Corporate Governance Mechanism: Evidence from Unit-IPO Firms Listed on Indonesia Stock Exchange

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Abstract

The purpose of this study is to examine the differences in corporate governance mechanisms between unit-IPO firms and share-only IPO firms. The mechanism of corporate governance is proxied with the number of directors on the board, outsider director and debt level. Sample covers 40 units-IPO firms listed between 2007 and 2014. The results show that 1) there are significant differences in the number of directors between unit-IPO firms and share-only IPO firms, 2) there is no significant difference in outsider director between unit-IPO firms and share-only IPO firms, and 3) there is no significant difference in debt level between unit-IPO firms and share-only IPO firms. Further, descriptive statistics indicate that the unit-IPO firms have higher risk compared with share-only IPO firms.

Key Words: corporate governance, option, IPO
1. Introduction

Research on corporate governance has been carried out around the world. The issue of corporate governance research is mostly linked to the performance / value of the company (see Latief, et al., 2014; Guest, 2009; Ghazali, 2010; Peni and Vahamaa, 2012; Velnampy, 2013). The better (worse) corporate governance mechanisms, the higher (lower) the performance of the company. In addition, research on governance is also associated with executive compensation (see Suherman, et al., 2010; Suherman, et al., 2015; Yang, et al., 2014; Lee, 2014; Vemala, et al., 2014; Lam, et al., 2013).

In contrast to the above issues, the present study will investigate the mechanisms of corporate governance and the characteristics of unit-IPO firms, in particular to find out whether the unit-IPO firms have corporate governance mechanisms are less effective than with share-only IPO firms and investigate whether the unit-IPO firms have a higher risk compared with share-only IPO firms. When will sell shares to the public, managers faced two choices bidding method whether to sell shares to the public without warrants or with accompanying warrants. Schultz (1993) states that the company sold shares with warrants is to reduce agency costs associated with the revenue received during the IPO. Howe and Olson (2009) argued that the warrant is a mechanism of corporate governance for companies doing IPOs. They also say that the options / warrants are as one substitution for corporate governance of a company that did an IPO.

Decision-unit method IPOs IPOs or share-only chosen by the company also depends on agency conflicts that exist in the company. Schultz (1993) argues that companies that go public accompanied warrants the companies that received venture capital backing. The company must realize the goals set by the owners of the venture capital to continue to grow and receive additional funding. IPO companies issuing shares with warrants to get the proceeds from the IPO in smaller amounts and must prove to the market that they (IPO firms) has a good economic prospects in the future. If the market's positive reaction to the IPO stock price rises. When the stock price reaches the price of 'exercise' warrants, each warrant holder to sell (exercise) warrants and gives the result (money) to the company's IPO in additional funds. Companies issuing warrants accept cash less current IPO, reducing the effects of free cash flow (Jensen, 1986).

IPO firms that sell shares with warrants (unit-IPOs) have characteristics of smaller size, age younger, and more at risk than the company IPO issue shares only (Schultz, 1993; Jain, 1994; How and Howe, 2001; Howe and Olsen, 2009). Unit-IPOfirms also sold its shares in an amount greater than the share-only IPO firms. Schultz (1993) suggests that companies are younger, smaller and more risky to have greater difficulty determining whether the company has projects that are profitable to do. Furthermore, if companies release large amounts of
shares in the IPO, agency cost becomes a major problem because insiders have reduced the incentive to act in the interests of shareholders. The difference between unit-IPO firms and the share-only IPOs shows that the decision warrants issued during the IPO depends on the agency conflict within the company, the same as the dividend distribution decision expressed by Officer (2006).

In the context of Indonesia, to our knowledge, there has never been done research on corporate governance and company characteristics in companies that do a good IPO offerings unit-share IPO and IPO-only. Thus, this study expands the literature related to corporate governance, especially in developing countries such as Indonesia. In particular, this research examines the agency theory in the context of the unit-IPO firms.

Further, below will be described on literature review, research methods, results, and conclusions.

