Pacific-Basin Finance Journal 36 (2016) 14–30

Contents lists available at ScienceDirect

Pacific-Basin Finance Journal

journal homepage: www.elsevier.com/locate/pacfin

Intended use of IPO proceeds and firm performance: A quantile regression approach☆

Andriansyah Andriansyah [a,b], George Messinis [a,*]

[a] Victoria Institute of Strategic Economic Studies, Victoria University, Melbourne, Australia
[b] Directorate General of Taxes, Ministry of Finance, Jakarta, Indonesia

ARTICLE INFO

Article history:
Received 15 May 2015
Revised 11 November 2015
Accepted 6 December 2015
Available online 11 December 2015

Keywords:
IPO intentions
Firm performance
Compositional data
Quantile regressions
Indonesia

ABSTRACT

This paper investigates the link between intended use of proceeds and the decline in post-issue operating performance of IPO firms. It distinguishes between capital and strategic motives and employs quantile regressions to examine the Indonesian equity market over the period of 2000–2010. The overall evidence shows that post-issue performance can be explained by firm motivation to IPO issue with the capital motive being the critical driver of good performance in Indonesia. Investment in fixed assets and in stock market shares lead to better performance while other usages lead to poor performance. The results are robust to accounting for ownership structure and to alternative classifications of IPO intent. These results have policy implications for the management of IPO proceeds.

1. Introduction

Jain and Kini (1994) first reported evidence of a post-issue operating performance decline in Initial Public Offering (IPO) firms in the U.S.A. markets. Since, numerous empirical studies have confirmed this phenomenon in other markets such as Italy (Pagano et al., 1996, 1998; Carpenter and Rondi, 2006), Australia (Balatbat et al., 2004), China (Wang et al., 2004; Wang, 2005), Japan (Cai and Wei, 1997) and Thailand (Kim et al., 2004). Three mainstream explanations have been advanced in this regard: namely, agency theory, window-dressing behavior theory, and market-timing theory (Jain and Kini, 1994; Loughran and Ritter, 1997; Mikkelson et al., 1997; Jenkinson and Ljungqvist, 2001; Draho, 2004).[1] Agency theory maintains that the reduced initial entrepreneur's ownership dampens managerial incentives which then lead to overinvestment. Window-dressing behavior theory postulates that pre-IPO performance is overstated. Meanwhile, market-timing theory states that firms go public coincidently in times of good but unsustainable performance or when the IPO market is overvalued or "hot". None of these explanations, however, relate to firm motivation in going public.

This paper explores the possibility that IPO motivation may be critical to post-IPO firm performance. For instance, financial motives aimed to raise capital for growth may lead to better performance than strategic non-capital motives. In this context, this paper seeks to utilize information on intended use of proceeds to examine the role of motivation in post-issue operating performance. Attention is paid to the distinction between capital and strategic motives.

☆ We wish to thank the editor and an anonymous referee for valuable comments on earlier drafts of this paper. The first author is also grateful for an AusAID scholarship (Australian Leadership Awards) and assistance by Eko Wijaya for providing prospectus files. The usual disclaimer applies for any errors or omissions.

* Corresponding author.
E-mail address: george.messinis@vu.edu.au (G. Messinis).

[1] These theoretical explanations are basically also similar to those for the other well-known IPO or seasonal equity offering (SEO) phenomena (e.g. initial under-pricing, long-run underperformance and IPO cycles).

http://dx.doi.org/10.1016/j.pacfin.2015.12.001

Pagano et al. (1998) and Carpenter and Rondi (2006) provide insights into different motivations for firms going public. The former suggests that independent firms go public in order to exploit a window of opportunity to recover their balance sheet after a high growth period, while carve-out firms go public to maximize the IPO proceeds for the benefit of previous owners. The latter study further shows that "new-style" firms (independent and small firms), utilize the proceeds to de-leverage and re-balance their capital structure, whereas the "old-style" firms (affiliated and large firms) seek to exploit a hot primary market.

IPO motivations, however, are interrelated and may be tacit. Three main approaches have been adopted to identify motivation in the IPO literature. The first is by surveying managers of issuing firms (Brau and Fawcett, 2006; Brau, 2012). The second entails the utilization of explicit statements of motivations in prospectus (Rydqvist and Hoghlom, 1995). Last is the Kim and Weisbach (2008) approach relying on accounting measures of IPO firms. In theory, the survey approach seems the best as it reveals ex-ante motivation but surveys are conducted with considerable lag and are costly. On the other hand, prospectus do not always disclose motivation while the indirect approach conflates motivation and the financial accounting of proceeds spread over several periods after the IPO year.

