sample consists of 379 IPOs. In order to explore the contribution of promoters' retained ownership in explaining the initial returns and to segregate this effect from contribution of control variables three separate regression models have been built. Model 1 includes only the control variables. Model 2 combines the control variables with the interest variable- promoter ownership while the Model 3 includes the quadratic form of promoter variable for its plausible non-linear relationship with dependent variable.



Table 3: Relationship between Promoter Ownership and Initial Unadjusted Returns

Independent Variables	Model 1	Model 2	Model 3
Constant	35.809 (2.311)**	23.376 (1.384)	-5.309 (-0.195)
Log (Issue Size)	-10.473 (-4.840)***	-11.217 (-4.601)***	-10.189 (-3.911)***
Subscription Ratio	1.146 (11.534)***	1.139 (11.190)***	1.158 (11.309)***
1/Issue Price	450.602 (2.260)**	511.903 (2.268)**	549.764 (2.444)***
Board Size	1.578 (1.677)	1.442 (1.515)#	1.441 (1.510)#
Block Shareholders	-1.839 (-0.936)	-1.336 (-0.649)	-1.559 (-0.757)
Promoter Ownership	0.287 (1.672)*	1.286 (1.7226)*	
Promoter Ownership Squared			-0.010 (-1.367)#
R <sup>2</sup>	0.3339	0.3363	0.3384
Adjusted R <sup>2</sup>	0.3254	0.3256	0.3259
Number of Observations	379	379	379
F Statistic	39.394***	31.421***	26.888***

*Note: One\*, two\*\* and three asterisks\*\*\* indicate statistical significance at the level of 10%, 5% and 1%, respectively. T-statistics are provided in the parentheses. # indicates loosely significant relationship at 20% level*

Deriving support from past literature, control variables have been included in the study for their ability to influence the initial day listing returns and these have been included in Model 1. These variables overall explain more than 32% of the total variations in dependent variable with subscription ratio, issue size and issue price being significant in all the models. In Model 1, subscription ratio, issue size and the inverse of issue price are found to positively influence the level of under pricing, though only subscription ratio has a statistically significant relationship. This indicates that investors perceive the extent of subscription as a sign of the good quality of an IPO firm and thus better performance of the issue and higher returns. In contrast, issue size (logarithmic transformation), has been found to have a negative association with initial returns. Larger issue size as inferred from the above, help to mitigate the existing levels of information asymmetry and thus reduce the extent of under pricing. Issue price (transformed as its inverse to better decipher the relationship) shares a positive significant relationship with under pricing contradicting the findings of Li (2005) and Be'dard *et al.*, (2008). The findings here seem to suggest that the price at which a firm offers shares is perceived as inherent ability of the firm to command premium for its issue and only firms with stronger credentials can dare to price its product in higher grade

which works in addressing the uncertainties of investors. Board size, introduced as an important component of board structures is found to be share a positive relationship and loosely significant at 10 and 15 percent significance levels. This signifies that board size remains a consideration for investors in India, though not a pertinent one. From the market's point of view, investors may perceive a large board as a signal of high degree of monitoring and effective decision making and intention of firms to protect the interests of shareholders by appointing more members on firm's board. Within the signaling theory framework, this also signifies that high-quality IPO firms may choose larger boards to communicate its quality and credibility to potential investors. With regards to block holder ownership, the number of block holders in IPO firms shares a positive relationship with under pricing, and the positive association highlights its role in signaling firm value to uninformed investors. This variable, however, lacks significance in the explanation of initial returns, highlighting the negligible importance attached by investors to this aspect when making their investment decisions.

Indian firms being primarily family promoted firms have a strong tendency to be owned and managed by the founders and hence it is attempted to study how this ownership affects



the returns of IPOs on listing day. Lemmon and Lins (2003) contend that ownership structure is a fundamental determinant of the extent of agency problems between insiders and outsiders, which may in turn affect the firm's valuation. Promoter ownership reflects the proportion of shares held by promoters in the firm's share capital after the issue. The relationship between returns and promoter ownership as pointed out by Morck, Shleifer, and Vishny (1988) depends on 2 opposing forces: the 'convergence of interests' effect (where higher ownership tends to align the interests of promoters with those of shareholders) and the

'entrenchment effect' (which allows them to entrench themselves and work for self-interests).

Ownership by promoters is included as a measure of family ownership by the founders of the concern which is likely to impact performance of IPOs under the influence of family interest protection (Shleifer and Vishny, 1997) and alignment of interests (Fama and Jensen, 1983) hypotheses. With the clues of operationalization of both these hypotheses and in accordance with Chahine (2004) efforts to check non-linearity of promoter ownership have been made through introduction of the square term.