2. Literature Review and Hypothesis

Howe and Olson (2009) argued that if the warrants (options) is a substitute for the mechanism of corporate governance in companies that do an IPO, a company that did an IPO with warrants have structures that corporate governance is less effective compared to companies that do an IPO shares only without warrants. As a mechanism of internal governance, the board of directors researched. Jensen (1993) and Yermack (1996) revealed that the greater the number of board of directors, the less effective the council to perform its functions. Furthermore, the larger the board of directors, the less independent board of directors (Weisbach, 1988; Hermalin and Weisbach, 1998; Howe and Olsen, 2009).

H1: Unit-IPO firms have more members in the board of director than shares-only IPO firms that go public at the Indonesia Stock Exchange between 2011 and 2014

H2: Outsiders in the board of directors of unit-IPO firms are fewer in number than the outsiders in the board of directors of shares-only IPO firms that go public at Indonesia Stock Exchange between 2011 and 2014

Companies with lower debt that does not benefit from the IPO oversight role performed by banks and other lenders (Diamond, 1984; Fama, 1985; James, 1987; Howe and Olsen, 2009).

H3: Debt-unit IPO firms is lower than the level of debt in shares-only IPO firms that go public at the Indonesia Stock Exchange between 2011 and 2014

3. Methods

Sample

Sample of this research consists of 40 unit-IPO firms between 2007 and 2014 listed on Indonesia Stock Exchange. We then compared the respective unit-IPO firm with respective shares-only IPO firm in 1) industry are the same, and / or 2) have a total stock market value
approaching (the number of ordinary shares outstanding after the IPO multiplied by the offer price).

**Variables**

a. Board of directors

   Board members are members who sit on the board of directors. Measured with the number of board members who sit as members.

b. Director Outsiders

   Director outsiders is a board of directors from outside the company and has no family relationship with dewan direktur. Director of outsiders is measured by the percentage of the total outsiders director of the board of directors.

c. Debt

   Debt is measured with debt to equity ratio.

**Data**

This study employs secondary data. Data were taken from the annual report.

**Metode Analisis**

Data were analyzed using two different test samples of different groups. The first two groups are unit-IPOs and share-only IPOs.

**Hypothesis Testing**

To test the hypothesis of the study carried out two different test independent groups (two independent sample t-test). Different groups first is governance unit IPO firms, and the second is a different group share-only IPO firms.

**4. Results**

Table 1 shows the descriptive value both companies IPO accompanied with warrants (unit-IPOs) in panel A and IPO without the warrants (share-only IPOs) in panel B. The average number of directors sitting on the company’s IPO with warrants more than the company's IPO without warrant (3.68 compared to 4.28). While the median number of directors on the company's IPO with or without warrants equal at 4. Statistically, there appears a large difference between the number of directors on the company's IPO is accompanied by warrants and the company's IPO without warrants.

Percentage of outsider directors on the company’s IPO accompanied by warrants and the company's IPO without warrants showed relatively similar. For example, the average percentage of outsider directors of companies the IPO is accompanied by warrants amounted to 22.61%, while the company's IPO without warrants amounted to 22.87%. The median value of IPO companies accompanied warrants and without warrants equal, ie 4. Furthermore, minimum and maximum values in the company's IPO with warrants and without warrants is the same that is 0% and 50%.
The amount of debt (measured by debt to equity ratio) on its IPO with warrants and without warrants indicate the numbers are not much different to the average value and median. The average debt held by the company IPO with warrants of 2.71, while the company's IPO without warrants is 2.89. Meanwhile, the median value of corporate debt that accompanied the IPO warrants was 1.19 compared with the median value of the company's IPO without warrants by 1.51. The maximum value of the debt on the company's IPO with warrants and without warrants showed a considerable difference, amounting to 28.82 at the IPO company with warrants and amounted to 14.77 at the company's IPO without warrants.

The average age of the company's IPO is accompanied warrants a bit younger than the company's IPO without warrants, namely 15.95 years and 16.25 years. Median age of the IPO company with warrants and without warrants is equal ie 13,50 years. The minimum age at the company's IPO with warrants and without warrants is the same that is 3 years. While the maximum age of the company's IPO with warrants is 57 years, and the company's IPO without warrants was 58 years old.

