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The pre & post-issue performance of IPO banks

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Abstract

This paper analyzes the performance of banks that went public in the year 2010 for a sample of two public sector banks in India. (Punjab and Sind bank and United bank of India). This study is done from the period of 5 years before going public (pre issue performance) and after five years of public (post issue performance). Various ratios have been taken to assess the performance of banks. Results show that there is a decline in the post-issue operating performance of IPO banks. Moreover, the change in return on assets after the IPO is unrelated to the level of profitability prior to the IPO. In the presented study, profitability ratios in the year before initial public offering increase over the previous year, and then, after the IPO, fall. The changes in the return on assets after going public seem to be explained, to a large extent, by the institutional characteristics of the financial systems, such as bank activity restrictiveness and regulatory requirements regarding the amount of capital. This confirms the phenomenon of distorting the level of profit before the IPO and partially equity dilution after the IPO.

Keywords: IPO bank, post-issue performance, pre-issue performance

1. Introduction

A wave of bank IPOs causes a series of relevant impacts to the financial system. The proceeds of IPOs are an important source of capital for financial institutions that allows the expansion of bank deposits and assets. Initial public offering (IPO) is an important moment in a bank's development process, and the owners are guided by different motives when deciding to start public trading of shares. Exchange can be a source of capital and prestige

However, it is uncertain what happens with respect to the return of banks after the IPO or whether the institutional and regulatory characteristics of the financial systems and the characteristics of the banks influence the changes in operating return of the banks after the IPO. Within this context, the aim of this paper is to analyze the post-issue operating performance of IPO banks and to study the aspects that influence the change in operating performance. This study uses two public sector banks of India who released their IPO in the same year (2010). These activities are usually aimed at maximizing the efficiency of the company before the IPO to raise as much as possible capital through the sale of shares on the stock exchange. The decisions are mainly concentrating on maximizing income and profitability ratios in the period preceding the valuation and determination of price of the shares. These indicators can be a fundamental criterion for the decision on the introduction of the company's shares to public trading, which boils down to raise equity capital to finance planned investments.

If a bank collects more capital than planned, then it may be unprepared to use a larger amount of money for investment purposes. Such a situation may result in equity surplus over the investment requirements and finally usage of this equity for the policy relaxing purposes ending with lower profitability ratios. The goal of this article is to present the profitability ratios behaviour before and after the IPO and to demonstrate certain regularities occurring in the company in the context of this event. There was verified the hypothesis that companies increase profitability before the IPO through windows dressing and gather more capital on the market than necessary for development, resulting in the equity dilution effect. It is expected that some profitability indicators of companies preparing for the IPO in the year before the IPO, increase over the previous year, and then fall after the IPO. The reason for this can be manipulating the profits before the IPO or equity surplus after the public offering, which will be determined by comparing the behaviour of the individual ratios before and after the IPO.

2. Review of Literature

Alanazi and Liu (2013) [3] analysed the 52 IPOs in the region of Gulf Cooperating Council in 2003–2010. The results indicated that IPO performance declines after going public. According to the authors the performance decline is associated with the firm transition from private into public ownership due to increasing agency cost. This research turn lends support to the window-dressing explanation of IPO perform.

Ahmad (2011) [2] conducted a study related to economic efficiency of Malaysian companies entering the public market. The author concluded that the operational activities after the IPO clearly shows decline.

Wu *et al*. (2009) have tested whether an IPO improves the performance of Chinese banks as measured by ratios: ROE and ROA. They found that in general the banks listed on the exchange have worse results than non-listed banks, and that the IPO had a significant positive impact on the growth of ROA before the IPO and the time when the emission was carried out. However, over time ROA fell. This means, according to them, that the presence of the bank in the stock market is not reflected in the operating results. Interestingly, not only on the U.S. market, but also on the Chinese one, there have been observed a phenomenon associated with lower performance of listed companies compared with those, that were not listed on the stock exchange.

Kurtaran and Bünyamin (2008) [9] studied the listed companies in Turkey and they compared the ROA for the year preceding

the IPO with ROA three years after the IPO. They showed that ROA three years after the IPO fell from 9% to -32.7%. The decrease in ROA was constant and continuous.

Barth *et al*. (2004) have revealed that regulatory and supervisory practices promote bank performance and stability. Within this context, it is also expected that aspects such as bank activity restrictiveness and regulatory requirements regarding the amount of capital may influence the change in return after the IPO.

Aharony *et al*. (2000) [1], who studied the ROA of companies in the year of the initial public offering and the year after that. In the year of the initial public offering they found that the average ROA of companies got its peak, then fell. This decrease was significantly lower in the companies in the sectors supported by the government, i.e. fuel, raw materials and energy.

3. Research methodology and data

In order to determine the effectiveness of the banks performance, we have selected indicators of profitability: return on assets (ROA) and return on equity (ROE). In addition two more indicators were taken into account, which are the return on investment (ROI) and net profit margin (NPM) to determine whether the increase in ROE and ROA before the IPO is the result of manipulation or equity dilution after IPO. If this is the dilution of equity, profit margins should remain at the same level after the IPO, while profitability ratios should fall due to the high level of unproductive cash and short-term investments. For each bank all available annual data on ROA, ROE, ROI, NPM, which are measurements of companies performance efficiency, were collected. All data relates to year, from 2006 to 2015.

4. Objectives of the study

1. To highlight the various profitability ratios of two selected public sector banks (i.e. Punjab and Sind bank, united bank of India). Before and after IPO release.
2. To analyze the overall profitability of banks Net profit margin, Return on equity, return on investments & Return on asset.

5. Period of study

The study covers a period of 10 years from 2005-2015 is taken for the study.

6. Methodology

6.1 Data Collection: The study is based on secondary data. Information required for the study has been collected from the annual report of Punjab and Sind bank, united bank of India & different books, journals, magazines & data collected from various bank websites.

6.2 Statistical Tools: In this study various statistical tools are used (i.e.,) Mean, Standard deviation, Coefficient of variation have been used for data analysis

7. Limitation of the study

a) The study is restricted to two public sector banks only.
b) The study is related to a period of 10 years only.
c) As the data are only secondary, i.e., they are collected from the published annual reports.

8. Overview of profitability

Profitability performance is the primary goal of all business ventures. Without profitability the business will not survive in the long run. So measuring current and past profitability and projecting future profitability is very important. Performance of banks is measured with income and expenses. The ability to earn a profit. Infect, efficiency of business is measured in terms of profits. Profitability ratios are calculated to measure the efficiency of banks. The following profitability ratios have been calculated as follows:

ROA (Return on assets) = net profit (loss) total assets

ROE (Return on equity) = net profit (loss) shareholders' equity

ROI (Return on Investment)

$$\text{Measures the income earned on the invested capital} = \frac{\text{Net Income *}}{\text{Long-term Liabilities + Equity}}$$

NPM = net profit (loss) Net revenues from sales of goods, products and materials'

9. Result and Data interpretation

Table 1: showing ratios of Punjab and Sind bank pre and post IPO listing

Ratios of Punjab and Sind Bank				
Years	**ROA**	**ROE**	**ROI**	**NPM**
2006	0.64	13.03	8.39	23.07
2007	1.01	16.63	8.37	17.55
2008	1.49	21.86	7.81	13.37
2009	1.24	20.37	6.52	12.41
2010	1.05	21.40	7.18	17.76
MEAN (PRE IPO)	1.08	18.65	7.65	16.83
STD DEV.	0.28	3.36	0.71	3.79
VARIANCE	0.07	11.29	0.51	14.36
2011	0.90	16.39	7.00	10.66
2012	0.65	11.21	7.59	6.97
2013	0.44	7.66	7.41	4.62
2014	0.35	6.25	7.40	3.77
2015	0.13	2.29	7.76	1.41
MEAN(POST IPO)	0.49	8.76	7.43	5.48
STD DEV.	0.26	4.76	0.25	3.13
VARIANCE	0.06	22.71	0.06	9.85

Table 2: showing ratios of united bank of India pre and post IPO listing

Ratios of United Bank of India				
YEARS	**ROA**	**ROE**	**ROI**	**NPM**
2006	0.66	10.81	8.17	8.83
2007	0.73	12.60	7.73	8.26
2008	0.68	12.57	7.81	3.96
2009	0.34	6.44	7.02	5.76
2010	0.45	9.24	7.03	4.80
MEAN(PRE IPO)	0.51	10.33	7.55	6.32
STD DEV.	0.15	2.31	0.45	1.91
VARIANCE	0.02	5.34	0.20	3.65
2011	0.66	11.74	6.39	8.26
2012	0.70	11.93	6.79	7.94
2013	0.38	6.84	7.23	4.23
2014	0.29	-21.73	6.63	-11.44
2015	0.21	4.61	6.66	2.51
MEAN(POST IPO)	0.44	2.67	6.74	2.3
STD DEV.	0.19	12.52	0.27	7.20
VARIANCE	0.03	156.90	0.07	51.97

Table 1 shows basic descriptive statistics for Punjab and Sind bank Table-2 shows united bank of India five observations before IPO and five years observations after IPO for a given bank. Only a glance at provided means and standard deviation leads to conclusion that, roughly speaking, banks performance, measured by any ratio, is better before IPO than after IPO. If before and after IPO, net profit margin and operating profit margin do not change, it will mean that the decline in ROE and ROA after the IPO results from the dilution of profit in relation to the equity and assets. If NPM and ROI fall as ROA and ROE, it will prove the windows dressing effect prior to the IPO. If a few years after IPO, ROE and ROA and NPM and ROI grow as well, this would mean a reduction in dilution and confirms that the decline in profitability after the IPO was the result of equity surplus. We do not have to reflect neither short-term fluctuations in the economy nor the deep transition within the 2000s. It is because we have focused on relation of ratios before IPO, the year of IPO and years after IPO separately for each bank. Ratios of different companies have not been compared with each other.

10. Conclusion

Profitability of public sector banks in India plays major role in banking sector without profit the investors cannot invest in this business. A strong financial system promotes investment by financing productive business opportunities, mobilizing savings, efficiently allocating resources and makes easy the trade of goods and services. To conclude that there is difference among the mean value of interest spread, net profit margin, return on long term fund and return on net worth and there is no difference among the mean value of return on asset of private banks. So profitability ratios are employed by the management in order to assess how efficiently they carry on their business operations and also it is suggested for the entire bank to take effective steps to improve the operating efficiency of the business. As it was stated in introduction of this paper, profitability of companies that go public, measured by ROE, ROA, ROI & NPM in a year before IPO is better than in earlier periods. We also confirmed, that profitability of banks in a years before IPO is better than 5 years after IPO. The expectation that profitability of banks that go public measured by ROE, ROA, NPM and OPM within period before IPO is better than performance of a company within period after IPO, was also confirmed by the analysis. During IPO the companies get a huge amount (usually more than they expected) of money, but they are not prepared to manage it efficiently or they do not have specific plans for investments connected to larger than expected, amount of money.. We noticed that NPM and ROI are not equal in two periods before IPO and after that. This result may confirm the effect of equity dilution, since ROE and ROA are worse after IPO when the same period is compared. This effect is weaker since the margins are the subject of manipulation before IPO as well.

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