**Table 4: Relationship between Promoter Ownership and Initial Unadjusted Returns**

Independent Variables	Model 1	Model 2	Model 3
Constant	32.594 (2.186)**	22.6123 (1.386)	-0.890 (-0.033)
Log (Issue Size)	-9.770 (-4.770)***	-10.359 (-4.474)***	-9.517 (-3.824)***
Subscription Ratio	1.1617 (11.794)***	1.111 (11.423)***	1.127 (11.531)***
1/Issue Price	439.269 (2.261)**	489.343 (2.268)**	520.362 (2.359)***
Board Size	1.301 (1.440)	1.145# (1.253)	1.144 (-0.512)#
Block Shareholders	-1.257 (-0.662)	-0.835 (-0.421)	-1.018 (-0.512)
Promoter Ownership		0.237 (1.444)*	1.056 (1.450)#

*Note: One\*, two\*\* and three asterisks\*\*\* indicate statistical significance at the level of 10%, 5% and 1%, respectively. T-statistics are provided in the parentheses. # indicates loosely significant relationship at 20% level*

The significance of coefficients for promoter ownership and its squared term (at 10% level of significance with respect to raw returns) confirm the existence of non-linear relationship of this ownership attribute to under pricing. The significant coefficients highlight the signaling potential of this ownership variable confirming that investors do consider this attribute while putting their money into a new issue. The curvilinear relationship explains that increasing ownership levels do address the concerns of information asymmetry and associated uncertainties but at higher levels of family ownership the concerns for entrenchment and sacrificing general interests for self-interests start dominating. The positive sign of coefficient of promoter ownership indicates the tendency of initial returns to increase with the increase in stake by founders under the effect of alignment of interest hypothesis. As, however, these levels increase the relationship to returns turns negative indicating that as ownership increases, the role of founders in firms' decision making becomes all the more critical, the managers tend to divert firm's resources for personal gains sacrificing the

general interest. The results indicate that the founder owners move from alignment to entrenchment as their stakes in the firm increase. Our findings are consistent with works by Morck, Shleifer, and Vishny (1988), Short and Keasey (1999), Mudambi and Nicosia (1998), Faccio and Lasfer (2000), Joh (2003), Florackis (2005); that is management moves from alignment, to entrenchment, to alignment as their ownership stake in the firm increases. However, their results were in relation to firm value and considered another higher degree of ownership as expressed through the cubic term.

The direction of relationship to the other measure of under pricing, i.e. MAER, also remains the same though degree of significance is diluted ostensibly by market forces. The operationalization of both alignment of interest and entrenchment hypothesis is, however, confirmed. The overall model largely remains the same with both the dependent variables leading to the same conclusions as discussed above for various control variables.

The results, therefore, confirm a non-linear relationship shared by promoter ownership and initial returns of IPOs.



The signaling potential of these ownership variables is confirmed highlighting that ownership and control of new issue firms is an important consideration for the investors when taking the investment decision. Another fact which surfaces from these results is that higher ownership with the promoters does dispel uncertainty and problems of information asymmetry but at higher levels tendencies of entrenchment of interests become evident and potential of insider ownership as signal reduces. These confirm that both alignment of interest and entrenchment hypothesis work in conjunction at different levels of ownership with their allied benefits and costs in terms of initial returns.

## 5. Conclusion

In the light of the documented evidence of eminence of promoter ownership at the time of IPO and after and its effect to influence the performance, the study attempts to study this potential relationship for Indian IPOs. The results confirm the potential of retained ownership by these founders to operate as signals and thus influence the decision of investors while putting their money into an IPO. This relationship, however, is found to be weak and offers a miniscule contribution in explaining the initial returns which derives its explanation from an emerging economy and typical allied attributes of such markets. The study confirms the operation of both the alignment of interest hypothesis and entrenchment tendencies at different levels. The owners tend to divert common resources towards personal interests as their stake and control over the funds and decisions of the firm increases. The study confirms these effects using regression models with both adjusted and unadjusted initial returns, as on the day of listing, as dependent variable.

It can, however, be concluded that in Indian markets ownership as a general variable and promoter/founder ownership specifically remains an important consideration. The present study confirms the hypothesis that higher ownership by insiders enables them to act as better monitors and contribute towards the objective of enhancing value and performance of the firm. At the initial and lower levels of ownership they do not have substantial stakes to entrench themselves and so work and contribute positively for better performance and higher stakes. This is where this relationship is perceived and adopted as signal by high quality firms. Explanatory power of this measure can definitely be enhanced when governance parameters evolve as distinguishing criteria amongst firms and investors realize their worth and their potential in improving firm performance. Insider ownership is undoubtedly beneficial and works as a value enhancer which must be considered by the policy makers in their regulations to pursue the objective of growth of markets and efficiency in operations.

The study can be extended further with the inclusion of other forms of this interest variable like cubic relationship to come to more specific levels at which these hypothesis start getting operational. Moreover, endogenetic of variables is another aspect which can be included to come to more concrete results with regards to IPOs and ownership variable.

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