Table 1: Descriptive Statistics

<table>
<thead>
<tr>
<th>Panel A: Unit-IPOs</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Median</th>
<th>STD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of directors</td>
<td>2</td>
<td>6</td>
<td>3.68</td>
<td>4</td>
<td>1.02</td>
</tr>
<tr>
<td>Director outsider (%)</td>
<td>0</td>
<td>50</td>
<td>22.61</td>
<td>25</td>
<td>15.03</td>
</tr>
<tr>
<td>Debt to equity ratio</td>
<td>0.07</td>
<td>28.81</td>
<td>2.71</td>
<td>1.19</td>
<td>4.92</td>
</tr>
<tr>
<td>Firm age (year)</td>
<td>3</td>
<td>57</td>
<td>15.95</td>
<td>13.50</td>
<td>11.54</td>
</tr>
<tr>
<td>Initial return (%)</td>
<td>-81.62</td>
<td>70</td>
<td>34.98</td>
<td>37.89</td>
<td>33.99</td>
</tr>
<tr>
<td>Shares sold at IPO (%)</td>
<td>10.18</td>
<td>70</td>
<td>30.74</td>
<td>30</td>
<td>12.36</td>
</tr>
<tr>
<td>Return volatility (%)</td>
<td>8.85</td>
<td>81.23</td>
<td>47.29</td>
<td>49.58</td>
<td>24.37</td>
</tr>
<tr>
<td>Gross proceeds (million Rp)</td>
<td>22,500</td>
<td>2,095,500</td>
<td>338,600.31</td>
<td>220,200</td>
<td>431,471.02</td>
</tr>
<tr>
<td>Options offered (million shares)</td>
<td>25.6</td>
<td>6,500</td>
<td>1,124.83</td>
<td>600</td>
<td>1,432.08</td>
</tr>
<tr>
<td>Age of option</td>
<td>1</td>
<td>5</td>
<td>3.22</td>
<td>3</td>
<td>1.12</td>
</tr>
<tr>
<td>Exercise price (Rp)</td>
<td>102</td>
<td>1,050</td>
<td>266.78</td>
<td>192.50</td>
<td>222.20</td>
</tr>
<tr>
<td>Observation</td>
<td>40</td>
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</table>

<table>
<thead>
<tr>
<th>Panel B: Share-Only IPOs</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Median</th>
<th>STD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of directors</td>
<td>2</td>
<td>7</td>
<td>4.28</td>
<td>4</td>
<td>1.38</td>
</tr>
<tr>
<td>Director outsider (%)</td>
<td>0</td>
<td>50</td>
<td>22.87</td>
<td>25</td>
<td>11.76</td>
</tr>
<tr>
<td>Debt to equity ratio</td>
<td>0.12</td>
<td>14.77</td>
<td>2.89</td>
<td>1.51</td>
<td>3.64</td>
</tr>
<tr>
<td>Firm age (year)</td>
<td>3.00</td>
<td>58.00</td>
<td>16.25</td>
<td>13.50</td>
<td>10.07</td>
</tr>
<tr>
<td>Initial return (%)</td>
<td>-17.27</td>
<td>70.00</td>
<td>18.34</td>
<td>10.00</td>
<td>24.81</td>
</tr>
<tr>
<td>Shares sold at IPO (%)</td>
<td>10.00</td>
<td>73.39</td>
<td>26.32</td>
<td>25.00</td>
<td>14.21</td>
</tr>
</tbody>
</table>
Average initial returns showed a considerable margin in which the company's IPO with warrants have an average return of its initial 34.98% and the company's IPO without warrants is 18.34%. Median initial IPO returns are accompanied by warrants and without warrants is 37.89% and 10%. The minimum initial return on IPO with warrants and without warrants was -81.62% and 17.27%. While the maximum initial IPO returns are accompanied by warrants and without warrants is the same, namely 70%.

Average price of shares released to the public in an IPO company with warrants is higher than the company's IPO without warrants, ie 30.74% versus 26.32%. Its median value was greater on the company's IPO with warrants, compared with the company's IPO without warrants, ie 30% versus 25%. However, the maximum value of the shares sold to the public by companies that accompanied the IPO warrants smaller (70%) compared with the company's IPO without warrants (by 73.39%). While the minimum value of the shares sold to the public by companies that accompanied the IPO warrants greater (ie 10.18%) compared with the company's IPO without warrants (at 10%).

