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Initial Public Offering Analysis on the Financial Performance of Companies in the Philippine Stock Exchange

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ABSTRACT

The initial public offering (IPO) is one of the money-making moves of a company to raise capital and to have more financial liquidity by selling shares of stocks to the public for the first time. This study concentrated on analyzing the effects of the initial public offering on the financial performance of four companies that went public three years before and three years after 2016 listed in the Philippine Stock Exchange (PSE). The data analysis procedures were accompanied by using the quantitative method that measures the effects of IPO on the financial performance, and t-test statistics are utilized to determine the mean difference between the pre-IPOs and post-IPOs' financial performance. The results indicated that the Return on Sales, Return on the Total Assets, and Return on Equity, Current Ratio, and Debt-to-Equity caused no significant difference in the financial performance of companies before and after the IPO event. In contrast, the Debt Ratio resulted in a significant difference after the IPO event. Thus, by interpreting the results, the study concluded that the debt ratio of the companies improved after IPO listing and signifies that the companies have more assets than liabilities. The implication of the study to various stakeholders such as policymakers, private companies, retail investors, and future researchers was also provided.

Keywords — Investment, Initial Public Offering, Quantitative Method t-Test Statistics, Philippine Stock Exchange

INTRODUCTION

Initial Public Offering (IPO) is one of the methods of private corporations to raise capital to improve and expand the business by issuing a share of stocks for the first time and goes public. A private corporation is a kind of business that privately-owned its share of stocks to its private shareholders and not publicly traded has improved its financial performance relatively with venture capitalists or angel investors. Rudianto (2021) states that with the initial public offering, there will be a change in the status of the company from a closed company to an open one. The author argues that IPO has great potential in influencing company performance, one of which is financial performance due to the potential for additional capital in a relatively large amount. The company's financial performance will be better than before the IPO. Munisi (2017) mentions that before a private company goes public, it must first present its prospectus, which contains vital insightful information about the company regarding issuing shares to the public. The author contends that the company's information presented to the public and the good intention to follow the rules and regulations, the prospect IPO Company might expose essential information, such as financial health, compensation scheme, intellectual properties, financial projections, financial obligation, and other material information.

The initial public offering (IPO) is a gateway for private corporations to become public companies which posit not only opportunities but also risks and challenges. Germo (2021) mentions in his Vlog that companies venturing IPO want to raise funds for whatever reason they may use the money for it could be for expansion, to pay off debt, or to reward those early investors that also want already to exit. In addition to the opportunities, Kupier and Dinklo (2017) indicate the total money collected from the IPO event can be used for investments such as retaining more cash or other assets which they can use for multiple purposes. The scholars contend that another reason for executing an IPO could be to profit from a change in leverage. The authors further argue that advantages for IPOs are overcoming borrowing constraints, greater bargaining power with banks, portfolio diversification, stock market discipline, liquidity, investor recognition, change of control, and windows of opportunity. However, the process before and after the IPO event is not that easy due to some risks and challenges involved. The study of Munisi (2017) states that an IPO process incurs some costs such as compliance cost and management time spent in the IPO process. The author argues that the company may outsource some professionals such as lawyers and accountants who may charge a significant amount of fees. As indicated on the website of PricewaterhouseCoopers (n.d.), an international professional services network that provides audit and assurance, tax, and consulting services, the cost of going public varies. It is also affected by various factors, such as the complexity of the IPO structure, company size, and offering proceeds, as well as the company's readiness to operate as a public company. The typical example of the cost incurred in the IPO process includes underwriting fees, accounting, legal, SEC registration, exchange listing, printing, miscellaneous, and non-disclosed costs. The complex process might be bothersome to the companies' core competence; as a result, the overall performance of the company will dwindle after the IPO operation is finished.

As indicated by Verma (2017), financial performance, in the broader sense, depicts the degree to which financial objectives being or have been accomplished and is an essential aspect of financial risk management. The author contends that the companies need to measure the overall financial health over an accounting period and compare their financial performance to similar business entities across the same industry. Thus, financial performance is measured through various financial ratios from financial statements to obtain helpful information about the company. Maina (2015) breaks down the analysis of the financial information of the IPO companies in Tanzania using profitability, liquidity, leverage, and company size.

