INSTITUTIONAL AND STRATEGIC IMPLICATIONS OF FOUNDER-CEO TRANSITIONS IN FIRMS ISSUING INITIAL PUBLIC OFFERINGS

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Abstract

Institutional and Strategic Implications of Founder-CEO Transitions
in Firms Issuing Initial Public Offerings

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Some of the most highly recognized CEOs were the entrepreneurial creators of their firms. These CEOs distinguished themselves, not only by starting their firms, but also by successfully managing them for long periods of time after they issued initial public offerings (IPOs) and became public. Considering such successes, it seems reasonable to ask the following question: Why do founders have a bad reputation among Venture Capitalists and Investment Bankers? Tashakori (1980) notes that Venture Capitalists realize that they put pressure on founders to leave their CEO positions. However, empirical research supporting the replacement of the Founder is limited. In this research, I examine the effect of replacing the founder with a professional CEO in firms that are issuing an initial public offering on a US stock exchange between 1996 and 2000. It is found that replacing the founder-CEO by a professional results in an increase of, on average, $12 million in the valuation of the issue. However, both the long-term stock performance and the firms' survival rate are higher for founder-led IPOs. If founder-led IPOs offer better returns and better chances of survival, then a favorable bias should exist in their favor. However, the better IPO performance showed by professional-led IPOs supports a new institutional theory perspective that the presence of a professional CEO in an IPO firm is a taken-for-granted marker for legitimacy that institutions seek and value.

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I would like to thank Dr. Martens for his important contribution to the development of this research. His knowledge of the field and dedication helped me learn tremendously while completing this thesis.

I also would like to thank my parents and sisters for their life-long encouragement and their constant support of my studies. Their care and generosity have been, and will always be, crucial to my success.

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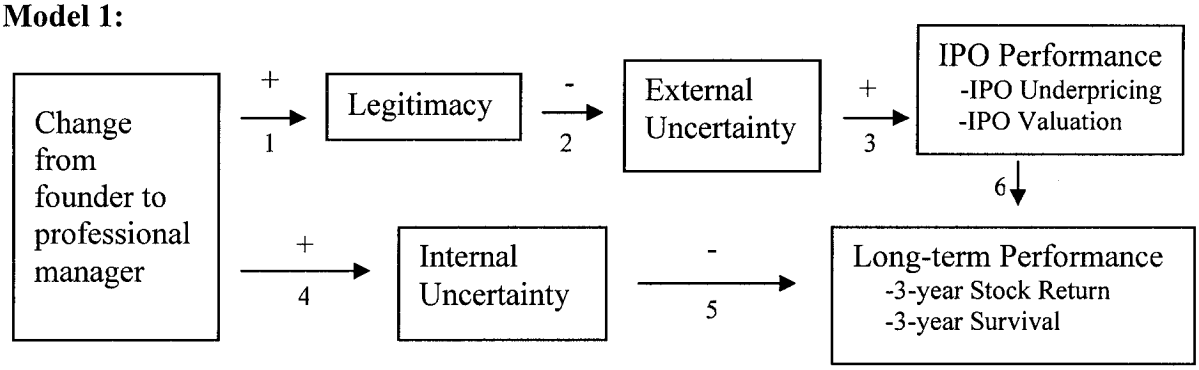
Introduction

Some of the most highly recognized managers of the last 20 years were the founders of firms that became huge international successes. These founders gained notoriety not only by starting their firms, but also by managing it for long periods of time after these firms have gone public. Of these founders, Bill Gates is probably the most well known with Microsoft. Michael Dell from Dell Computer, Jeffery Bezos from Amazon.com are also at the top of very successful firms. Even the all-powerful Wal-Mart had been managed by its founder Sam Walter for over 30 years before his death and for more than 20 years after the firm went public. Looking at these successes, it is reasonable to ask the question: Why do founders have a bad reputation among institutions such as investment bankers and venture capitalists? It is easy to find in various academic literatures reasons explaining why founders should not keep managing their firms once public. They are said to be overoptimistic, unprepared, not capable of changing their management style when needed, not educated enough, and many other reasons (Daily & Dalton 1992; Rubenson & Gupta 1992; Flamholtz 1990; Hambrick & Crozier 1985). However, empirical results that would support such claims are not abundant. Tashakori (1980) mentions that venture capitalists themselves would agree that they put pressure on founders to leave their CEO positions, but that they have no empirical reasons to act as such. There is some research supporting the idea. Certo et al. (2001) found that founder-led IPOs are more underpriced than professionally managed IPOs. However, the reasons for this result are not well explained in the literature, and this is why my thesis re-examines the effect of founders on underpricing of their issues and integrates it in a much more comprehensive model

(*see Model 1*) to explain the external and internal effects of a change from a founder to a professional CEO at the time of the Initial Public Offering of the firm.

The external effect is defined as the effect of a change in top management on institutional investors, and thus on IPO Performance, which includes the level of underpricing and the valuation of the issue. The internal effect on the other hand is the effect of a change in top management on the future performance of the firm. According to the following model, which I test in this research, I argue that founder departure increases the firm's legitimacy, which reduces uncertainty for investors. Therefore, professionally managed IPOs should be less underpriced and with higher valuations than founder- managed IPOs. From the internal perspective, I argue that founder departure creates an important amount of uncertainty inside the firm, which reduces the future performance of the firm.

Model 1:



Primary Research Questions:

- What are the internal and external effects of a change of CEO from a founder to a professional manager in an entrepreneurial firm?
- Are professional managers increasing the performance of newly public firms?
- Does the initial underpricing of an IPO relate to the future performance of the firm?

IPO Process

First, let us start with a description of the process which each and every growing entrepreneurial firm needs to go through in order to become publicly traded. There are a number of reasons for a firm to issue an IPO. Sometimes, the firm is seeking financial resources in order to finance growth. It could also be because the founder and original shareholders would like to spread their risk and sell a percentage of the firm. Other reasons, such as gaining the ability to give stock options to employees in order to attract highly qualified personnel, could also lead a firm to issue their IPO (Jenkinson & Ljungqvist 1996). The process of going public requires a long preparation and the involvement of a "deal network kernel" involving important actors such as an investment bank, a law firm and an accounting firm (Pollack et al 2004). It is important for a firm that wishes to issue stock to start acting as a public firm some years before the actual offering. Acting as such requires the firm to prepare financial results every quarter and to develop a business plan (Chevitz 2003).

The IPO process in itself starts with an all-hands meeting which gathers at the same table the issuing firm, the investment bankers, the accountants and the lawyers. This meeting determines the role of each member present and establishes the timetable for the issue. Another crucial task is the preparation of the prospectus. The prospectus includes all the important information that investors may want to know about the firm. The financial statements, the competitors, a thorough description of the firm and risk factors are all elements found in this document that will have to help selling the issue during the quiet period imposed by the Securities Exchange Commission. Prior to the quiet period,

however, the firm's top management meets with investors in the major financial capitals of the world in order to publicize and evaluate the demand for the issue, which will help setting the final price and size of the offering (Chevitz 2003).

Most recent IPOs issued on United States stock exchanges are sold on a firm commitment basis. In a firm commitment or bought deal, the underwriter buys all the shares issued in the offering and takes the responsibility for selling them (Jenkinson & Ljungqvist 1996). Most of the time the lead underwriter gathers other banks and institutional investors into a syndicate in order to spread the risk among several institutions. The underwriter of the IPO also has an important role in supporting the stock price by trading the stock on the market in the period immediately following the IPO. This operation ensures that the price will not be excessively volatile in the first days of trading (Jenkinson & Ljungqvist 1996). The IPO is declared final seven days after the first day of trading on the market, but in reality it is very rare that an IPO is cancelled after it has started trading (Chevitz 2003)

Underpricing Theories

Underpricing is the most frequently studied concept in the IPO literature. It is defined as the difference between the issue price set by the underwriter and the closing price at the end of the first trading day or week, when the closing price is higher than the issue price. It is termed 'underpricing' since a higher price at the close of the first day is an indication that the firm may have been able to obtain a higher price for its stock than the price set in the issue. In other words, the underwriter and the firm have set an issue price under what it may have been able to obtain. When firms issue an initial public offering, they sell stock to institutional investors who "subscribe" or agree to purchase a certain amount of shares at the price that was negotiated between the firm and the underwriter. If a firm is highly underpriced, it is believed that the firm "left money on the table" and failed to obtain the full value for its shares.

Since prior research has found higher levels of underpricing for founder-led firms (Certo et al. 2001), it is important to evaluate why underpricing exists and what variables have an impact on its size. IPO underpricing is a widely examined concept and the literature on the topic is quite expansive.

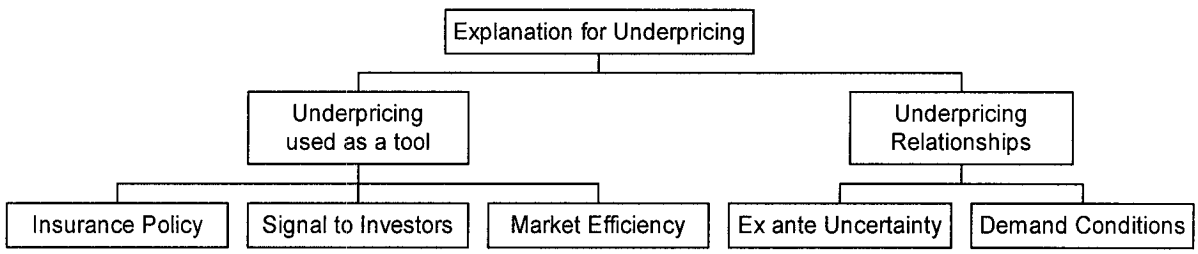
Many, if not most of the articles on underpricing do not take the time to demonstrate underpricing. The phenomenon has been around for quite some time. Many articles rely on Ibbotson (1975) or Ritter (1984) who showed that underpricing does exist. Ritter (1984), for example, studied 5,000 IPOs from 1960 to 1982 in order to draw his conclusions. However, even if the literature from then on generally accepted the

phenomenon as a fact, some still argued against the effect as recently as 1993 when Ruud argued that the price stabilization activities during the first days of trading skew the average initial performance of IPO and increase it to much higher level than it would otherwise be if no stabilization was done by the underwriters. She argued that overpriced firms are kept at an abnormally high price and thus overpricing is never shown in the first day return. Although Ruud makes a solid argument, it has not received much support in the literature. Since 1993 however, IPO underpricing has increased tremendously and the Internet bubble at the end of the 1990's produced a very high level of underpricing. It is also important to note that there are more than 300 IPO firms involved in a class action lawsuit that argues that investment banks purposely inflated market prices of these IPOs during the period from 1998 to 2000. If the allegations in the lawsuit are true, the underpricing level of these IPOs may be inflated and thus it would be important to take this element into account. Nevertheless, with the generally high levels of underpricing in the past decade, no more scholars are arguing that the phenomenon does not exist. In fact, it seems to have given researchers even more incentive to keep looking for explanations.

There are different categories of explanations for underpricing (Tinic 1988). On one side, the underpricing is said to be used as a tool for different purposes such as an insurance policy, a signal to investors, or the efficiency of the financial markets. On the other hand, others explain underpricing by establishing links between some characteristics of the firm and the future level of underpricing. These relationships include such variables as the revisions in the offer price from the filing of the preliminary prospectus to the offer date and, perhaps most importantly, the ex-ante uncertainty of the firm (MacCrimmon &

Martens 2000; Clarkson & Merkley 1994). This second approach assumes that underpricing is present because of rational calculations by investors and underwriters based on demand conditions for the IPO or elements specific to one particular IPO instead of being premeditated in order to attain a specific goal.

Figure 1:



Underpricing used as a tool:

Insurance Policy Theory:

Tinic's (1988) article is probably the most well known article that speaks in favour of this theory. The assumption is that, reputation being the most important asset to underwriters, a possible loss from lawsuits is very large, not only in terms of money, but more importantly, in terms of reputation. Moreover, issuing firms usually lack resources and thus may wish to reduce their own liability risk. In the case where an IPO is overpriced or the absence of critical information in the prospectuses occurs, a lawsuit could be filed against both the investment bankers and the issuers. In this condition where both parties are at risk, the solution to underprice the issue as a protection against the possible lawsuits liabilities makes sense. Tinic (1988) argues that insurance from an insurance

company could be bought but the incentive to cheat would be higher. Moreover, if one was caught cheating on the valuation of the issue, the underwriters and the issuers could face severe reputational damages that would be just as detrimental to them as financial losses. Therefore, underpricing might be the easiest and most efficient solution. Alexander (1993) and Drake and Vetsuypens (1993) contest this argument as a method to reduce lawsuit liability. They argue that it is the long-run performance of the stock price that is responsible for most lawsuits and short-term underpricing is not a significant factor.

Underpricing as a Signal to Investors:

Another hypothesis for the existence of underpricing is that it is a signal to investors that a certain issue has a promising future. This signal creates an incentive for investors to collect information about the issuing firm. Welch (1989) and Chemmanur (1993) mention that once information is gathered by investors, the IPO firm may obtain a higher price for their seasoned equity offering. This higher price allows the IPO firm to recoup the cost of underpricing incurred in the initial public offering. Allen and Faulhaber (1989) emphasize the idea that only good firms can use underpricing as a signal mechanism since they are the only ones that may be able to recoup the cost of underpricing after the true value of their prospects is assessed by investors through the information gathered. On the other hand, it could be argued that an IPO firm with the best potential does not need to give as much incentive to investors for them to gather information since the potential of high returns itself should be enough for investors, assuming that investors are capable enough to detect firms that deserve more attention than others.

Underpricing for Market Efficiency:

A third important theory found in the literature for the presence of underpricing is that it helps make the initial public offering market more efficient. This explanation is derived from the winner's curse problem that uninformed investors experience in the initial public offering market. According to this hypothesis, uninformed investors will get an allocation of shares more easily for the worst performing IPOs and will have more difficulty getting a share allocation for the best IPOs. This happens because there are informed investors who will only bid on good IPOs, which increases the number of applicants for these IPOs (Levis 1990; Koh & Walter 1989; Beatty & Ritter 1986). Since uninformed investors are necessary for the well functioning of the IPO market as a whole, IPO firms and underwriters have an incentive to compensate them with underpricing, and thus give them an incentive to continue investing in the IPO market (Levis 1990). This price reduction of the offering attract the uninformed investors and increases the probability that the issue will all be sold and that the issuing firm will be able to gather enough money to pursue their intended use of the proceeds (Rock 1986) with the funds gathered on the financial markets.

It does not seem that these three theories of underpricing could explain why or how the top management of firm may influence underpricing. If underpricing is a tool that is used by issuing firms and underwriters, the underpricing level should not differ between founder-led and professional-led firms. These theories may in part explain underpricing but other explanations are required in order to understand why founder-led firms are associated with higher levels of underpricing.

Underpricing Relationships:

Underpricing in Relation to Demand Conditions:

Other theories of underpricing note that higher levels of underpricing might be present to compensate investors who not only gather but also disclose favourable information about a certain IPO. According to Hanley (1993) underpricing can somewhat be predicted when looking at the final offering price compared to the initial offering price range disclosed in the preliminary prospectuses of IPO firms. The idea is that underwriters and issuers both want information to be honestly disclosed about the IPO in order to sell all the allocated shares and in order to price the issue at a more favourable price. The theory first put forward by Benveniste and Spindt (1989) states that underwriters and issuers need to give an incentive to investors to disclose honest information. This incentive needs to be higher than the profit generated by the investors if they would not disclose their information and then buy an IPO which has a high likelihood of trading at a lower price. Theory shows that the price of an issue must be low enough to provide that incentive to the investors. In exchange for their information investors make sure they will have an interesting allocation and first day return on their investment.

Benveniste and Spindt (1989) also note that underwriters can maximize their proceeds when dealing repeatedly with the same investors. When the same investors get abnormal return on their IPO investments they have much more to lose if the underwriter cut their allocation. The incentive of not disclosing information is therefore reduced and the

underwriter may somewhat reduce the amount of money left on the table and still get the information on the actual demand of investors for the issue.

Underpricing in Relation to Ex Ante Uncertainty:

Beatty and Ritter (1986) and Clarkson and Merkley (1994) take a different approach to explain the variation in underpricing levels. From their perspective, the uncertainty surrounding the true price at which the issue will be traded in the open market is responsible for the increase in underpricing. In their opinion, this uncertainty is responsible for intensifying the winner's curse problem previously explained in the section "Underpricing for Market Efficiency", which leads to uninformed investors demanding an even higher return for them to continue to participate in the IPO market. This higher return is given back to them in the form of underpricing. For example, Clarkson and Merkley (1986) found that in "hot" industries, where growth possibilities are high and where the proceeds of the issues are used to finance new projects, IPOs are characterized by a higher level of underpricing. On the other hand, IPOs of firms in more regulated industries or IPOs for which the proceeds will be used for financing purposes are much less underpriced. In addition, Beatty and Ritter (1986) argue that underwriters, in order to keep their market share in the IPO market, need to underprice the issues so that the initial return is commensurate with the ex ante uncertainty of the issue. Underpricing above or below this level would result in a loss of reputation, and thus of market share, for the underwriter.

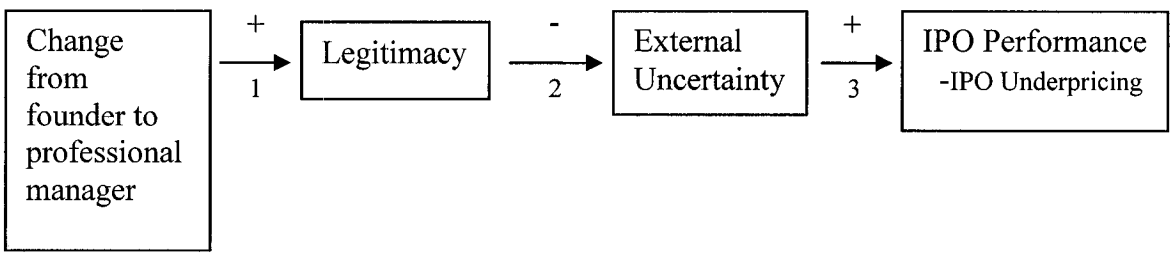
Founder Departure and Underpricing:

Out of the numerous explanations for underpricing, emphasis needs to be put on one that may give a rational explanation for the fact that higher underpricing is observed for founder-led IPOs (Certo et al. 2001). There are no reasons for founders to take more insurance against future litigation than professional managers, especially when the literature accuses founders to be over-optimistic (Daily & Dalton 1992; Flamholtz 1990; Hambrick & Crozier 1985). There are also no reasons to see a difference in underpricing between founder and professional-led IPOs if underpricing is present to ensure market efficiency.

The argument is one of perception. I argue that the presence of the founder creates uncertainty for investors of the firm. Investors' confidence would be affected by his presence and thus, as Beatty and Ritter (1986) and Clarkson and Merkley (1994) suggest, the ex ante uncertainty created would be responsible for the higher underpricing. At the center of this relationship lays the feeling by external constituents, such as venture capitalists, investment bankers and institutional investors that the founder is not the most appropriate person to manage a firm that is going public. This feeling would reduce the legitimacy of the IPO, and thus, as argued by the new institutional theorists, would increase uncertainty (Oliver 1991). This relationship, illustrated in Model 2, constitutes a central element of the argument developed in this research. The concept of legitimacy will be further developed later in this paper, but I argue that founder departure is an important marker for legitimacy in the highly institutionalized process of Initial Public

Offerings. It is also believed that the increased legitimacy resulting from this change at the top of the issuing firm decreases the ex ante uncertainty of the issue and thus reduces underpricing.

Model 2:



The link between the change in the top management team and the underpricing level of an issue has been supported in research by Certo et al. (2001). However, it is interesting to reassure this link by testing this same relationship with the sample collected in this research.

Hypothesis 1a:

> *A change in the CEO from a founder to a professional manager prior to the IPO will lead to lower levels of underpricing.*

This research will also try to go further by looking at the impact of the founder's departure from the CEO seat toward another position within the Top Management Team or the Board of Directors. I argue that, as much as the presence of the founder as CEO should increase the level of underpricing, the presence of the founder in another position

within the organization should have the opposite effect. The presence of the founder should indeed allow keeping his knowledge and vision for the firm without having the detrimental effect caused by his[1] lack of experience at managing a public firm. That way, uncertainty is decreased and the underpricing level should be lowered.

Hypothesis 1b:

> *Compared to the average underpricing level of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to lower levels of underpricing.*

For the same reasons, the founder who stays on the Board of Directors should also have a positive impact (lower underpricing) on the level of underpricing.

Hypothesis 1c:

> *Compared to the average underpricing level of IPO firms, having the founder remain only as a member of the board of directors will lead to lower levels of underpricing.*

In order to fully develop the concept involved in my argument, I will discuss the Founder-CEO Succession literature, followed by a description of the organizational legitimacy literature. To complete the original Model 1, I will discuss how internal uncertainty is created by founder departure.

[1] Although current custom normally dictates the use of 'his or her' when referring to a CEO, in this thesis I will use the word 'his' to refer to the CEO since more than 97% of them in my dataset are male.

Founder-CEO Succession Literature

To understand the higher underpricing of founder-led IPOs (Certo et al. 2001), it is necessary to understand why founder-CEOs would create more uncertainty for their firms than professional-CEOs. Uncertainty, which is a very important factor for underpricing (Clarkson & Merkley 1993; Beatty & Ritter 1986), may come from the argument that founders are inappropriate for managing their firms once public. On the other hand, what I propose is not that founders are inappropriate for managing their firms once public, but that they may be the victims of the preconceived ideas about their inability to manage a public firm.

The reasons behind CEO succession have been examined thoroughly in the past, but interpretations differ among academics.

Size of the Firm:

One of the ideas that can be found in the literature is that founders should not manage their firms as they grow above a certain size (Flamholtz 1990). Flamholtz (1990) suggests that professional managers should manage a firm once it reaches a threshold of $10 million in sales. Although Boeker and Karichalil (2002) find no significant relationship between founder departure and firm size when size is calculated in terms of sales, they do find a significant relationship when size is measured in terms of number of employees. Firm size may thus be a source of pressure for founder departure (Wasserman, 2003;

Rubenson & Gupta, 1992). Indeed, as a firm grows, both in terms of revenue and employees, the complexity of the manager's job increases, and the founder may not have the ability to handle this increased complexity. It is also common to read that founders have a very centralized way of managing their firms and that, as a firm grows, it becomes impossible for the founder-CEO to oversee every aspect of it, which leads to his departure (Rubenson & Gupta 1992; Clifford 1973). However, Daily and Dalton (1992) do not find any significant relationship between performance, management structure and firm size.

Growth Rate of the Firm:

The growth rate of both the industry and the firm is another factor suggested as an indicator of founder departure. The primary reason for this suggestion is that founders face significant difficulties adapting their management styles to their rapidly growing firms (Flamholtz 1990), and to the changing role of CEO this growth implies (Rubenson & Gupta, 1992; Daily & Dalton, 1992). Hambrick & Crozier (1985) suggest that high-growth firms face specific challenges that may trigger the questioning of the top management team's abilities. They point out four major challenges that fast growing firms face: instant size, sense of infallibility, internal turmoil and frenzy and extraordinary resources needs.

Instant Size:

A rapid increase in size provokes a series of problems inside the firm such as disaffection, disorientation, inadequate skills and/or inadequate systems. One of the important reasons leading to such problems is that the family spirit that was once felt by every employee is gone. Moreover, the systems of control and certain procedures often are not adapted to the increasing complexity of the firm. Finally, some key employees that were hired at the start of the firm see their responsibilities dramatically increase while not having the adequate ability to face them efficiently. These employees might constitute significant obstacles for the future growth of the firm (Rubenson & Gupta 1996; Flamholtz 1990; Hambrick & Crozier 1985).

Sense of Infallibility:

Another problem for fast growing companies is their inability to adapt to changes in their environments. They often feel that their strategy, which has been so successful in the past, is the best way to go forward. Too often this sense of infallibility will be responsible for disregarding the actions of their competitors and the new trends in their industries (Flamholtz 1990; Hambrick & Crozier 1985).

Internal Turmoil and Frenzy:

The increasing number of new employees changes the dynamics of the firm. Interactions between employees may suffer from it and the new organizational structure may prevent old employees from interacting in the same manner as they used to. There is also a new incomprehension of the coworkers' work. If no appropriate training is given, the different

departments may as a consequence work in a less coordinated manner, which decreases the efficiency of the firm. This incomprehension and, possibly, the amount of work falling on each employee resulting from the lack of organization in the firm's structure, might also be responsible for high employee turnover, and thus in a loss of human capital. In addition, the dramatic increase in the number of employees, which is necessary to sustain a high level of growth, might also put a lot of pressure on the human resource department of the firm, especially in its recruiting activities. (Flamholtz 1990; Hambrick & Crozier 1985).

Founder's Power:

Founder-CEO succession is often a question of power difference between the founder and other stakeholders such as the underwriters and the venture capitalists. Ownership and ownership concentration are two important determinants of power within organizations. Fredrickson, Hambrick & Baumrin (1988) identify ownership as one CEO characteristic that leads to a lower likelihood of CEO dismissal. Boeker and Karichalil (2002) also test for ownership and find a significant and negative relationship with founder departure. Wasserman (2003) also considers ownership as an important source of power for the founder. Wasserman (2003) tells us that the more capital the firm is seeking from outside investors, the more power these investors will gain in the firm, and thus the greater their ability to remove the founder from his CEO position. The results of his research support the notion that the number of rounds of financing and the amounts raised in the financing are positively associated with the likelihood of founder departure as they are positively

related to the level of power acquired by outside investors. Finally, Ritter and Welch (2002) note that when shares are scattered among small investors instead of being held by a low number of powerful shareholders, the power of the entrepreneur is increased and he is thus less likely to be replaced. However, Boeker and Karichalil (2002) do not find a significant relationship between ownership concentration and founder departure.

The board of directors is another important factor in founder-CEO succession literature as it is where the game of power is played between the founder and the other stakeholders. Rubenson and Gupta (1996) hypothesize that the number of insiders on the board is positively related to founder tenure. Boeker and Karichalil (2002) test this hypothesis and find a significant relationship between the variables. Fredrickson, Hambrick & Baumrin (1988) put forward other board characteristics such as size that could explain founder departure. An increase in the board's size, for example, may diminish its cohesiveness and may put pressure on the CEO's succession. The financial interest of board members might also be correlated to CEO dismissal because it is more likely that members with large interests in the firm will be more critical of the CEO's actions. Finally, as mentioned by Fredrickson, Hambrick & Baumrin (1988), the longer the members are on the board, the more likely they are to have strong ties to the CEO, and thus the less pressure they would put for his departure. Although Fredrickson, Hambrick & Baumrin (1988) attribute these factors to all CEO dismissals, I argue that they could also be applicable to the specific case of founders.

Firm's Life Cycle:

Some life cycle theorists such as Adizes (1999) view firm age as a key indicator for founder succession, but one empirical investigation (Boeker & Karichalil 2002) found no significant relationship between these two variables. Wasserman's (2003) argument is that, once the product development stage of an entrepreneurial firm is successfully completed, the skills required to manage the firm change, which might lead to the inability of the founder to keep his CEO position. In this argument, firm age is not as important as the critical phases a firm goes through, which are likely to influence founder departure. As mentioned before in this study, the IPO process is a critical phase for entrepreneurial firms. It involves many changes in the organization's operations and environment which might cause founder departure.

Founder Characteristics:

Founder characteristics are also considered as valid factors for founder succession. One of the criticisms of founders lies in their lack of objectivity and their over-optimism due to their high level of attachment to the firm. These characteristics attributed to founders may become obstacles to effective management as they might limit founders' ability to make tough decisions (Ritter & Welch 2002; Daily & Dalton, 1992; Flamholtz, 1990). Moreover, Rubenson and Gupta (1992) find that founders with a business background are more likely to depart, or be removed, from their firms than founders with a science background. Founders' age is also found to have a marginal effect in this study. In a later

study, Rubenson and Gupta (1996) hypothesize that the founders' level of experience as general managers could also be a significant factor influencing departure.

As mentioned before, entrepreneurs have a strong sense of involvement in their firms. They often oversee all aspects of the business to make sure everything is going according to what they had planned and take great pride in the development of the product. However, as the firm grows and the managerial tasks of the founder increases, the founder might find himself in a position that does not satisfy him anymore. His implication in the day-to-day operations and the diversity of work that previously characterized his role may diminish. The founder may thus be willing, and to some extent look forward, to quit his CEO position and take on a new challenge that best fits his abilities (Boeker & Karichalil 2002; Flamholtz 1990). Therefore, the desire of the founder to remain in control of his organization cannot be taken for granted.

All of these beliefs about founders are unfortunately not empirically tested. They are based on a generalization of certain cases at the most and on beliefs at the least. Empirically, I found evidence that neither of these arguments about the inability of founders are true nor do they influence the firm's performance. Rubenson and Gupta (1992) conclude that entrepreneurs can change management style and that the argument which mentions their inability to change is simplistic in nature. Williard, Krueger and Feeser (1992) found that founder-led growing firms are actually slightly more profitable than professionally managed ones. Moreover, founders have some characteristics that are essential for ensuring the well- being of their firms, and for overcoming the challenges faced by growing firms as mentioned by Hambrick and Crozier (1985). For example, the

founder, by representing and transcending the organizational culture, ensures that the culture of the firm is preserved and reinforced so that everyone in the organization knows where the firm is going. In addition, founders are likely to keep a flat organizational structure since they usually want to stay close to the action. The structural smallness they thus promote is also considered by Hambrick and Crozier (1985) to be one of the solutions to the challenges faced by growing firms.

A review of the literature appears to strongly suggest that founders are inappropriate for managing a public firm, but is lacking in solid empirical data. As it is easy to find examples of founder-CEOs that have been very successful and because, as mentioned before, some financial institution would agree that they do not base their opinion of founders on any empirical data (Tashakori 1980), I argue that the change in founder has become a taken-for-granted marker for legitimacy that people involved in the IPO process seek. This explains why founder departure may increase legitimacy and reduce uncertainty of an issue, which would in turn affect the underpricing and, as it will be explained, the valuation of the issue.

Institutionalization of the IPO process and Legitimacy

It is crucial to realize that the IPO process is highly institutionalized. Institutionalized actions are those that have shared meaning, and where the action itself identifies the actor as a member of a particular group. As there are very few important players in the financial markets, these financial institutions tend to hold a substantial amount of power and can significantly influence the market. Large financial institutions are indeed capable of publicizing an issue in order to attract the attention of potential investors. Moreover, they may well be the issuer's creditors and therefore may hold an increased amount of power. The restricted circle of the major players in the IPO market is thus in a very good position to control every aspect of the IPO process. Their power can be seen in numerous aspects of the IPO market. For example, Chen and Ritter (2000) describe how investment bankers choose not to compete on price in order to keep the market as a non-commodity one, and to take advantage of higher prices.

The institutionalization of the IPO process also comes from government regulation, the securities commission, and the stock exchanges such as the NYSE and the NASDAQ. IPO firms need to comply with all these external constituents, which only increases the pressure to follow the institutional norms that they are facing. These norms, such as founder succession, fall into the normal ways of operation for issuing firms although they might not be officially required. It is for this reason that such norms are said to be taken-for-granted and are unchallenged empirically.

Firms listen to these institutions because they believe they will benefit by following the norms. The literature suggests that there is a link between following institutionalized norms and uncertainty. In New Institutional Theory for example, uncertainty is reduced by the use of specialized norms and values or roles (Scott 2001). These roles represent a logic of appropriateness (March 1981). It is that logic that financial institutions, governments and other regulatory agencies construct and hold.

Institutionalized Norms and Legitimacy:

The process of legitimacy and institutionalization are essentially the same thing (Tolbert & Zucker 1996). Legitimacy is "a generalized perception or assumption that the actions of an entity are desirable, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995, p. 574). Organizations adopt attributes that are valued by stakeholders in order to gain legitimacy (Suchman 1995). Institutionalization provides stability by bringing predictability in the firms' actions. There are many ways firm seek legitimacy (Suchman 1995; Oliver 1991; Meyer & Rowan 1977). For example, firms may use organizational communication to explain their actions in terms of socially accepted norms (Baum & Oliver 1992). However, ultimately, it is the different stakeholders that determine the appropriateness of the organization's structure and its legitimacy (Baum & Oliver 1992). The level of stakeholders' influence in the environment will determine the value of the legitimacy gained through them (Reuf & Scott 1998).

The new institutional theory perspective notes that building legitimacy reduces uncertainty and this suggests that the appropriateness of the CEO, as perceived by stakeholders and board members, is responsible for increasing the legitimacy of IPO firms. This research also puts forward the idea that the shift from founder to professional manager is an important marker of legitimacy for these firms and serves to reduce some of the uncertainty involved in the IPO process.

Different Kinds of Legitimacy:

The concept of legitimacy is quite complex. Legitimacy can be gained in different ways and can mean different things. There are three main types of legitimacy that will be explained here in order to identify the type of legitimacy an IPO firm is seeking. These three types are Pragmatic, Moral and Cognitive legitimacy (Suchman 1995). Inside these three types, there are yet other forms, from which the most important will be explained here.

Pragmatic Legitimacy:

Pragmatic legitimacy rests in the self-interest of the audience (Suchman 1995). The audience grants legitimacy when there are direct effects on the audience's well being. In this case, the audience evaluates the organization in order to establish if and how the organization will be beneficial to them. This direct exchange between the organization and the audience may be to the limits of bribes, but is nonetheless a consequence of the power-dependence relationship between the two parties (Suchman 1995). Another

variation of pragmatic legitimacy is the influence legitimacy. The audience might be inclined to support an organization if its philosophy and its activities are in line with the audience's. Even if no actual exchange takes place, the presence of the organization might give a sort of power of authority, which aligns both the organization and the audience interest. A third line of thought in pragmatic legitimacy is the dispositional legitimacy which is granted by the audience when the organization seeking legitimacy is "honest", "wise", "share our values" or "have our best interest at heart". This form of legitimacy, although not so rational, appears to be quite important for organizations (Suchman 1995).

Moral Legitimacy:

Moral legitimacy is quite different from pragmatic legitimacy because it does not rest on the benefits that the audience may receive. What is important in this case is whether the activity of the organization is the right activity to pursue or not. The audience is governed by a set of values, and they evaluate the appropriateness of an organization according to these values. However, what is right according to the audience might be biased in their favor, and thus even if moral legitimacy is not as purposive as pragmatic legitimacy, it might not be "interest free" either (Suchman 1995). Moral legitimacy can be based on three main aspects: the evaluation of the output, the consequences of the procedures and the evaluation of the structure (Suchman 1995).

Cognitive Legitimacy:

The taken-for-grantedness aspect of legitimacy suggests that there is a third type of legitimacy, which is the cognitive one. Legitimacy from this perspective can be based on either comprehensibility or on taken-for-grantedness. In the first case, legitimacy comes from existing models that are well-accepted and that can be reproduced (Suchman 1995; Aldrich & Fiol 1994). On the other hand, legitimacy based on taken-for-grantedness is based on the explanation given by institutions, which are above all possible disagreements (Suchman 1995).

Different Approaches to Legitimacy:

Legitimacy as a construct can be viewed in two different ways. Support for both the Strategic and Institutional approaches can be found in the literature.

Strategic Approach:

Scholars who see legitimacy according to the strategic approach would argue that legitimacy is a resource (Zimmerman & Zeitz 2002; Suchman 1995; Massey 1991). This resource is extracted from the environment and can be manipulated and used at the advantage of the corporation (Suchman 1995). Legitimacy as a resource is argued to be as important as other more tangible resources such as technology, personnel and networks. Furthermore, legitimacy is seen as a means to access even more resources (Zimmerman & Zeitz 2002), in our case more money from financial markets at the time of the IPO.

The strategic approach assumes that the management of an organization has control over the processes by which the organization gains legitimacy (Pfeffer 1981). "Legitimation, according to this view, is purposive, calculated and frequently oppositional" (Suchman 1995). This partial control over the legitimation process mainly comes from the perspective that as incompatible demands are made to the organization by different external stakeholders (Oliver 1991), the firm can adopt a strategic management of these demands.

Institutional Approach:

On the other hand, the institutional approach to legitimacy is centered on the environment. The idea here is that the environment becomes a constraint to the organization (Massey 1991) by constituting a symbolic environment that imposes a collective structuration (DiMaggio & Powell 1983). The institutions that shape the organization are said to have an almost infinite amount of power to impose the activities that are deemed to be accepted as norms. According to this view, legitimacy is almost a synonym for institutionalization (Suchman 1995). The institutional rules are built within the society and may be either simply taken-for-granted, or supported by the laws and regulations, or by the public opinion. Institutions involve norms that most often become facts that must be taken into account by corporations. These facts are rapidly transformed into a rationale that helps the understanding by giving meaning to the institutionalized social structure. Finally, this institutionalized social structure becomes

proper, adequate, rational and necessary for organizations to avoid illegitimacy (Meyer & Rowen 1977).

The strategic approach might be more appropriate in industries where new entrants may be a threat to the established firms. The size of the entrant relative to the industry may be significant, and therefore the entrant may have more latitude to bend accepted rules by managing the legitimacy of their operations. Also, when the possible legitimacy and economic gains are low, organizations will attempt to use their power to compromise instead of conforming to accepted rules and norms (Oliver 1991). On the other hand, in the Initial Public Offering setting, the second perspective seems more appropriate. This is the case mainly because of the little power that new entrants have. IPO firms do not weigh much in the financial markets in general. In fact, they are for the most part young entrepreneurial firms (MacCrimmon & Martens 1998). Their addition to an exchange has no impact on the liquidity, reputation or any other aspect of an exchange such as the NYSE. The institutions in place are stable and, most of all, very powerful. The ability that IPO firms have to manage their legitimacy is so low compared to the benefits of conformity that the institutional approach is much more attractive for understanding these organizations.

How to Obtain Legitimacy:

There are two different means by which an organization may seek legitimacy. Symbolic management and substantive management are both used by organizations (Suchman 1995) and one could say that they are closely related to the type of approach to legitimacy used to understand organizational actions.

Symbolic Management:

Symbolic management is the management of appearances and meanings. It is a matter of portraying the firm's actions so that they fit with the accepted social values and expectations from the organization. The organization's actions can often be ambiguous in meaning and can often be given different interpretations. It is therefore in the best interest of the firm to defend its actions in a way that will be accepted by the audience. The organization may publicize socially accepted goals while in fact pursuing other goals that are not as acceptable (Oliver 1991). The organization may simply deny and conceal information that would have a negative impact on its legitimacy (Ashforth & Gibbs 1990). In fact, many other strategies could be used by the firm. Oliver (1991) puts forward a list of possible strategic responses to institutional processes.

Table 1:

Strategic Responses to Institutional Processes		
Strategies	Tactics	Examples
Acquiesce	Habit	Following invisible, taken-for-granted norms
	Imitate	Mimicking rules and accepting norms
	Comply	Obeying rules and accepting norms
Compromise	Balance	Balancing the expectations of multiple constituents
	Pacify	Placating and accommodating institutional elements
	Bargain	Negotiating with institutional stakeholders
Avoid	Conceal	Disguising nonconformity
	Buffer	Loosening institutional attachments
	Escape	Changing goals, activities, or domains
Defy	Dismiss	Ignoring explicit norms and values
	Challenge	Contesting rules and requirements
	Attack	Assaulting the sources of institutional pressures
Manipulate	Co-opt	Importing influential constituents
	Influence	Shaping values and criteria
	Control	Dominating institutional constituents and processes

(Oliver 1991)

Substantive Management:

Substantive management is based on the real change of structure and practices in order to align them with the accepted line of conduct. One way of doing this is for the firm to meet the performance expectations set by the different stakeholders around them. As mentioned when describing pragmatic legitimacy, the audience will exchange support to the organization for expected performance in return. Isomorphism is another strategy that an organization may pursue. By imitating the actions of accepted firms, an organization may protect itself from being illegitimate. This strategy might be important if the firm's actions are not easy to evaluate and explain (Ashforth & Gibbs 1990).

The importance of Legitimacy:

Now that the different aspects of legitimacy have been explained, it is important to understand why legitimacy is important at all. There are a number of reasons why stakeholders and board of directors' members want to obtain legitimacy. Concepts such as the audience-candidate interface put forward by Zuckerman (1999) are a good example of such reasons.

According to Zuckerman, the audience-candidate interface is developed in two stages. In the first step, the firm must conform to certain characteristics in order to be accepted and to be evaluated by the audience. Otherwise, it may be quite difficult for the audience to compare one firm to another. This requirement creates an effect of isomorphism among the firms, which is necessary in order to comply with the socially accepted norms of an industry or group. However, during the second step, all the firms that have been accepted as legitimate, and thus are being evaluated by the audience, are trying to differentiate themselves from the others in order to stand out of the group and get the attention of the audience. "Gaining the favor of an audience requires conformity with the audience's minimal criteria for what offers should look like and differentiation from all other legitimate offers." (Zuckerman 1999 pg 1402.) It is proposed that one of the minimal criteria used by the audience may be the presence of a professional manager as CEO of the organization.

Legitimacy is necessary for the organization (Scott 2001; Suchman 1995). The organization's activities are first defined and categorized in a specific industry (Porac & Thomas 1990; Spender 1989). For firms that are publicly traded, or are about to become publicly traded equities, this segregation process occurs because buy-side analysts are assigned to particular sectors. Failing to establish the activities of the organization within one of these sectors may create confusion and increase uncertainty, and hence the stock might not be followed as much by analysts who would have a difficult time comparing the results of the "illegitimate" corporation with the results of other corporations, making the valuation process more complex. In order to get the attention of market analysts, the firm has to conform to some characteristics of one particular industry. With these characteristics, the firm is deemed legitimate and is able to get the attention of the audience as described by the candidate-audience interface theory (Zuckerman 1999). It is important for firms to get this attention because less coverage from market analysts has a negative effect on initial firm valuation and stock price, which can be called an illegitimacy cost (Zuckerman 1999).

In the case of a firm whose identity fails to enter in the norm, actively promoting the firm to analysts will be an essential process to make sure that the market interprets the organization's actions favorably (Zuckerman 1999). By manipulating the interpretation of the firm's actions, the organization may increase legitimacy by giving them a rational meaning. Taking this perspective on stock price valuation may be contrary to some finance theories, one of them being the efficiency theory, which implies that "all available information" is taken into account in the stock price (Bodie et al. 2000).

On the other hand, managing legitimacy may have a pervasive effect. Some scholars believe that protesting their legitimacy too much might be perceived as even more suspicious. Ashforth and Gibbs (1990) mentioned: "Since protests of competence are more likely when actual competence is problematic or unknown, individuals tend to discount such protests" (p. 186). The probability that the protestors have personal interests is high, and thus the validity of their claims suffers from this lack of credibility (Ashforth & Gibbs 1990). The perceived lack of credibility of promoters of legitimacy for their firms needs to be taken into consideration in order to avoid the pervasive effect of manipulating the interpretation of the firm's action.

Because of these risks, IPO firms may find it more attractive to use a substantive management strategy instead of a symbolic one in order to increase legitimacy. This is based on the idea that many IPO firms will take active steps, such as changes in the top management, toward conformity.

Legitimacy in the IPO Process:

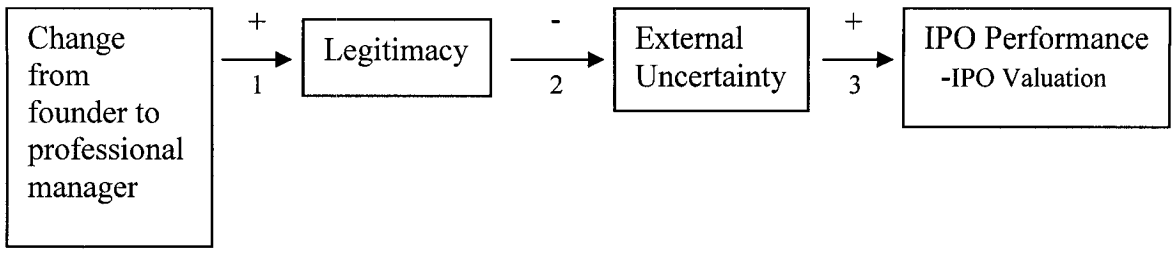
As previously mentioned, board members and other stakeholders seek indicators of legitimacy as a way to reduce the high uncertainty that the IPO process generates. IPO firms do not have a significant influence in their environments. Perhaps for this reason, IPO firms use a substantive method to obtaining legitimacy, which allows managing the perceptions of stakeholders using direct actions such as removing the founder-CEO and replacing him with a professional manager. This change, which appears to be appropriate

in the IPO setting, indicates the use of an institutional approach to legitimacy by the IPO firms. Moreover, since no empirical evidence shows the value of the founder departure in the IPO process, it can be argued that members of the board, who decide of this change, seek primarily a better IPO performance rather than a better firm performance, which suggests the use of cognitive legitimacy. It is cognitive because it relies on improving the IPO performance by influencing investors' perceptions as opposed to the actual performance of the firm. Finally, it is possible to argue that this is a form of cognitive legitimacy that falls into the taken-for-granted category in which the reasons for a change in top management are not questioned, but simply accepted by the constituents. In summary, replacing the founder by a professional manager at the CEO position of the IPO firm would positively influence the legitimacy of the IPO firm, which would therefore reduce the uncertainty of the issue (Oliver 1991).

Legitimacy and Valuation of the IPO:

As much as an increase in legitimacy is essential to reduce the uncertainty of an IPO, and thus to reduce the underpricing level, it also influences other forms of IPO performance. This applies to the valuation of the IPO or, in other words, the capacity of firms to gather resources at the time of their Initial Public Offering. Non-compliance with institutional norms could indeed have repercussions on the amount that investors would be willing to invest in a firm. Since I argue that having a professional manager is a marker for the legitimacy of an IPO firm, the valuation of professionally managed firms should increase *(see Model 3).*

Model 3:



Hypothesis 2a:

A change from a founder to a professional managed IPO firm will increase the valuation of the issue.

I argue that, as explained in the underpricing section, if the founder leaves the CEO position but stays within the organization as a member of the top management team or the board of directors, then the legitimacy of the firm should increase. This added legitimacy is explained by maintaining the knowledge, vision and network provided by the founder without worrying about his inexperience as a CEO of a public firm. Two additional hypotheses can therefore be stated.

Hypothesis 2b:

Compared to the average valuation of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to higher levels of valuation.

Hypothesis 2c:

Compared to the average valuation of IPO firms, having the founder remain only as a member of the board of directors will lead to a higher IPO valuation.

