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SAUDI ARABIAN PRE AND POST IPO PERFORMANCE

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ABSTRACT:

The study aims to examination of the performance of Saudi Arabian firms is required as they make the transition from private ownership into public ownership. A sample of 8 Saudi IPOs performance is investigated. A matched pair approach is implemented to compare the pre and post IPOS performance. The result indicated that Saudi IPOs exhibit a significant decline in the productivity after the IPO as compared to the pre-IPO level. The post IPO compared to the pre-IPO level was measured by profitability ratios: the return on assets (ROA) and return on sales (ROS).

INTRODUCTION:

Initial public offerings can be defined as "a first-time offering of shares by a specific company to the public" [1]. The firm will be listed in the stock market after the issue and its shares will start trading immediately. The decision for private firms to go public is one of the most difficult decisions that a company faces in its life. It is the decision that is going to change the whole capital structure of the company, and in many cases it ends up with the ownership power being transferred and taken away from the company's original owner. It is not surprising then that the IPO topic has attracted the attention of scholars, investors, and decision makers. Consequently, a vast number of studies have been conducted on the IPO topic, and it has been growing at faster pace in recent years.There are many advantages that private firms can gain by going public. These are accessing other sources of funds for current and future investments, diversification purposes, increasing the publicity and the reputation of the firm, transfer the risk to shareholders and increasing the bargaining power with banks. However, these advantages usually come at the cost of the firm loss of confidentiality, and decision control. Saudi firms apparently value confidentiality very highly, and one of the Tadawul's new listing requirements disclosure of information to potential investors when going public [2].

Al-anazi [3] examined the performance of Saudi Arabian firms as they make the transition from private ownership into public ownership. A sample of 13 Saudi IPOs performance is investigated. The author used data envelopment analysis (DEA) method to construct the Malmquist productivity and efficiency indices. Al-anazi found Saudi IPOs exhibit a significant decline in the productivity after the IPO as compared to the pre-IPO level. Besides that, Al-anezi [4] investigated the financial and operating performance of 52 IPOs made in the GCC region between 2003 and 2010 and found that IPO performance declines after going public. The performance decline is associated with the firm transition from private into public ownership due to increasing agency costs.The aim of this study is to measure the firms' profitability after they go public via an Initial Public Offering (IPO), and to analyze the impact of the IPO on the performance of Saudi IPOs as measured by productivity and efficiency. The study also explores the factors associated with the financial performance variation between pre- and post-IPO by measuring the ROA and ROS.

METHODOLOGY

The new regulations applied by the Capital Market Authority (CMA) have obliged Saudi firms to reveal their financial statements prior to going public. Financial statements for the Pre and post IPO period were gathered from the Tadawul [2]. Each firm listed in the stock market has to produce quarterly and annual reports.There are about 51 Companies from different industries went public from 2008 to 2013 are available such as insurance, Hotel and tourism, telecommunications, petrochemicals, food and agriculture, building and construction and industrial investment. Several filters are applied to restrict the sample.

- Firms that went public as a new establishment (start-ups) were excluded because these firms need a long time frame in order to judge their performance, and there is no prior performance
- Firms with no pre-IPO data were excluded due to the lack of comparability between the pre and post-IPO periods
- Firms that went public 111 2013 and 2012 were excluded because there is no post performance.These filters reduced the final sample to 8 companies which belong to 3 industries, agricultural and food, industrial investment, construction and building

Two sources of data have been used to implement this study, the first one being prospectuses. Capital market authorities in Saudi Arabia requires that any company that wishes to join the capital market must provide three years of audited-accounting information, which includes the balance sheet, income statement and cash flow operation. These prospectuses also include general information regarding the offering such as the offering price, the number of shares that were offered, the period of subscription, the eligibility and the purpose of the offering. These data are maintained on the capital market authority website which is publicly available for collection and assessment. The second source of data is the annual reports. As a regulatory procedure in the Saudi Arabian capital markets, all listed companies must publish their quarterly and annual financial performance. The annual reports of the IPOs from the stock market website (Tadawul) were collected, and in the cases where such annual reports were not available, companies' official websites were accessed.

Table 1: The sample chosen for this research according to industry and date of IPO

Industry	Companies	Date of IPO
Building and Construction Industry	Hail Cement Co. (HCC)	16/10/2011
	United Wire Factories Company (ASLAK)	21/08/2011
	Al-Jouf Cement Co. (JOUFCMNT)	11/08/2010
	Abdullah A.M. Al khodari Sons Co. (ALKHODARI)	23/10/2010
Food Industry	Halawani Brothers Co. (HB)	16/07/2008
	Herfy Food Services Co. (HERFY)	02/02/2010
Industrial investment	Al-hassan Ghazi Ibrahim Shaker Co. (SHAKER)	17/05/2010
	Alsoraya Trading and Industrial Group (Sorayai)	22/02/2010

A matched pairs is used to investigate the profitability and efficiency of IPOs in Saudi Arabia. The matched pairs' method compares the firms' performance change between two time periods, i.e. before and after the IPO, to measure and then draw conclusions about performance change. If the performance in the post-IPO period is better, it is appropriate to conclude that IPO has improved performance. In contrast, if the post-IPO happens to be worse, the IPO has a negative effect on the firms' performance. It is noted, of course, that other factors such as changing business conditions can affect the validity of this comparison.

For each IPO the time horizon will be divided in three segments;

- The first period is the pre-IPO, labeled as "Y-1", which is the year before the company goes public.
- The second period is the year of the event or the IPO year, which is labeled as "YO". This is the year when the IPO event took place.
- The third segment is the post IPO period which will be labeled as "Y+t". This is the year following the IPO, when the company becomes listed.

The ROA and ROS of"Y-1" will be compared to the "Y+l". The mean pre-IPO and mean post-IPO for all firms in an industry are compared. The performance of each industry is compared to another. If the performance in the post-IPO period is better, it is appropriate to conclude that IPO has improved performance. In contrast, if the post-IPO happens to be worse, the IPO has a negative effect on the firms' performance.

Measuring Profitability

The return on assets (ROA) is the most used ratio to evaluate the performance of IPOs. This ratio assesses the efficiency of the firm in utilizing its assets to generate income. A higher ratio after the IPO is considered an indication of a better performance, and vice versa. The ROA ratio can be calculated using the following equation:

$$ROA = \frac{Profit\ after\ depreciation, interest\ and\ tax(Zakat)}{Total\ Assets} \times 100$$

The second used ratio to measure the performance of firms is the return on sales (ROS), or profit margin. It has been argued in the literature that ROS is a better measurement of profitability because IPO firms show a large increase in assets but no immediate increase in income. Thus, the profitability of IPOs should be evaluated relative to the net sales. In this paper, both ratios are used to assess the performance. The ROS can be calculated using the following equation:

$$ROS = \frac{Profit\ after\ depreciation, interest\ and\ tax(Zakat)}{Total\ Sales} \times 100$$

RESULT AND DISCUSSION

Table 2 shows the return on assets of each firm one year before the IPO (Y-1) and one year after the TPO (Y+ 1). The three industries chosen for this study were evaluated separately in order to compare the industries performances to one another. Moreover the mean performance is calculated for all the firms in each industry. The average performance for building and construction show a decline in the post-IPO period with an average drop from 9.6% to 8.35%. Only one company out of four companies in this industry has improved in performance compared to previous year. This Company is Al-Jouf Cement Co., it went from -2.8% to 4.6%. As for the other two industries; food and industrial investment, there is a performance fall in all the companies taken in the sample.

Table 2: Comparison of the ROA between Year-1 and Year+1

Company	Change	Status	Y-1	Y+1
HCC	0.003	Decreases	-0.021	-0.024
ASLAK	0.036	Decreases	0.281	0.245
JOUFCMNT	-0.074	Increases	-0.028	0.046
ALKHODARI	0.083	Decreases	0.150	0.067
Average performance of Building and Construction industry			0.096	0.0835
HB	0.029	Decreases	0.279	0.250
HERFY	0.017	Decreases	0.092	0.075
Average performance of Food industry			0.1855	0.163

SHAKER	0.052	Decreases	0.201	0.149
Sorayai	0.052	Decreases	0.085	0.033
Average performance of Industrial Investment industry			0.143	0.091

Table 3 shows the return on sales of each firm one year before the IPO (Y-1) and one year after the IPO (Y+ 1). In this table there is a mixed result. In the building and construction industry, Hail Cement Co. shows no change in performance between the two periods. On the other hand AIJouf cement shows improved ROS going from O to 26. l %. The other two companies in this industry show a decline in ROS. Food and industrial investment show a decline in both ROS and ROA.

Table 3: Comparison of the ROS between Year-1 and Year+1

Company	Change	Status	Y-1	Y+1
HCC	0	No Change	0	0
ASLAK	0.084	Decreases	0.190	0.106
JOUFCMNT	-0.261	Increases	0	0.261
ALKHODARI	0.074	Decreases	0.207	0.133
Average performance of Building and Construction industry			0.09925	0.125
HB	0.014	Decreases	0.221	0.207
HERFY	0.006	Decreases	0.075	0.069
Average performance of Food industry			0.148	0.138
SHAKER	0.018	Decreases	0.133	0.115
Sorayai	0.045	Decreases	0.085	0.040
Average performance of Industrial Investment industry			0.109	0.0775

Overall measures of profitability ROA and ROS exhibit the same observed pattern of severe decline from Y-1 to Y+ I and concluded that the operating performance of IPOS in Saudi Arabia is worse in the pas IPO. This result of performance decline is consistent result with many authors in the IPO literature from both developed and developing countries such as Jain & Kini (1994), Kenneth et al., (2004) and Al- Barrak (2005) [1, 5, 6]. The reason behind these negative results in TPO performance could be related change in ownership structure. It has been proven that change in ownership structure has a significant negative impact on the performance of the IPO. Another reason could be the size of the company, large companies show superior performance to small IPOs [7].

CONCLUSION

In this study, the operating performance of 8 IPOs made in Saudi Arabia between 2008- 2013 was examined. The results indicate that performance deteriorates one year after the IPO. The average ROA and ROS of each industry have declined. Only one Company in the building and construction industry has experienced improvement in profitability. The reasons behind the performance decline were identified. The change in ownership structure, which results from the IPO has a significant negative impact on the change in performance. The link is linear and demonstrates that the cost of the agency increases as the original owners increase their retention. This leads to a performance decline due to increasing agency conflict. Moreover, evidence is found that suggests that the size of the IPO has a significant positive impact on performance, in that large IPOs show superior performance to small IPOs, while the age of the firm does not seem to be as important. In conclusion, the explanation for the decline in the operating performance of an IPO is a complex function of multiple factors, and no single theory or hypothesis can explain this decline.

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