Lee et al. (2019), and Doski (2014) uncovers that the IPO event has various effects on the company performance, operational performance, and financial performance. Kuiper and Dinklo (2017) revealed that the most mentioned reason why a firm executes an IPO is raising capital for investment, and the money collected can be used for various purposes that affect shareholder's equity significantly with cash from the primary issuance. Besides, the newest public company can capitalize through secondary offerings that give the company another way to raise funds. (Business World, 2021). As indicated in the study of Mungure (2017), another effect of the IPO on financial performance is it allows the firm to overcome the borrowing constraints that keep production at an optimal level. The scholar contends that the decision to be listed under a stock exchange is triggered by a sudden and permanent increase in total factor productivity. Furthermore, the level of capital employed in production is set to advance at a level that is lower than the ex-post efficient one, the return on assets increases too. The study of Fan (2019) concluded that highly leveraged firms tend to use the proceeds of IPOs to repay more existing debt. The scholar added that the increased debt capacity and reduced interest burden enables firms to expand their business. The scholar further contends that firms that have previously labeled low-growth firms can achieve high growth in the post-IPO period by conducting debt retirement. On the flip side, there are several destructive effects of IPO on the financial performance of a new public company. According to Amor and Kooli (2017), IPOs declaring investment plans as the primary use of proceeds exhibit insignificant average abnormal returns in the three years following the IPO, while IPOs that state debt repayment as the primary use of proceeding is the highest underperformers. Furthermore, the authors argue that the results confirm the role that the primary use of proceeds plays in explaining the timing motive of IPO firms. Mania (2015) indicates that previous scholars have concluded that post-issue declines in the market-to-book ratio, price-earnings ratio, and earnings per share ratio. This is consistent with this interpretation, suggesting that potential investors initially have high expectations of future earnings growth, which are not subsequently fulfilled.

The Philippine Stock Exchange (PSE) is the marketplace where the companies go public through IPO and get listed. The PSE aims at around eight IPO's per year. In 2016, four private companies successfully went public (PSE Edge). Patag (2019) reveals that the target is based on the continuous slowdown of inflation (2 to 4 percent range. The author argues that fiscal and monetary policies encourage aggregate spending and the strengthening of the peso against the dollar, which influence not only the market but also IPOs. If the performance of the local market holds strong, more private companies will be enticed to go public and participate in the market (Patag, 2019). However, the author further argues that several companies listed are not performing well after going public. Investors should not discount the fact that IPOs did not execute well and not even reached their IPO price after listed in the stock market after several years.

The research conducted by Kim and Weisbach (2005) revealed that issuance of primary shares is correlated with higher increases of investment, higher repayment of debt and increases in cash, and more subsequent capital-raising through offerings. The scholars contend that capital raising is an important motive in the going-public decision. Sheila (2019) studied and analyzed the effect of an IPO on the financial performance of listed companies in the Nairobi Securities Exchange. The study concluded that selling shares to the public enhances a firm's financial flexibility by generating additional sources of capital to finance growth and expansion, and this is reflected by the high share prices. The author further argues that an increase in investor recognition and shareholder base due to an IPO lowers the firm's cost of equity; enhances stock liquidity which is valuable for managerial incentive schemes, which in turn increases the firm's value. Lee et al. (2019) investigated the comparative analysis of financial performance and operational performance of 12 Low-Cost Carrier before and after going public. The findings revealed the improvement of liquidity that management actively attempted to enhance activities based on the money collected provided by the IPO. Strong liquidity convinces potential investors and creditors that the business has enough assets to combat any difficult times. The findings also revealed that the debt ratio decreased in most of the sample enterprises. It indicated that the LCCs collected a substantial amount of funding through IPO and carried out visible efforts for improvement, utilizing the money for activities such as debt retirement.

As presented in the abstract of Pastusiak et al. (2016), there is a decline in profitability after the IPO event that confirms the phenomenon of distorting the level of profit before the IPO and partially equity dilution after the IPO. A study by Alanazi et al. (2011) indicated that 16 IPO companies listed at the Saudi Stock Exchange Market experience a significant decline in the post-IPO performance in comparison to the pre-IPO performance level as measured by the return on assets and return on sales. The findings also showed that the financial performance downturn is correlated with the IPO phenomenon. Descriptive research conducted by Kuria (2014) examined the changes in the financial performance of companies in Kenya as they shift from private to public companies through initial public offerings (IPOs). It showed conclusively 67% decline in their financial performance for three years after IPO while 33% increased on their financial performance after the IPO listing. The study of Rudianto (2021) indicated that an initial public offering had been proven to reduce financial leverage in companies. This means that the purpose of companies conducting an IPO in Indonesia is one of which is a funding portfolio, so to encourage the progress of companies and the national economy, it is important to create new policy innovations such as the provision of tax incentives that have been implemented previously. The scholar argues that one year after the initial public offering, it is proven that there will be a decrease in the company' performance in terms of financial ratios, this happens to the average company, the decline is influenced by the effectiveness of the use of assets in creating sales, and financial leverage effects, this is normal, especially if capital funds used in long-term investment, it is necessary to carry out a more careful assessment in terms of making investment decisions.

A study by Ritter and Welch (2002) raised two theories concerning IPO: the market-timing theory and the life cycle theory. Market-timing theory was introduced by Baker and Wurlger (2002). Setyawan (2011) stated that the essence of this theory is described when prices of stocks are overvalued, firms will finance projects through debts, and otherwise, the firms will be undervalued and be relied on equity financing. Another theory anchored in the life cycle theory by Modigliani (1957) argues that radically innovative industries are more likely to default, which lead to a lower optimal level of leverage (DeHan, 2014). The author contends that since the innovative firms have additional capital requirements above the optimal leverage ratio, they will be forced to raise the additional funds through the stock market. Ritter and Welch (2002) indicated that the decision to go public is more influenced by market conditions and then the life cycle of the business itself.

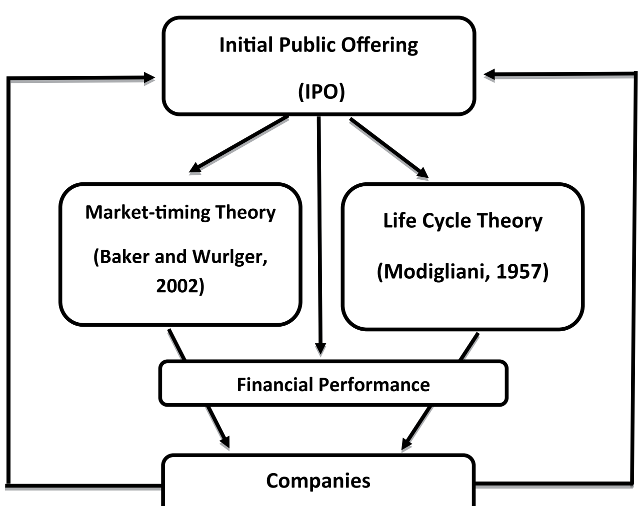

Figure 1: Theoretical Framework

OBJECTIVES OF THE STUDY

The study analyzed the effects of the initial public offering on the financial performance of the four publicly held companies before and after the IPO listing date in 2016 using the selected financial ratios. After that, the results were analyzed whether there is a significant difference in the mean of each variable before and after IPO proceedings. Data were tabulated and assessed according to its conclusions, and implications to be used by policymakers help potential private companies which want to undergo the IPO process. The results were to guide retail investors toward investing in newly publicly held companies and adds to the body of knowledge on how it affects the financial performance of the companies.

METHODOLOGY

The data utilized in this study was gathered manually from the IPO prospectus of the companies before the IPO event in 2016 and disclosures of the annual reports after the IPO listing obtained from respective company's websites and PSE's website. According to PSE Edge, there are four publicly listed companies in 2016, which are Cemex Holdings Philippines, Inc. (CHP), Golden Bria Holdings, Inc. (HVN), Shakey's Pizza Asia Ventures, Inc. (PIZZA), and Pilipinas Shell Petroleum Corporation (SHLPH). These mentioned companies are the primary source of data in this study.

The quantitative type of research method was used, specifically described the given data and focused on the particular variables. Data was comprehensively analyzed with the effect of Initial Public Offering on the financial performance and also on whether there is a significant difference in mean before and after IPO proceedings. Various methods can be used to measure financial performance. The financial measurements commonly used are accounting performance and stock market performance.

This study employed accounting performance to measure its financial performance because accounting performance is a better quantification of overall performance than stock price movement. The comprehensive analysis of the financial performance was based on financial ratios in the study, such as Return on Sales (ROS), Return on Total Asset (ROTA), Return on Equity (ROE), Current Ratio (CR), Debt Ratio (DR), and Debt-to-Equity Ratio (D/E).

Profitability

Return on Sales

Return on Sales (ROS) is a barometer of the profitability of the company's efficient course of action to turn sales into profits. It is computed by dividing operating profit by net sales. Return on Sales (ROS) calculation reveals how effectively a company produces its goods or services and how its management handles the business.

Return on Total Assets

Return on Total Assets (ROTA) is a profitability ratio that indicates the quantification of a company's earnings before interest and taxes (EBIT) divided by total operating assets. Return on Total Assets shows how management effectively utilizes its assets to generate earnings.

Return on Equity

Return on Equity (ROE) is a reckoning of the profitability of the company about equity. The measurement of financial performance is calculated by dividing net income by shareholder's equity. Return on Equity is considered an indicator that discloses how much profit a company earned in contrast to the shareholder's equity found on the Statement of Financial Position.

Liquidity

Current Ratio

The Current Ratio (CR) is part of the liquidity ratio that determines the company's ability to pay short-term financial obligations or due within one year. The calculation of the current ratio is dividing the company's current assets by current liabilities. It notifies the management that the company maximizes the current assets on its financial position to fulfill its current debt and other short-term payables.

Stability

Debt Ratio

Debt Ratio (DR) is a financial ratio under stability that describes the financial health of a company and measures the extent of a company's leverage. It is calculated by dividing liabilities over assets. The ratio shows whether or not it has loans, if so, how its credit financing compares with its assets.

Debt-to-Equity Ratio

The Debt-to-Equity ratio (D/E) indicates the financial stability of a company and its ability to raise additional capital to be used as leverage. It is quantified by dividing the company's liabilities by its shareholder's equity. The result of this equation can be used in measuring a company's financial health relative to shareholder's equity.

RESULTS AND DISCUSSION

This study examined the effects of Initial Public Offering on the financial performance of companies that go public in 2016. Financial performance is measured using the selected financial ratios as shown below:

Table 1. Return on Sales (In Percentage)

	Pre-IPO			Post-IPO		
Stock Symbol	2014	2015	2016	2017	2018	2019
CHP	10.56	12.03	19.04	9.12	6.49	9.92
HVN	34.86	30.07	30.4	26.8	29	32.8
PIZZA	11.65	12.08	11.74	14.57	13.43	12.7
SHLPH	-4.79	4.39	8.21	7.69	3.61	4.12
Total	52	59	69	58	53	60
Mean		15			14.33	

Source: Authors (2020)

Table 1 reveals a slight decline in Return on Sales with the mean after going public compared with pre-IPO. CHP and HVN pre-IPO and post-IPO financial performance show a material decrease in Return on Sales that affects the company's operational efficiency. However, PIZZA and SHLPH appear positive results of post- IPO financial performance compares to pre-IPO. The decrease in Return on Sales implies possible financial troubles that affect the company's operational efficiency.

Table 2. Return on the Total Asset (In Percentage)

	Pre-IPO			Post-IPO		
Stock Symbol	2014	2015	2016	2017	2018	2019
CHP	7.84	1.44	9.52	3.90	2.51	0.92
HVN	14.79	13.26	5	6	10	11
PIZZA	38.40	37.47	11.58	11.54	11.53	12.37
SHLPH	-11.54	5.37	17.3	13	6	5
Total	49	58	43	31	28	28
Mean		12.33			7.33	

Source: Authors (2020)

Table 2 shows the comparison in return on the total assets for three years (2014-2016) before and three years (2017-2019) after IPO. It indicates that the mean from pre-IPO declines substantially compared with after listing. CHP, HVN, and PIZZA incurred a decrease in Return on Total Assets after IPO listing. However, SHLPH recorded an increase in Return on Total Assets after the publicly-held company in 2016 onwards. This is an indicator that SHLPH is using its total assets effectively to generate earnings.

Table 3. Return on Equity (In Percentage)

	Pre-IPO			Post-IPO		
Stock Symbol	2014	2015	2016	2017	2018	2019
CHP	-4.57	0.78	5.30	2.42	4.77	1.32
HVN	13.35	34.77	15	15.48	25.79	35
PIZZA	33.93	30.39	22.6	19.18	18.29	17.07
SHLPH	-104	24	22.6	24.9	13.2	14.3
Total	-61	90	66	62	57	66
Mean		7.67			15.33	

Source: Authors (2020)

Table 3 depicts the results of the Return on Equity concerning before and after listing to become a public company. The table above uncovers a double increase in the mean before IPO compared to after IPO. Nevertheless, PIZZA's comparative assessment of pre-IPO to post-IPO reveals a substantial decline in

Return on Equity. The ratio indicates how capital is utilized effectively and being re-invested properly.

Table 4. Current Ratio

	Pre-IPO			Post-IPO		
Stock Symbol	2014	2015	2016	2017	2018	2019
CHP	0.88	1.43	1.49	1	0.9	0.8
HVN	3.93	0.95	2.65	1.57	1.51	2.02
PIZZA	1.05	1.23	1.08	1.13	1.66	1.03
SHLPH	0.9	1.94	1.7	1.5	1.4	1.2
Total	6.8	5.6	6.9	5.2	5.5	5
Mean		1.6			1.33	

Source: Authors (2020)

Table 4 shows the current ratio of the companies three years before and three years after the IPO listing. Findings indicated a decrease in the mean of the current ratio after IPO listing compared with before IPO. HVN records the highest plunge of the current ratio post-IPO performance among all companies listed. Research results revealed that all companies that opted for IPO listing registered a decline in their current ratio, implying a taper of company's paying their current financial obligations or due within one year.

Table 5. Debt Ratio (In Percentage)

	Pre-IPO			Post-IPO		
Stock Symbol	2014	2015	2016	2017	2018	2019
CHP	71.22	69.80	67.20	40	50	50
HVN	34.98	75.68	17	11	11	28
PIZZA	47.79	40.76	64.20	56.37	52.56	58.90
SHLPH	94.79	52.71	53.37	10.9	9.7	13.6
Total	249	239	202	118	123	151
Mean		57.33			33	

Source: Authors (2020)

Table 5 represents the comparative analysis of the effect of IPO on the debt ratio of the publicly listed companies. It unveils a substantial decrease in the mean of the debt ratio after IPO listing. SHLPH's debt ratio after three years of becoming a public company (2017-2019) discloses a massive decrease in the debt ratio. It means they have a substantial financial structure and more excellent creditworthiness. Furthermore, having a lower debt ratio is more advantageous than a higher debt ratio.

Table 6. Debt-to-Equity

	Pre-IPO			Post-IPO		
Stock Symbol	2014	2015	2016	2017	2018	2019
CHP	2.48	0.70	0.70	0.80	0.90	1.00
HVN	0.54	3.12	0.38	0.33	0.33	0.88
PIZZA	0.92	0.69	1.79	1.29	1.11	1.43
SHLPH	12.71	1.54	1.14	0.20	0.20	0.40
Total	16.64	6.04	4.01	2.62	2.54	3.71
Mean		2.22			0.74	

Source: Authors (2020)

Table 6 uncovers a substantial decline of the mean of the debt-to-equity ratio after IPO listing in contrast to before the IPO process. SHLPH divulges a substantive decrease of the debt-to-equity ratio in the post-IPO listing among all publicly held companies. The substantive decrease implies better corporate valuation that highlights a company's dependence on borrowed funds and its ability to meet those financial obligations. Therefore, a low ratio means a low risk of failure to pay loans and fewer chances of bankruptcy in the event of an economic downfall.

Test of Significance between Pre-IPO and Post-IPO Financial Performance

This study scrutinized whether the mean difference between pre-IPO and post-IPO financial performance is significant by using an MS Excel t-test paired with two samples for means of each variable. The test was done at a 95% significance level using the two-tail test.

Ho: There is no significant difference between the financial performance of companies before and after going public at the Philippine Stock Exchange.

Ha: There is a significant difference between the financial performance of companies before and after going public at the Philippine Stock Exchange.

Table 7. Financial Ratio Test Statistics

Financial Ratios		
Return on Sales	Pre- IPO	15
	Post-IPO	14.33
	t-Statistics	0.424
Return on Total Assets	Pre- IPO	12.33
	Post-IPO	7.33
	t-Statistics	1.098
Return on Equity	Pre- IPO	7.67
	Post-IPO	15.33
	t-Statistics	-0.663
Current Ratio	Pre- IPO	1.6
	Post-IPO	1.33
	t-Statistics	1.314
Debt Ratio	Pre- IPO	57.33
	Post-IPO	33
	t-Statistics	2.560
Debt-to-Equity	Pre- IPO	2.22
	Post-IPO	0.74
	t-Statistics	1.285

Source: Authors (2020)

The results of the test statistics on Return on Sales, Return on Total Assets, Return on Equity, Current Ratio, and Debt-to-Equity ratio show no significant differences before and after IPO event and fell in the acceptance region defined by values between -2.2281 and 2.2281. Thus, there is no significant difference between the financial performance of companies before and after going public in the Philippine Stock Exchange, which leads to the acceptance of the null hypothesis. Therefore, based on these results, there is no enough evidence to reject the null hypothesis when financial performance is measured by Return on Sales (ROS), Return on Total Assets (ROTA), Return on Equity (ROE), Current

Ratio (CR), and Debt-to-Equity Ratio (D/E). On the other hand, the Debt Ratio test statistics computed was 2.560 that shows a significant difference in this variable before and after the IPO event.

CONCLUSIONS

The stock exchange market plays a crucial role as a money-making strategy for the companies that want to raise capital for the general public. The issuance of shares of stocks is one of the companies' strategies to achieve goals and objectives and to be financially liquid and stable. Therefore, investors are participating in this platform by buying shares and becoming a shareholder of listed companies with the financial objective of benefiting from this type of investment vehicle through price appreciation and future dividends. Investors can derive these benefits if the new publicly held companies outshine after the IPO event.

Based on the findings of the study, it shows that there is a difference between pre-IPO and post-IPO. However, the statistical treatment used in this study concludes that the differences in the mean of the selected financial ratios are mostly insignificant. The findings indicate that using the financial ratios as independent variables such as Return on Sale, Return on Total Assets, Return on Equity, Current Ratio, and Debt-to-Equity Ratio results in no significant difference between the financial performance before IPO and after IPO event. The result contradicts the findings of other studies, such as the study by Rudianto (2021), whose conclusion showed a significant difference in Current Ratio, Debt-to-Equity, and Return on Assets; Lee, Lim, and Lee (2019) indicated that IPO improves liquidity; Pastusiak et al. (2016) which revealed a significant decline in profitability, and Alanazi et al. (2011) found a significant decline in the post-IPO especially on the return on assets and returned on sales. It indicated the financial performance significantly declines after IPO. This implies that there are no consistent findings in IPO listing studies. This gives arduous tasks for future researchers and practitioners to achieve a general conclusion on whether companies accomplish better financial performance after IPO. The lack of definitive findings of the study may be due to several factors such as the following: selecting financial ratios as part of variables, methodology, years covered of data gathered, and context of the study. On the other hand, the study's result supports the conclusion of Munisi (2012) that there is no consistency in findings in IPO event studies. The findings reveal that among all selected financial ratios, the Debt Ratio resulted in a significant difference after the IPO event. The result implies that the Debt Ratio of the companies improved after IPO listing and signifies that the companies have more assets than liabilities. Studies by Lee, Lim, and Lee (2016); Kim and Weisbach (2005) corroborated that the debt ratio will decrease after IPO and issuance of primary shares has a relationship with higher repayment of debt. Therefore, the IPO event reduces the debt ratio that gives conviction to the companies to pay their liabilities.

The outcome of this study has implications for policymakers, private companies, retail investors, and future researchers. The results have policy implications for regulators of the stock market and governance of publicly held companies. It unveils that the financial performance of the listed companies does not significantly decline after IPO. For the private companies, the outcome of the study gives insight and guidelines to the private companies who want to raise capital through the IPO process. The result of the study provides data on how financial performance changes after the IPO. Rudianto (2021) concluded in his study that the expectation of improved financial performance does not occur in all aspects one year after the initial public offering. The study's findings imply retail investors in IPOs, specifically in PSE, wherein both foreign and local investors engage in trading and investing stocks. It shows a comprehensive analysis of financial performance helps a retail investor develop a quality investment decision before investing in an IPO. Thus investors should be clear on the information available of the companies that they want to invest in. The findings of the study have necessary implications for future researchers of IPO performance. Explicitly, the results show that the conclusion drawn on the financial performance of the listed companies should be explained prudently, and the reason being that the outcome of the study may be affected by selecting financial ratios and different industries of the company.

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