This paper seeks to overcome these limitations by utilizing prospectus information on the intended use of proceeds. Such information has been utilized in the context of the IPO under-pricing (Leone et al., 2007; Wyatt, 2014), and performance of SEO firms (Jeanneret, 2005; Autore et al., 2009). Yet, the information has not been exploited in the context of post-issue performance of IPO firms. This study builds on Chemmanur and Fulghieri (1999) and Subrahmanyam and Titman (1999) who highlight the role of capital motives (i.e., working capital financing and fixed asset investment), as compared to strategic, non-capital motives.

The most interesting feature of intended use of proceeds data is that it is compositional data. The use of such data as in regression analysis may lead to either perfect multicollinearity or misleading interpretations (Hron et al., 2012). In the current IPO literature, the compositional nature of intended use of proceeds data is generally ignored (Fry, 2011). Here, we adopt the zero replacement technique of Fry et al. (2000) and the repeating isometric log ratio transformation of Hron et al. (2012) to avoid these shortcomings. These techniques allow us to employ quantile regressions to examine the role of IPO intention along the distribution of post-issue operating performance.

This study also distinguishes between capital motives and strategic motives as drivers of IPOs to examine the relationship between the post-issue operating performance and the intended use of IPO proceeds in Indonesia. As an emerging economy, Indonesia has seen the number of IPOs grow in the period 1977–2010, during which 522 companies went public raising Indonesian Rupiah (IDR) 495.61 trillion (i.e., approximately USD 52 billion). Compared to its neighbors in South-East Asia, the number of Indonesian IPOs in 2010 (23) were lower than Singapore (31) and Malaysia (29) but higher than Thailand (11) and Philippines (3).[2]

Intended use of proceeds data was collected manually from prospectus to ensure accuracy and easy access to prospectus.[3] By regulation, all firms must stipulate how they intend to use IPO proceeds. This study extends Bapepam-LK (2009)[4] in several ways. First, it only focuses on equity public offerings, while Bapepam-LK (2009) also examines rights issues, corporate bonds, and sukuk (Islamic bonds). Second, it expands the sample into a panel of 140 non-finance listed firms over the period 2000–2010 and Bapepam-LK (2009) only examines 16 IPO firms for one year. Third, it only utilizes data on intended use of proceeds[5] while Bapepam-LK (2009) compares intended use of proceeds data with actual use of proceeds interim data. Last but not least, in contrast to Bapepam-LK (2009) that only uses a simple descriptive analysis, this study employs formal econometric techniques to assess the impact of different uses of the proceeds on a variety of operating performance indicators.

This study is structured as follows. Section 2 describes the data and the classification of intended use of proceeds. Section 3 outlines the empirical methodology dealing with compositional data with zero in quantile regressions. Section 4 presents and discusses the results. Finally, Section 5 summarizes and concludes.

2. Data

The sample includes public firms that have obtained the securities authority's[6] approval to go public over the period of 2000–2010. This period is chosen on the basis that 1999 was loosely the end of the Asian Financial Crises (Hill and Cham, 2012) and data availability given that only 42 of 321 firms going public in the period 1977–1999 had prospectus available at *Bloomberg Terminal*. Of 201 public firms with effective statements in the period under investigation, the following were excluded: 5 due to unavailable prospectus; 2 that did not undertake an IPO; 1 which undertook limited offering to its existing shareholders; 13 due to lack of financial data from *Thomson Reuters* fundamentals collected from *Datastream Professional*, and 40 due to incomparability with those of industrial firms. Our final sample consists of 140 firms listed on the Indonesia Stock Exchange (IDX).

[2] This is on the basis of World Federation of Exchanges data.

[3] Autore et al. (2009) also highlight the importance of manual data collection on the intended use of proceeds. SDC Platinum, the well-known new issue database, for example, classifies almost all cases as "general corporate purpose".

[4] The first author was the leader of the research team conducting the study.

[5] Note, the intended use of proceeds may not match the actual use of proceeds in a particular year, given that the use of proceeds may take place over several years. Yet, a change from intended to actual requires approval by shareholders at an annual general meeting. In Indonesia, disclosure on actual use of proceeds can be found in the Report on the Use of Fund Received from a Public Offering (Rule X.K.4) which must be submitted to the securities authority on quarterly basis until all the proceeds have been fully used.

[6] The principal regulator is the Financial Services Authority of Indonesia (OJK in Indonesian abbreviation), previously known as Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK).