



Impact of internal governance mechanisms on the initial returns during the listing period

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Abstract

The application of simultaneous equation regressions on a sample of 110 French IPO firms between 2005-2010, allowed us to say that the initial return is significantly influenced by the under / overpricing. The results of our study show that the underpricing can improve the initial return. On the other hand, this return is affected negatively and significantly by the overpricing. Thus, we have shown that the governance structure is a major determinant of initial returns, observed in the listing period. Our work shows that there is a very significant relation between the overpricing and the internal governance mechanisms. Nevertheless, the impact of these mechanisms on the underpricing is poorly recorded.

Keywords: Initial public offering, internal governance mechanisms, initial return, under/overpricing

Introduction

The relationship between governance structure and performance of the firm was the subject of several previous studies. An important variety of the indicators of the performance is, thus, noticed. By referring to the context of IPO, we will choose the under/overpricing as a measure of a short-term performance, during the period of listing.

Several factors are considered to determine IPO initial returns. Indeed, the governance structure, especially the ownership structure and board of directors, are two mechanisms whose role cannot be ignored in explaining the underpricing (Juan (2007), Certo *et al* (2001), Certo *et al* (2007), Li and Naughton (2007), Boulton *et al* (2007), Arthurs *et al* (2008), Kroll *et al* (2007), Chancharat and Tian (2008) ...) and can be overlooked in explaining the overpricing.

Indeed, if several hypotheses are advanced to explain the short-term performance, few studies are devoted to the study of the existing relationship between the structure of governance and underpricing, in spite of the importance of the effect that can practice the corporate governance on the decision of initial public offering.

However, the idea that there is a relationship between the governance structure and the overpricing has never been

Explored Note that the concentration of ownership, the nature of shareholders and the main features of the board are factors whose contribution in the explanation of the underpricing or the overpricing depends on the degree of control exercised by the shareholders.

Our aim is to show that the governance structure is a major determinant of the initial return, found during the listing period. Therefore, regressions are ways to better understand the impact that can have the internal mechanisms of governance on the initial returns at the IPO. We start first by presenting our various research hypotheses, our sample, the model which we will refer in order to arrive to the results and definitions of variables constituting the model. The results will be illustrated and analyzed in a final section.

I-Context of the study and hypothesis of research

I-1: Ownership Concentration

The process of listing leads to a loss of control held by the original shareholders, as it is to sell a large block of shares. The result is a transfer of shareholder wealth for new investors. Miloud (2003) asserts that before the initial public offering, the ownership is, generally, concentrated in the

hands of the founding shareholder or the partners of origin. Consequences in the new subscriptions which the company receives, the structure of ownership becomes more scattered after the listing period, especially, when these partners choose to partially or completely divest the company. Which leads to a transformation of the ownership of those who do not want to keep control of their company to new investors.

During the initial public offering, the founding shareholders are forced to give up the control to new investors when they have no means to pursue the financing of their firm (Miloud (2003)). Consequently, these founders have an incentive to evaluate their shares in order to attract outside investors and increase the possibility of having high funds.

Nevertheless, if it is not the case, in other words, if these founders are not forced to give up the control, then those shareholders who have an excess of voting are less interested to underprice their shares in the fear of the emergence of new blockholders. Where from, the hypothesis of the reduced control is justified here, in the sense that, the gap between voting rights and rights to cash flow is significantly and negatively correlated with the underpricing. Alternatively, the controlling shareholders who are usually the founders in SMEs, have no interest in setting offer prices relatively low so as not to attract small shareholders. This can increase the risk of observing actions overpriced during the listing, after such behavior.

Hence, we can speak here of an unintentional overpricing. Our hypothesis is as follows:

H 1: The concentration of ownership weakens the extent of underpricing and increase that of the overpricing, during the initial public offering.

I-2: Managerial Ownership

The hypothesis of agency cost (Jensen and Meckling (1976)) states that the incentive to undertake unprofitable projects may be reduced when the insiders own a significant part of capital. Conversely, reducing the percentage of equity held by insiders can lead to a divergence of interest with the new shareholders. Therefore, the hypothesis of agency cost is considered as a possible explanation for the evolution of the initial returns of listed companies. Indeed, the proportion held by insiders can explain largely the underpricing as well as the overpricing given that these last ones do not have interest to underprice their shares in order to have no enormous losses and should rather attribute the overpriced shares to the small badly informed carriers. We can thus put the following hypothesis:

H 2.1: the negative relationship between managerial ownership before initial public offering and the underpricing verifies the hypothesis of the alignment of interests.

H 2.2: The managerial entrenchment comes from the positive relationship between the part of property held by the leaders before the IPO and the underpricing.

We note that the study of Lowry and Murthy (2007) shows a neutral relationship between the managerial ownership and the underpricing. In other words, the managerial ownership does not have impact anymore on the underpricing observed during the listing period, but, she can be in touch with the overpricing. Indeed, we can wonder, here, about the existence of such a link, given the neutrality of the relation characterizing the study of Lowry and Murthy (2007). Well it depends on the nature of the relationship between the overpricing and managerial ownership to judge whether it was an alignment of interests or managerial entrenchment. This, however, we still lack empirical studies dealing with this last relationship. Nevertheless, we believe that the managers of society, whose shares are overpriced, may behave opportunistically in order to keep their own interests and pass the operation of listing at the expense of shareholders and to the detriment of small shareholders who are badly informed.

Therefore, this behavior will no longer move towards an alignment of interests but it can be explained by managerial entrenchment where the manager, by disposing of the overpriced shares during the IPO, will encourage the purchase of small shareholders, is going to encourage the subscription of the small carriers, in order to keep his power within the listed company. Thus, informed investors will no longer subscribe to new issues whose shares are overpriced, because they will not make an abnormal profit during the listing period. That leaves at home a doubt concerning the potential profitability of the company. Indeed, we considered necessary to emit the hypothesis according to which:

H 2.3: There is a relationship between managerial ownership and the overpricing during the listing period

I-3: institutional ownership

Kor *et al.* (2008) show that the presence of institutional investors is more pronounced in areas characterized by high uncertainty behavior. This is because these investors can add significant value to the company by a positive signal that is manifested by better control exercised within the board of directors of a listed company. In other words, the strong uncertainty of the sector of the company implies a strong asymmetry of information and, consequently, an important underpricing during the initial public offering. The presence of institutional investors within the listed company allows reducing this asymmetry of information.

Hence, an inverse relationship between the underpricing and the part of capital held by these investors.

H 3.1: The institutional ownership weakens the extent of the underpricing

Since institutional investors have a relatively privileged access to information, their behavior is likely to influence those of small shareholders (Leung and Liu (2006)). They can thus incite them to participate in new issues whose shares are overpriced given that these small shareholders are, generally, badly informed. Empirical studies on the relationship between institutional ownership and abnormal return in the short term focus primarily on the underpricing as a performance during the initial IPO ignoring the idea that new issues may be overpriced. Thus, the strong presence of institutional investors in the firm reduces the possibility of observing overpricing during the listing period. This reinforces the hypothesis of revelation of information, proposed by Benveniste and Spindt (1989) that the underpricing is seen as a reward to professional investors in exchange for information they provided on society with honesty. Hence, the presence of these investors weakens the level of the overpricing. On the basis of the above mentioned ideas, we can illustrate the following hypothesis:

H 3.2: There is a relationship between the level of institutional ownership and the overpricing during the listing period

I-4: Board independence

Kor *et al.* (2008) predict that the presence of outside directors on the board of listed companies is an increasing function of the level of uncertainty in the sector and therefore the level of information asymmetry. Indeed, this hypothesis is empirically verified by Kor *et al.* (2008) showing that the high level of information asymmetry, due to the uncertainty in the sector, incites to opt for some form of surveillance by the independent directors to reduce this information asymmetry.

We can assert that the presence of these administrators contributes to a reduction in underpricing. Hence an inverse relationship may exist between board independence and IPO underpricing. Indeed, the uncertainty from potential problems associated with the low board independence, can motivate investors to ask for a higher level of underpricing (Juan (2007)).

According to their research hypothesis, Filatotchev and Chahine (2008) assert the existence of a negative relationship between board independence and IPO underpricing. This suggests that independent board implies

a reduction in the risk premium demanded by outside investors at the time of the initial public offering.

However, Juan (2007) finds a result contrary to his hypothesis of research where he finds that the relationship between the proportion of outside directors and IPO underpricing is positive. The same result is in accordance with that found by Certo *et al.* (2001).

H 4.1: the strong involvement of the independent administrators weakens the level of IPO underpricing.

Li and Naughton (2007) argue that the characteristics of Chinese stock market, the year of the IPO, explain strongly IPO underpricing. On the other hand, the proportion of the independent administrators influences positively but not significantly the level of underpricing. This means that the new governance policy has no impact on the underpricing. This means, for example, that the governance structure is not taken into account in the decision of the investor, during the listing period. Thus, the neutrality of this relationship can lead us to wonder about the existence of a link between the proportion of the external administrators and the IPO overpricing, during the listing period.

H 4.2: There is a relationship between board independence and IPO overpricing.

I-5: CEO Duality

According to Fama and Jensen (1983), a monistic system, characterized by a common arrangement of president and leader, indicates a manager potential opportunism. So, we note that the new investors have no interest to participate in the capital of firm whose board structure takes the monistic form. Indeed, the management control is threatened as long as the person assuring both functions, in his quality of president of board, becomes more aligned with the direction than with the shareholders (Jensen and Meckling (1983)).

On the basis of a sample of companies in Britain, Dahya *et al.* (1996) find that when companies pass from a structure of separation of the functions to a structure of accumulation, the stock market reacts unfavorably.

Aware of the negative effect that can follow the accumulation of the functions on the performance of the firm, the potential investors can ask for a high level of IPO underpricing when they want to subscribe to the new issues (Juan (2007)). Consequently, we can emit the hypothesis according to which the combination of the functions affects positively IPO underpricing.

So, it is necessary to note that these potential investors are the best informed about the perspectives of the listed firm

given that they try to take advantage of existing opportunities during the listing period.

On the other hand, those who are not or badly informed are going to have overpriced allocations. Their ignorance of the effect that can practice the accumulation of the functions on the stock-exchange profitability of the company makes deteriorate their situation by obtaining overpriced shares.

H 5.1: there is a positive relationship between the accumulation of the functions and IPO underpricing during the initial public offering.

H 5.2: the positive relationship between the accumulation of the functions and IPO overpricing means that the shares are attributed to badly informed investors.

I-6: Size of the board

For agency theorists, the size of the Board promotes high dominance of the leader by raising coalitions and group conflicts (Jensen (1993)). The result is the existence of boards which have a difficult to operate efficiently and have difficulty in reaching consensus on important decisions (Herman (1981)). Thus, Hermalin *et al.* (2003) argue that over the board is small it will be more able to make decisions for the benefit of shareholders. Ginglinger (2002) confirms the ineffectiveness of large board in the exercise of executive control, despite the advantages of building expertise.

Certo *et al.* (2001) find a negative and significant relationship between IPO underpricing and the size of the board of directors. Indeed, a large board size reduces the uncertainty of the value of the company. A reduction of the asymmetry of information is to be observed, leading to a subsequent low IPO underpricing during a new initial public offering.

This is contradictory to the study of Li and Naughton (2007), where the size of the board of listed companies affects positively and significantly the short term abnormal return. This is moreover justified by Adam and Mehran (2003).

On the basis of the above mentioned ideas, by taking into account the absence of the empirical studies treating the idea according to which there is a relationship between the size of the firm board and the overpricing, we can illustrate the following hypothesis:

H6: there is a relationship between the size of the board of directors and the initial return during the listing period.

II- Methodology

II-1: Sampling and Data Collection

II-1-1: Sampling

Our study concerns a sample of 110 French companies listed on the Stock Exchange, between 2005-2010. This sample was obtained from the site of Euronext (www.euronext.com). We removed certain observations of our sample as far as the logic of transfer of markets or the private placement does not correspond to that of the first initial public offering. So, we note that the number of new issues during 2006-2007 is relatively important. This involves the existence of a relatively favorable stock-exchange context.

Table 1: Sample Selection Procedure

	2005	2006	2007	2008	2009	2010	Total
Eurolist	12	19	10	4	1	5	51
Alternext	-	38	16	-	-	5	59
Total	12	57	26	4	1	10	110

II-1-2: Data collection

We tried to obtain all the stock-exchange data with the site of Euronext. So, we turned to the prospectus of initial public offering to determine internal governance mechanisms and other general data about the company. These leaflets shall be deposited with the Authority of Financial Markets and can be consulted with the site of every listed company.

II-2: Equations of the model to be studied and description of variables

II-2-1: Presentation of the model

By referring to the study of Gao (2010), we can formulate the idea according to which the initial return includes elements of under / overpricing, in the first equation of the model, while adding the FS and the DV as being variables of control.

The impact of the governance structure on the IPO underpricing has been the subject of several previous studies. Our will, thus, is to contribute to the development of these last studies concerning the nature of the link between the corporate governance and IPO underpricing. What is the subject of the second equation of our model?

The nature of the relationship between governance structure and IPO overpricing has done so far any particular object of study. The nature of the relationship between governance

structure and IPO overpricing has done so far any particular object of study. However, the governance structure has important implications for determining the initial return. Indeed, the initial return also represents IPO underpricing when the positive effect of the underpricing is more important than the negative effect of the overpricing. What makes the initial return positive. Consequently, IPO underpricing observed during the offer and influenced by the variables of corporate governance, none other than the initial return. It can justify our hypothesis according to which the structure of governance can influence the level of the overpricing. This last idea is illustrated in the third equation.

The model to be estimated is the following one:

Which can be written as follows:

Where :

- ✓ OC : Ownership Concentration
- ✓ MO : Managerial Ownership
- ✓ IO : Institutional Ownership
- ✓ BI : Board Independance
- ✓ DUAL : CEO Duality
- ✓ BS : Board Size
- ✓ FA : Firm Age
- ✓ F.S : Firm Size
- ✓ D.V : Dummy Variable

II-2-2: Variables definition

The measures adopted to study the impact of internal governance mechanisms on the initial returns during the period of listing are presented in the table 2.

III-Description and analysis of the results

III-1: Determination of the initial returns

We obtained the initial underpricing by turning to the application of the difference between the price of the offer and the intrinsic value of the new issues. It is from the study of Gao (2010) that we brought to light this definition of this underpricing. This definition is different from those mentioned in the other studies. Indeed, most of the previous studies ended in results according to which the initial underpricing also represents the initial return. Nevertheless, the study of Gao (2010) comes to contradict all these studies by showing that the initial return includes components of the under/overpricing.

According to Gao (2010), we thus have:

$$\text{Initial Return} = \frac{(\text{Offer Price} - \text{Market Price})}{\text{Intrinsic Value}}$$

Market Price

$$\text{Underpricing} = \frac{(\text{Offer Price} - \text{Intrinsic Value})}{\text{Intrinsic Value}}$$

$$\text{Overpricing} = \frac{(\text{Market Price} - \text{Intrinsic Value})}{\text{Intrinsic Value}}$$

Table 2: Variables definition

Variables	Definitions
Explanatory Variables of IPO Under/Overpricing	
Ownership Concentration (OC)	Dummy variable taking one if the percentage of capital owned by the largest shareholder is greater than or equal to 20%, 0 otherwise.
Managerial Ownership (MO)	The percentage of shares owned by managers and directors
Institutional Ownership (IO)	The percentage of shares held by institutional investors.
Board Independance (BI)	The percentage of independent(non-affiliated) outside directors on a firm's board (number of outside directors/board size)
CEO Duality (DUAL)	Dummy variable taking one if CEO is also the chairman of the board, and is 0 otherwise.
Board Size (BS)	The number of directors on a board for each firm
Firm Age (FA)	Logarithm of the number of years between the year of creation and the IPO
Explanatory Variables of the Initial Return	
Underpricing	(Offer Price – Intrinsic Value)/Intrinsic Value
Overpricing	(Market Price – Intrinsic Value)/Intrinsic Value
Firm Size (FS)	Logarithm of total assets at the end of the year preceding the IPO of the issuing firm
Dummy Variable (DV)	Dummy variable taking one if the company is listed on Alternext, 0 otherwise.

The separation between the underpricing and the overpricing is difficult on the developed markets where the initial returns are low (Gao (2010)).

To calculate the intrinsic value, we opted for a method different from that of Gao (2010). Indeed, these last ones referred to a methodology identical to that of Purnandam and Swaminathan (2004), based on the use of the rate of price / profits. However, several initial public offerings had no positive profits, what limited the size of their sample. For

that reason, these authors replaced profits by sales and used the rate of price / sales (P/S), because sales are generally available. These authors, also, used the rate Price / EBITDA (P / EBITDA), because EBITDA measures the cash operational flow, and it is less subjected to the accounting manipulations.

$VI_{i,t} = \alpha + \beta RM_{i,t} + \epsilon_{i,t}$				
Variable	Coefficient	S.Dev	t-Student	Prob.
α	12.71434	2.234084	5.69	0.000
β	1.847272	0.9967695	1.85	0.067
R^2	0.0308			
Adjusted R^2	0.0218			
F-statistic	3.43			
Prob (F-statistic)	0.0666			

Concerning our study, the intrinsic value is obtained by a linear regression while considering the market price and the listing price, of all the new issues, between 2005-2010.

Table 3: Determination of the intrinsic value

Replacing α and β by their value in the equation of the model according to the market price observed the first day of listing, the shares listed on the Stock Exchange of Paris, we succeeded to determine the intrinsic value of every listed share.

The model, thus, spells as follows:

$$IV_{i,t} = \alpha + \beta MR_{i,t} + \epsilon_{i,t}$$

It stands out from the following table, that the coefficients α and β , are statistically significant (α is significant at the level of 1 % and β at the level of 10 %).

III-2: Nature of the link between the internal mechanisms of governance and the initial returns

III-2-1: Correlation matrix between the independent variables

The problem of multicollinearity arises when two variables are highly correlated. Kervin (1992) states that a problem of multicollinearity is present when the correlation coefficient is greater than 7. Examination of the various correlation coefficients contained in the two tables shows that they are below the limits set by Kervin (1992). This means the absence of a critical correlation that can present a serious problem of collinearity between the independent variables included in our regression model. These findings allow us to apply multivariate regressions without fear that there is a problem of multicollinearity between the independent variables included in our model.

Criterion, SC and Hannan–Quinn Criterion, HQC. Based on these criteria, the lag order is selected to be 3 as shown by the table below.

	Firm Age	Manag.Own	Instit.Own	CEO Duality	Board Size	Board. Indep	Own.Conc
Firm Age	1.0000						
Manag.Own	0.0258	1.0000					
Instit.Own	-0.1392	-0.2704***	1.0000				
CEO Duality	0.1684*	0.4384***	-0.0141	1.0000			
Board Size	0.1125	-0.5140***	0.0713***	-0.3734	1.0000		
Board. Indep	-0.1640*	-0.0999	-0.0541	-0.1646*	0.2046**	1.0000	
Own.Conc	0.1039	0.1856**	-0.0083	0.3191***	-0.2305**	-0.1289	1.0000

Table 4: Correlation coefficients of the explanatory variables of IPO Under/Overpricing

Table 5: Correlation coefficients of the explanatory variables of the initial return

	F.Size	Underpricing	Overpricing	Dummy.V
F.Size	1.0000			
Underpricing	0.0649	1.0000		
Overpricing	0.1393	0.0738	1.0000	
Dummy.V	0.0442	0.2300**	0.5677***	1.0000

III-2-2: Impact of internal governance mechanisms on the initial returns

The results in Table 6 show that the initial return is highly dependent on the under and overpricing. Indeed, this last influences negatively and significantly the initial return (at 1 %). On the other hand, underpricing has a positive and significant impact (at 5 %) on the initial return. Consequently, the sign of the abnormal return, observed during the listing period, depends on the degree of influence of IPO under/overpricing. In other words, a positive initial return implies a more important impact on behalf of IPO underpricing. By opposition, a negative abnormal return reflects a more important overpricing as compared to the underpricing.

The results show that the underpricing can improve the initial return. On the other hand, this return is affected negatively and significantly by the overpricing. It should be noted that the governance structure is a major determinant of initial returns, given that the managers of the firm can decide the magnitude of IPO under/overpricing. Therefore, our results mentioned above, can be attributed to factors that relate to certain governance mechanisms.

The idea according to which the structure of governance can affect the IPO overpricing was not investigated. However, our analysis shows that there is a very significant relationship between the overpricing and the internal mechanisms of governance. On the other hand, the impact of these mechanisms on IPO underpricing is weakly observed. Indeed, the observation of the table allows us to note that the internal mechanisms of governance influence strongly and appreciably the overpricing. Nevertheless, we note that only institutional ownership and board size have a significant effect on IPO underpricing. So, with the

exception of the variable relative to the duality, all other variables of the corporate governance have an effect significantly negative on the overpricing.

Indeed, a concentrated shareholder ownership adversely affects IPO overpricing. In other words, a shareholder holding a part superior or equal to 20 % of the capital, before initial public offering, should not overprice the shares of the firm in which he placed his shares. On the other hand, he finds his interest in the underpricing of shares despite the non-significance of the relationship between the concentration of ownership and IPO underpricing.

This result can be explained by the fact that these shareholders have no necessary funds to pursue the financing of their firm. This incites to them to give up the control to new investors (Miloud (2003)) by increasing IPO underpricing and reducing IPO overpricing to attract new blockholders. Consequently, we can speak here about an intentional IPO underpricing. Nevertheless, this last one is not significant. The main part is that these shareholders reduce at most the level of overpricing to make a success of IPO and find necessary funds to finance their firm. A concentrated shareholder ownership, thus, affects the initial return, given that the overpricing represents a constituent element of this last one.

We also note a negative and significant relationship between the manager ownership and the overpricing.

Indeed, an important presence of insiders can increase the capacity of CEO founders to negotiate the initial price of offer with investment banks, reflecting the evaluations of their companies by the market, during the first trading day (Certo (2001)). This can reduce the risk of observation of IPO overpricing. Also, an important internal strengthens the system set up to control the interests of shareholders. This

leads in turn to an increase of the value of the share due to the better functioning of the management of the company. Managers expect, therefore, an under subscription which is

going to be created on the offer of the new issues, due to the overpricing observed during the listing period.

Table 6: Results of the regression model for the study of the impact of the governance structure on the initial returns

Variables	Initial Return		Underpricing		Overpricing	
	Coef	t-stat	Coef	t-stat	Coef	t-stat
Underpricing	6.099426**	2.57	-	-	-	-
Overpricing	-7.808319***	-2.94	-	-	-	-
F.Size	0.3642642	0.86	-	-	-	-
Dummy.V	-1.236864	-0.90	-	-	-	-
Own.Con	-	-	0.1769719	0.62	-0.444215***	-8.74
Manag.Own	-	-	-0.2577019	-0.96	-0.208437***	-4.39
Instit.Own	-	-	-0.543036**	-2.35	-0.131358***	-3.21
B.Indep	-	-	-0.5383055	-1.18	-0.1358667*	-1.68
Duality	-	-	0.2500032	1.12	-0.023798	-0.60
B.Size	-	-	0.070534***	2.75	-0.025098***	-5.53
F.Age	-	-	-0.3035185	-1.60	-0.079987**	-2.39
R²	0.6420		0.1409		0.9720	
F-Value	47.08367		2.413494		511.275	
Prob (F)	0.0000		0.0250		0.0000	
N	109		110		110	

*significant at 10% **significant at 5% ***significant at 1%

Consequently, a reduction of the value of the share must be taken into account, to reduce the risk of observation of IPO overpricing. The negative relationship between the overpricing and the ownership of insiders results, thus, from an alignment of the interests between the stakeholders of the company, by reducing the level of the overpricing to make a success of IPO activity. In other words, the manager, with a high part of ownership, is going to act in the interest of the firm by reducing the risk of under subscription, and consequently, the risk of IPO overpricing. Which implies an alignment of its interests with those of other shareholders.

So, the results of the table 6 show that the institutional ownership is negatively and significantly correlated with the under / overpricing. Indeed, the negative relationship between the underpricing and the institutional ownership means that the sector which the company belongs is characterized by a strong uncertainty, before IPO, and the presence of institutional investors allows reducing this information asymmetry, and consequently, the level of the underpricing. However, these investors have no interest to observe a reduced level of IPO underpricing given that they must be rewarded in return of the information that they supplied on the company with honesty (according to the hypothesis of the revelation of information advanced by Benveniste and Spindt (1989). Hence, their strong presence within the firm reduces, thus, the possibilities of observation

of IPO overpricing. Which justifies the negative relationship between this last one and the part of the capital held by These investors.

This result can thus be interpreted with reference to the nature of these investors and their ability to control the managers within the firm. The results show that the impact of institutional ownership on the overpricing is significantly higher compared to that observed in the presence of IPO underpricing. Consequently, independently of their nature and of their capacity to control the managers, these institutional have no interest to overprice the initial public offering, given the negative relation between both variables.

We note as well that the existence of the independent administrators within the board weakens the extent of the overpricing but in a less significant way (at 10 %). Juan (2007) predicts that the uncertainty resulting from potential problems associated to the low independence of the board can motivate the investors to ask for a high level of IPO underpricing. Nevertheless, the finding contradicts the research hypothesis to the extent that an independent board is associated with a high level of underpricing. This may justify the negative and significant link between the overpricing and board independence. This means that a larger board can improve the underpricing and reduce the overpricing observed during the listing period.

Our results reflect in some ways the ideas of Hermalin *et al* (2003) to the extent that the board size is ineffective in the exercise of the control of the leaders. This reduces the possibilities of making the decisions for the benefit of the shareholders and strengthens the discretionary power of the leaders. These last ones go, afterward, act in their own interests by increasing the level of the underpricing to attract new investors while making sure that their manager power remains strengthened. So, an improvement of IPO underpricing comes along, generally, by a deterioration of the scale of IPO overpricing.

Conclusion

In this study, we showed that the structure of governance is a major determinant of the initial returns observed during the listing period. Indeed, the application of simultaneous equation regressions on a sample of 110 IPO French companies between 2005-2010, allowed us to say that the initial return is significantly influenced by the under / overpricing. Otherwise formulated, a positive initial return, observed during the initial public offering, reflects a level of IPO underpricing more important by comparison for the overpricing. In contrast, the negative abnormal return implies a greater impact from the overpricing as compared to the underpricing. Our study comes to rectify some relatively erroneous ideas, in the sense where IPO underpricing observed in most of the previous studies constitute in fact, a positive initial return. By opposition to the previous studies, our work allows to accentuate the importance of IPO under/overpricing in the explanation of the initial return. This claim is recognized as part of our results in the sense where the underpricing allows improving the initial return that is affected negatively and significantly by the overpricing (at 1 %).

Our results confirm in some ways our theoretical predictions based on the idea that the governance structure affects the underpricing. This is well illustrated at the negative and significant relationship (at 5%) between the underpricing and institutional ownership. So, the results show that the size of the board has a positive and significant impact (at 1 %) on the underpricing observed during the listing period. On the other hand, with the exception of the variable relative to the duality, all other variables of the corporate governance have an effect significantly negative on the overpricing.

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