

Financial Performance of Initial Public Offerings: Companies listed on Dar es Salaam Stock Exchange

Gibson Hosea Munisi*

Department of Business Studies, School of Earth Sciences, Real Estates, Business and Informatics, Ardhi University, P.O.BOX 35176, Dar es Salaam, Tanzania

*Corresponding author: Gibson Hosea Munisi, Department of Business Studies, School of Earth Sciences, Real Estates, Business and Informatics, Ardhi University, P.O.BOX 35176, Dar es Salaam, Tanzania, Tel: +255 752 309 909; E-mail: gibson2munisi@gmail.com

Received date: May 11, 2017, Accepted date: May 29, 2017, Published date: June 05, 2017

Copyright: © 2017 Munisi GH. This is an open-access article distributed under the terms of the Creative Commons Attribution License, which permits unrestricted use, distribution, and reproduction in any medium, provided the original author and source are credited.

Abstract

The purpose of this study is to examine the difference in financial performance before and after Initial Public Offerings (IPOs) in companies listed on Dar es Salaam Stock Exchange (DSE) in Tanzania. The company financial performance is measured by using financial performance ratios. Hypothesis of difference between pre-IPOs and post-IPOs financial performance is tested by using significance test on the difference between the mean score of the pre-IPOs and the mean score of the post-IPOs financial performance. The findings indicate there is significant difference between pre-IPOs and post-IPOs financial performance. Specifically, the findings indicate there is significant increase of post-IPOs financial performance. At least, the study indicates there is no significant evidence that pre-IPOs performance is higher than post-IPOs performance. However, the study indicates the results depend on measurements of performance used in the data analysis. The study is of value to various stakeholders who are interested in the financial performance of listed companies in developing countries in Sub-Saharan Africa and Tanzania in particular. These findings are useful to current and potential investors in stock exchanges in developing countries in general and DSE in particular. The findings have policy implication for roles of the regulators of stock market, shareholders monitoring and governance of listed companies, as results indicate at least performance of listed companies do not deteriorate after IPOs. This has implication for attraction of investment from both domestic and foreign investors because indicators of better performance after IPOs increase the confidence of investors as they become more optimistic on future financial performance of IPOs.

Keywords: Financial performance; Initial public offerings; Working capital

Introduction

Initial Public Offering (IPO) involves the issuing of the securities to the public for the first time. It happens when company engages in offering of shares to the public and listed on stock exchange for the first time. IPO allows company to raise funds from the general public for the first time. IPO is considered as an important event for some entrepreneurs, executives, board members and shareholders because it is an achievement that demonstrates their success in building a strong business and creating value for owners, employees and customers [1]. IPO is an entrance into a new stage life as public company that possesses not only its own unique opportunities but also risks and challenges [1]. Some of those opportunities are such as opening door to liquidity for investors and general public, who can invest their money in company by buying shares in stock exchange markets [1]. Company can use capital generated from IPO for common company purposes, such as working capital, research and development, retiring existing indebtedness and acquiring other companies or businesses which in turns may have significance implication for future performance of company. In the other hand, there are some challenges during the process of issuing shares such as exposing company's information to public and more seriously to competitors [1]. This is because an IPO company must present its prospectus, which contains key inside information about company, to the public as part of requirements of issuing shares to the public. By providing this information to the public, albeit with good intention to abide to

requirements of listing, company may expose important strategic information such as intellectual property, compensation, financial status and projections, material agreements and business plans. This can provide opportunity to competitors to imitate company's strategies and accelerate implementation of similar strategies or counterattack strategies in advance of listing company [1,2]. In the other words, competitors may use this information to know about strategies of listing company and formulate or adjust their own strategies to become more competitive at expense of listing company [2]. Additionally, when involved in IPO process, listing company incurs some costs such as compliance cost and management time spent in IPO process. Company may outsource some professionals such as lawyers and accountants who may charge significant amount of fees. Top management must their use valuable time to engage in IPO process activities such as planning and meeting potential and significant investors and regulatory bodies [1]. This may distract their attention from core mission of business; as a result, performance of company may decline after IPO exercise is completed.

Existence of both advantages and disadvantages of IPO suggests that listing of company on stock market can have positive and/or negative effects on financial performance. The positive and negative effects may improve and weaken after IPO performance respectively which creates uncertainty about future performance of listing company. The uncertainty on performance after IPO, suggests that before engaging in IPO; management of company must critically analyze all relevant circumstances by considering not only its own strengths and weaknesses but also opportunities and threats that exist in the external environment. In the other words, management of listing company must carefully weigh both advantages and disadvantages of public

listing before implementing final decision to initiate IPO process and finally list shares on stock exchange.