The average return volatility that accompanied the company's IPO warrants higher than the company's IPO without warrants, ie 47.29% against 28.65%. The lowest value and the highest return volatility that accompanied the company's IPO warrants was 8.85% and 81.23%. While the lowest value and the highest volatility of return of IPO without warrants was 2.21% and 80.22%. Standard deviation value return volatility that accompanied the IPO company warrants a lower (ie 24.37%) compared to its IPO without warrants (26.89%).

Average gross receipts from sales of IPO (gross proceeds) IPO accompanied warrants greater than the company's IPO without warrants, ie 338.6 billion rupiah compared to 337.4 billion rupiah. Minimum and maximum gross proceeds of IPO companies that accompanied the warrants was 22.5 billion rupiah and 2.09 trillion rupiah. While the company's gross IPO proceeds without warrants was 30.1 billion rupiah and 2.06 trillion rupiah.

Table 1 panel A (unit-IPOs) shows the number of options / warrants are sold, the life of the options / warrants and the exercise price. Average options / warrants sold was $ 1.12 billion more pieces. Median options / warrants offered are as many as 600 million shares. Options / warrants offered the lowest and the highest was 25.6 million shares and 6.5 billion shares. While the standard deviation is high at 1.43 billion more pieces. Age options / warrants have an average age of 3.22 years for. The median of 3 years. Age fastest and longest option is 1 year and 5 years. The average exercise price is Rp.266,78 with a standard

Table 2 shows the results of different test IPO companies with options (unit-IPO firms) and the company's IPO without options (share-only IPO firms). Different test using the t test and Z test (Wilcoxon test). Corporate governance using three proxies, namely the number of directors, the director of outsider and a debt to equity ratio. The number of directors on the company's IPO accompanied the options / warrants differ significantly from the number of directors on the company's IPO without an option where the average number of directors on the company's IPO with a lot more options than in the company's IPO without options. It is seen from the t value of 2.212 (significant at 95%) and the value of Z = 2.029 (significant at 95%). This result is contrary to Howe and Olsen (2009), which found the number of directors on the company's IPO is accompanied by a lot more options than in the company's IPO without options. Yawson (2006) suggested that the large size of the board that lead to high costs manejerial causing a decline in profitability. The number of members of the board of directors that much can cause communication problems and coordinators which could negatively affect the company's performance (Beasley, 1996; Yermack, 1996).

<table>
<thead>
<tr>
<th></th>
<th>Unit-IPO firms</th>
<th>Shares-only IPO firms</th>
<th>Difference test</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>Median</td>
<td>Mean</td>
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<td>4.28</td>
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<tr>
<td>Directors outsider (%)</td>
<td>22.61</td>
<td>25.00</td>
<td>22.87</td>
</tr>
<tr>
<td>Debt to equity ratio</td>
<td>2.71</td>
<td>1.19</td>
<td>2.89</td>
</tr>
</tbody>
</table>

b denotes significance at level of 95%

Two other proxy of corporate governance is the director of the outsider and the debt to equity ratio showed no significant difference in the company's IPO and the company with the option IPO without options. Test value t and z on director outsider just .090 and .700. While the value of t and z debt to equity ratio of 0.239 and 0.245. These results do not support the findings of Howe and Olsen (2009), which revealed no significant difference in the number of outsider directors and the debt to equity ratio of the company accompanied IPO and IPO option without options.

In general it can be said that the mechanism of corporate governance at the company's IPO accompanied the options / warrants and the company's IPO without options is no different.

5. Conclusion

When the company decided to "go public", managers are faced with two choices: 1) selling shares debut with warrants (called unit-IPOs), or 2) sell any shares without warrants (called a share-only IPOs). Unit IPOs provide the right (not the obligation) for the owner to
buy the stock (s) at a price agreed upon at the beginning of a period of time. From a practical standpoint, the IPO with warrants named as "sweeteners". This study examines differences in corporate governance mechanisms between unit-IPO firms and the share-only IPO firms. The results showed no difference in general corporate governance mechanisms between unit-IPO firms and the share-only IPO firms.

References