In addition to general benefits and costs associated with IPO, there are some other factors which can lead to change in pre-listing performance. Previous studies have identified at least three potential factors which can cause decline of company financial performance [3-8]. First, companies tend to go public at the peak of their long-run performance, which they know cannot be sustained in the future [3]. Second, the dilution of shares of company when company goes public is likely to give rise to agency problem [5] which in turns, may cause poor financial performance in the future. Third, managers may attempt to window-dress accounting information before listing by using earnings management techniques [8], which may overstates pre-IPO performance while understating post-IPO performance. This is more likely to happen when managers can use accrual accounting to borrow future profits [6,7]. The earnings management and borrowing of future profit just before IPO aim to portray artificial good performance to attract members of public to invest in shares.

Given the existence of uncertainty in the process of IPO, it is obvious that the process is likely to have either negative or positive effects on company's future financial performance. In this respect, this study examines the change in company's financial performance between pre-IPO and post-IPO. Specifically, the study examines whether pre-IPO financial performance is significantly different from post-IPO financial performance. This study contributes to understanding of reliability of pre-listing financial performance as indicators of future financial performance of companies listed in Dar es Salaam Stock Exchange. The indicators of financial performance are one of the most important factors used by investors to make decisions of either or not to invest in IPOs. Since most investors are likely to be attracted by good financial performance they are likely to make decision based on wrong information if listing company intentionally is deceptive in relation to its indicators of financial performance. The findings are useful to stock market regulators who receive and evaluate applications of companies seeking public listing. Furthermore, the findings are useful to accounting profession and stock market policy makers who are concerned with financial information presented by companies where they are going public.

Initial Public Offering and Stock Exchange Markets

The history of IPO goes back when the earliest form of company which issued public shares during the Roman Republic. Dutch East India Company is believed to be the first modern company to issue public shares in the beginning of 17th century. In developed countries many large companies are listed in stock exchanges. The New York Stock Exchange (NYSE) is the biggest equity market in the world with a market capitalization of about \$21 trillion in year 2015. Generally, stock exchange is one of major sources of capital finance in the world [9]. However, in most African countries, specifically in Sub-Saharan Africa, stock exchanges opened in the 1990s, except in the cases of Kenya and Nigeria, where stock exchanges started in the year 1954 and the year 1960 respectively [10]. In addition, many countries in Sub-Saharan Africa have not yet established stock exchanges and many of those which have been established are not very active [10].

In Tanzania, shares are listed on and traded at Dar es Salaam Stock Exchange (DSE). The formation of the DSE followed the enactment of the Capital Markets and Securities Act, in the year 1994 and the establishment of the Capital Markets and Securities Authority (CMSA)

which is the agency of Tanzania Government established to promote and regulate securities business in the country [11]. DSE was incorporated in the year 1996 and began trading operations in the year 1998. DSE is the only formal trading place for securities in Tanzania. Both local and foreign investors are allowed to participate in DSE. Foreign investors were not allowed until recently when the Tanzania government issue the capital markets and securities (foreign investors) regulation in the year 2014 [12]. The participation of foreign investors is significant achievement as it allows companies listed in the exchange to attract capital from foreign market. According to recently market reports from DSE, foreign investors are major buyers of shares traded at DSE as about seventy percent of all shares purchases at DSE during the period from July 2014 to August 2015 were done by foreign investors [13]. The participation of foreign investors exposes the exchange and listed companies to global financial market; therefore, more analysis is likely to be done by foreign investors who have more skills, knowledge and experience than domestic investors in stock exchange dealings.

CMSA licenses and regulates investments intermediaries and deals with the issuance and trade of securities, approves all companies wishing to be listed at the DSE. According to daily market reports issued by DSE, total market capitalization of DSE as of 12th August 2015 was Tshs 22,601.29 billion which is equivalent to USD 10,796.76 million [13]. Although the DSE commenced operation about seventeen years ago the historical records indicate that the speed of companies to list is going at a very low pace because until August 2015 there were only twenty one companies which were listed on DSE [13]. Moreover, out of these listed companies, fourteen companies were primary listed and the remaining companies were cross listed predominantly from the Nairobi Stock Exchange in Kenya. This low pace may be due to several factors. Although, this is not the aim of this study, but one of reasons may be the fact that many companies put more weights on disadvantages rather than on advantages that are associated with public listing; so as result, they become reluctant to list shares on stock exchange.

Since DSE started its operations, one company, National Investment Company Limited, was delisted because of presentation of misleading accounting information in their annual report. Additionally, according to DSE daily market reports for the year 2014/2015, three companies which are TOL Gases Ltd, Tatepa Company Ltd, and Precision Air Services Plc, their shares had been relatively inactive in trading for a very long period. These listings are examples of non-performing IPOs which received public money but have not performed as were expected by many investors who participated in these IPOs. The factors which could contribute to poor performance may not be very clear but one thing which investors should be aware of is investment in IPOs is a risk business which needs careful assessment before making the final decision to invest [14,15]. Some IPOs may portray a very promising future which may attract a lot of attention and positive interest from several investors. However, these IPOs may turn out to be just window dressing or projections based on weak assumptions [16]. Investors can only obtain the expected returns if IPOs can at least maintain pre-IPO performance for a reasonable time in the future. Therefore, it is important to study trend of IPOs performance in order to understand whether there is a significant difference between pre-IPO performance and post-IPO performance.

Data and Methodology

Data used in this study was manually collected from the annual reports of the companies listed on DSE. A sample includes companies which are primary listed on DSE. A list of all listed companies was obtained from the website of DSE. This list indicates among other things the name and the year in which company was listed on DSE. The list has twenty one companies, out of these companies, fourteen are primary listed and the rest are secondary listed. This study focuses only on the primary listed companies because they are more relevant to IPO events studies because these companies were widely exposed to the public for the first time when engaged in IPOs rather than secondary listed companies which have already endured storms of post IPO events in stock exchange where they are primary listed. The final sample includes ten companies that were possible to collect data both before and after IPO. Data were collected for five years before IPO and after IPO period from annual reports which were obtained from either respective companies' websites or offices and DSE's website or office. However, a size of sub-sample of before IPO is smaller than that of sub-sample of after IPO. This is because of unavailability of reports for some of previous years.

The analysis focuses on assessing whether there is significant difference on company financial performance before and after IPO events. Financial performance can be measured in different ways, however, the most common measures are accounting performance and stock market price performance. This study uses accounting performance to measure company performance because accounting performance is a better measurement of performance than stock price measurement especially in developing countries stock markets. The stock market developing countries, like Tanzania, are characterized by a high degree of inefficiency, high illiquidity and stock prices which do not reflect available information [3,10,17]. In this environment the stock market information may not reflect a reasonable market value of the shares as it might be the case in stock markets in developed countries. The financial performance is measured by some accounting performance ratios which are return on assets (ROA), return on equity (ROE), return on capital employed (ROCE) and sales to assets (SA).

Definition and Measures of Variable

Return on Assets

Return on Assets (ROA) is an indicator of profitability of company in relation to its operating asset. It is computed by dividing operating profit before tax by total operating assets. ROA gives an idea as to how efficient management is at using its assets to generate profit. It shows ability of company to generate returns from its operating profit.

Return on Equity

Return on Equity ratio (ROE) is a profitability ratio that measures the ability of company to generate profits from its shareholders equity. ROE is expressed as a percentage of net income to shareholder's Equity. Return on equity measures ability of company to generate returns on shareholders equity.

Return on Capital Employed

Return on Capital Employed (ROCE) is the ratio of net operating profit to capital employed. It measures the profitability of company by expressing its operating profit as a percentage of its capital employed.

Capital employed is the sum of stockholders' equity and long-term finance. Alternatively, capital employed can be calculated as the difference between total assets and current liabilities. A higher ROCE indicates more efficient use of capital.

Sales to Assets

Sales to Asset ratio (SA) is an efficiency ratio that measures ability of company to generate sales from its assets by comparing net sales with average total assets. In the other words, this ratio shows how efficiently company can use its assets to generate sales. This is computed by dividing net sales by total operating assets. Table 1 provides information on the descriptive statistics before and after IPO.

Panel 1: Before IPO					
	Observations	Min	Max	Mean	Std. Deviation
ROA	33	-0.121	0.515	0.122	0.165
ROE	33	-1.312	0.59	0.24	0.331
ROCE	33	-0.183	0.524	0.161	0.17
SA	33	0.056	3.998	0.989	0.895
Panel 2: After IPO					
	Observations	Min	Max	Mean	Std. Deviation
ROA	44	-0.245	0.438	0.13	0.188
ROE	44	-1.752	0.662	0.122	0.563
ROCE	44	-1.206	0.525	0.155	0.386
SA	44	0.087	4.969	1.526	0.931

Table 1: Summary statistics of performance variable.

Table 1 indicates that ROA marginally increased from 12.2 percent before IPO to 13 percent after IPO. This suggests that the performance of companies as measured by return on assets improved marginally by 0.8 percent. This indicates that after IPO the rate of utilization of assets to generate operating profit increase by 0.8 percent. In the other hand, there is high decrease of ROE as it is only 12.2 percent after IPO compared to 24 percent before IPO. This change is a decrease of about one hundred percent. This may be explained by change in size of equity values of some companies after issue of shares. Issue of new shares may increase both a number of shares and amount of equity while the operating profit may remain almost at the same level as it was before an IPO's event.

From Table 1, the ROCE ratio was 16.1 percent before IPO but it decreased to 15.5 percent after IPO. This is decline of 0.6 percent which implies that companies did not employ their capital effectively and is not generating good value to shareholders after the IPO. Moreover, SA ratio indicates that the ability of companies to generate revenue out of total assets increased from 0.989 times before IPO's event to 1.53 times after IPO's event.

Two Sample means difference between Pre-IPO and Post-IPO Financial Performance

This study examines whether the mean difference between pre-IPO and post-IPO financial performance is significant by carry out two-sample t-test with the null hypothesis that the mean difference between pre-IPO and post-IPO financial performance is zero. Table 2 presents the results of two samples means differences.

Variables		
ROA	Before	0.122
	After	0.130
	t-Statistics	0.846
ROE	Before	0.240
	After	0.120
	t-Statistics	0.279*
ROCE	Before	0.161
	After	0.155
	t-Statistics	0.934**
SA	Before	0.989
	After	0.526
	t-statistics	0.013***
***p<0.01, **p<0.05, *p<0.1		

Table 2: Result of test of two sample mean differences.

The results show that when measure of performance is ROA, post-IPO performance is higher than pre-IPO performance; however, the difference is not significant. As for ROE and ROCE measurements, the results indicate that financial performance increased after IPO, but the difference is not significant. Therefore, based on these results, there is no a sufficient evidence to reject the null hypothesis when financial performance is measured by ROA, ROE or ROCE. In the other hand, the results indicate when financial performance is measured by Sales to Assets ratio, the post-IPO performance is higher than pre-IPO performance and the difference is statistically significant ($p > 0.01$). In this case there is a sufficient evidence to reject the null hypothesis.

Conclusions and Implications

Stock exchange markets play major role in mobilization of capital finance from general members of public who when considered individually may have a very little amount of capital but which may be significant when aggregated in one basket [9]. Due to possibility of existence of significant amount investment capital from general public the stock exchanges is one of good sources where companies which are looking for capital can issue financial instruments such as shares and bonds to general public to raise more capital funds. Investors can use stock exchange to buy shares and become shareholders of listed companies with expectation of obtaining benefit from these investments through future dividends and capital gains by increase in value of shares. However, investors can only obtain these benefits if the listed company performs better after IPO.

Listed company might fail to perform if management either fails to make appropriate analysis of internal and external environment or make wrong conclusion about future performance of company. Furthermore, some companies may deliberately mislead investors by window dressing or dishonestly utilize the existence asymmetric information to exploit investors [7]. This may lead to poor company performance in the future because good performance reported before IPO will not be sustainable since it was based on false assumption. This problem can affect many investors in underdeveloped stock exchanges like DSE where many investors do not have sufficient skills, knowledge and experience about stock market and dealing with securities. In the other hand, listed company can make appropriate analysis and arrive at correct and positive conclusion about future company performance. Also, management may present a true and fair view about company performance which may indicate actual good performance. If information presented before IPO indicates company performance is good based on true and fair view, there is a high probability that company may continue to perform either at same level or even better given that other factors remain constant. However, because of existence of uncertainty about the accuracy of information presented by company, there is no clear indication of direction in which company performance may take after listing. Principally, there are three possible changes on future performance of company after IPO. The performance after IPO may increase, remain constant or decline relative to performance before IPO. Therefore, this study examines the difference in accounting performance before and after IPOs.

In general the findings indicate there is difference between pre-IPO and post-IPO accounting performance. However, the significance of the difference depends on measurement of performance used in the analysis. Specifically, the findings indicate post-IPO is high than pre-IPO when performance is measured by Sales to Assets ratio. The findings of this study contradict the findings of other studies such as Kim et al. [5], Wang [4] and Wong [18] which indicated the performance declines after IPO. This implies there is no consistency in findings in IPO's events studies. This makes difficult for researchers and practitioners to reach a general conclusion on whether companies perform better after IPO or otherwise. The lack of conclusive results may be due to a number of factors such as selection of variables and their measurements, timing of data collection and contexts of studies. For example, this study uses three different measures of financial performance and only one measure indicates there is significant difference between post-IPO and pre-IPO performance. This implies that measurement of financial performance can influence the final results in these types of studies.

Results of this study have implication for policy makers, investors and future research. The findings have policy implication for roles of regulators of stock market, shareholders monitoring and governance of listed companies. This is because the results indicate at least the performance of listed companies does not deteriorate after IPOs. The findings of this study have implication for investors in IPOs, particularly in DSE where both local and foreign investors participate in trading shares. Specifically, the results indicate that it is important to make analysis of performance of listing company both before and after investment decision. Also, it is equally important to be aware not every measurement of performance may provide appropriate information about company performance. The study also has important implication for the future research on IPO performance. Specifically, the results indicate that conclusion drawn on performance of IPO should be interpreted cautiously because the result may be affected by measurement of company performance. Moreover, the context of study

may affect the findings as it may explain to a certain extent the current situation of lack of consensus in IPOs performance research.

Acknowledgment

The acknowledgement goes to a group of students of Bachelor of Accounting and Finance at Ardhi University in the year 2015 who participated in the preliminary stages of this study.

References

1. Allison S, Hall C, Mcshea D, Vanye K (2008) The Initial Public Offering Handbook: A Guide for Entrepreneurs, Executives, Directors and Private Investors. Minnesota, USA.
2. Singh I, Mitchell Van Der Zahn JLW (2008) Determinants of Intellectual Capital Disclosure in Prospectuses of Initial Public Offerings. *Accounting and Business Research* 38: 409-431.
3. Jain BA, Kini O (1994) The Post-Issue Operating Performance of IPO Firms. *Journal of Finance* 49: 1699-1726.
4. Wang C (2005) Ownership and Operating Performance of Chinese IPOs. *Journal of Banking & Finance* 29: 1835-1856.
5. Kim KA, Kitsabunnarat P, Nofsinger JR (2004) Ownership and Operating Performance in An Emerging Market: Evidence from Thai IPO Firms. *Journal of Corporate Finance* 10: 355-381.
6. Aharony J, Lee CWJ, Wong TJ (2000) Financial Packaging of IPO Firms in China. *Journal of Accounting Research* 38: 103-126.
7. Roosenboom P, Van Der Goot T, Mertens G (2003) Earnings Management and Initial Public Offerings: Evidence from the Netherlands. *The International Journal of Accounting* 38: 243-266.
8. Rahman RA, Abdullah WRW (2005) The New Issue Puzzle In Malaysia: Performance And Earnings Management. *Journal of Financial Reporting and Accounting* 3: 91-110.
9. Levine R, Zervos S (1996) Stock Market Development and Long-Run Growth. *The World Bank Economic Review* 10: 323-339.
10. Munisi G, Randoy T (2013) Corporate Governance and Company Performance across Sub-Saharan African Countries. *Journal of Economics and Business* 70: 92-110.
11. Urt (1994) Capital Markets and Securities Act.
12. Urt (2014) The Capital Markets And Securities (Foreign Investors) Regulation. In: Tanzania TURO (Ed.) Dar Es Salaam: Government Printer.
13. Dse (2015) Dar Es Salaam Stock Exchange Market Report. Tanzania.
14. Wysocki PD (2007) Discussion of IPO Failure Risk. *Journal of Accounting Research* 45: 373-384.
15. Demers E, Joos P (2007) IPO Failure Risk. *Journal of Accounting Research* 45: 333-371.
16. Alhadab M, Clacher I, Keasey K (2014) Real And Accrual Earnings Management And IPO Failure Risk. *Accounting and Business Research* 45: 55-92.
17. Lo AW, Mackinlay AC (1988). Stock Market Prices Do Not Follow Random Walks: Evidence from a Simple Specification Test. *Review of Financial Studies* 1: 41-66.
18. Wong J (2012) Operating Performance of Initial Public Offering Companies in Hong Kong. *Journal of Modern Accounting and Auditing* 8: 46-65.