Succession and Future Performance Relationship

Many years have passed since the attention of academics was first directed onto founders and their succession. Many important articles related to this issue date back to the sixties; however, for a long time there was no clear understanding of the effects of founder succession and they were seen as unpredictable (McGivern 1978). Still, academics do not seem to have reached an agreement as to whether founder succession improves firm performance, deteriorates firm performance or has an impact at all on firm performance. In this context, it is not surprising that Smith et al. (1984) mention that further research would be useful. Pfeffer and Davis-Blake (1986) also mention that further investigation should pay attention to the conditions surrounding the succession of the founder, which will be done here by looking specifically at firms going through the initial public offering process.

The literature has also been concerned with all major organizational changes and their impact on firm mortality. A considerable amount of research focuses on changes that often occur after a new CEO is appointed but once again no specific and clear relationship has received broad empirical support (Barnett & Carroll 1995).

Positive Impact of Succession:

Different arguments are put forward to promote the value of founder succession. For example, Guest (1962) found, in a case study, that succession reduces organizational conflict. Others such as Helmich (1974) show that succession increases organizational growth rate and find that this is especially true when an outsider is the successor. Pfeffer and Salancik (1978) put forward a different theory stating that executive succession is an important process by which the organization gets information from its environment. They found that succession has a positive impact on the coordination of organizational activities, and thus enables better performance. A number of researchers have examined various arguments for CEO succession. For example, it appears to be taken for granted that founders should manage their firms only up to a certain age or size. One of the ideas found in the literature is that founders are generally not capable of or have difficulties adapting to the new challenges they face as their firms grow larger (Rubenson & Gupta 1992; Daily & Dalton 1992; Flamholtz 1990). Moreover, as a firm grows, managers may need to make tough decisions and the lack of objectivity and over-optimistic outlook of its founder, due to his high level of attachment to his firm, might constitute another obstacle for effective management (Ritter & Welch 2002; Daily & Dalton 1992; Flamholtz 1990).

Negative Impact of Succession:

Many academics do not share these opinions and argue that founder succession has a negative impact on firm performance, especially shortly after the transition has occurred. Gouldner (1954) showed that firm performance decreased after such a transition. His observations included, for example, increased bureaucracy and tension between employees. He qualified the situation immediately following a change in top management as a temporary crisis created by the new reforms put in place. This type of crisis, and the instability inside the firm that comes with it, is significantly increased when the successor is an outsider (Friedman & Saul 1991; Carlson 1961). Grusky (1963, 1964) also shows a lower level of performance following the transition. He believes that succession has a tendency to promote instability, and that this disruptive effect causes deterioration in performance. These arguments are confirmed in a more recent article by Fizel and D'Itri (1997). Barnett and Carroll (1995) took a closer look at different fundamental structural changes and their effects on firm survival. Their study concludes that the second most disruptive structural change was a change in authority structure. They also mentioned that such a change was costly and increased significantly the risk of death of a firm.

Succession is likely to change the top management team's leadership style, which will be felt by everyone in the firm as it is transmitted from top to bottom in the organization (Likerts 1967). It is found in the literature that the reaction to a change in leadership style is often negative and that group cohesiveness suffers as a result (Koch 1978). It is important to mention that group cohesiveness directly influences employee satisfaction

(Koch 1978), and therefore may have a major impact on the firm's operations. Moreover, an abrupt shift in leadership style, especially one that changes from a supportive to a more goal-oriented style, will be responsible for a reduction in goal acceptance and in the satisfaction level of lower level employees (Gouldner 1954). As a result, the departure of the organization's leader may significantly increase the resistance to change that occurs throughout the IPO process, may deteriorate the working atmosphere of the firm, and may decrease employee commitment (Koch 1978). However, this reaction can, to a certain extent, be prevented when employees have the opportunity to get involved in the new goal setting process (Koch 1978).

The founder often has more influence on the firm than other CEOs. This is because of the strong bonds developed while the firm was growing between the founder and important stakeholders of the firm. The founder is also more likely than other CEOs to have the structural blueprint of the firm in his head, which may be lost with his departure (Carroll 1984). A change in blueprint or fundamental model of the organization has significant consequences in terms of employee turnover and firm performance. The increase in turnover is particularly more pronounced among senior employees who have a significant impact on the firm's operations (Baron Hannan & Burton 2001). Friedman and Saul (1991) found very interesting results that further support the reasons behind the negative effect on firm performance in the event of founder succession prior to the IPO. First, they found that the turnover rate among senior executives is more pronounced when an outsider is the CEO's successor. Furthermore, they found that a high turnover rate after the arrival of a new CEO was correlated with the level of disruption, and that these

disruptions were increased for younger firms, which is typically the case of IPO firms (Martens 2002). Finally, when unplanned succession is initiated by the board of directors, as it is usually the case when the founder is replaced by a professional manager, the disruptive effect is greater (Friedman & Saul 1991).

Inexistent Impact of Succession:

The third perspective that can be found in the literature is that succession has no impact at all on firm performance. Gamson and Scotch (1964), in their study of baseball teams, found that many factors influencing performance were not controlled by the coach, and thus succession in this case has no effect on future performance. On the other hand, instead of arguing that there is no effect on future performance, others argue that there are in fact two distinct effects that cancel each other out. According to this view, there would be a positive effect from the removal of a bad manager and a negative effect from the change itself and the situation of crisis that follows (Smith et al. 1984; Grusky 1963). These two effects would result in unchanged performance.

Considerations to keep in mind:

It is important to keep in mind that the relationship between the top management team and the performance of the organization is not a simple one, and that a number of considerations need to be taken into account in measuring the effect of founder succession on performance. Founder succession is the first critical transition period of an entrepreneurial firm (Lippitt & Schmidt 1967), which makes its timing in relation to the organizational life cycle very important. Other important considerations include the organizational context at the moment of the succession event, as well as the past performance of successors (Pfeffer & Davis-Blake 1986; Carroll 1984).

Context of past research:

Empirical research on succession has usually been based on sports teams, such as basketball or baseball teams, and the succession of their coaches (Allen, Parian & Lotz 1979; Eitzen &Yetman 1972; Grusky 1963 & 1964). The reasons are simple: performance is easy to measure (win and loss record), and the coach has direct control over the principal actors of the performance (the players). It is, however, not so obvious that the findings in this type of setting can be transposed into other environments such as entrepreneurial firms. Unlike the business environment, sport is a very static environment. The game can only be played in one way, and strategies, although present, are limited by the rules of the game. Business environment is more complex and offers much more possibilities to innovate or change the way things are done within the

organization. As mentioned before, it is important to keep in mind the context and the organizational life cycle, two elements that are nonexistent in sport. The fact that only few empirical studies have been made in the business environment to test the relationship between founder succession and performance of the organization makes it essential that research tries to replicate the previous studies based on firms in a competitive environment.

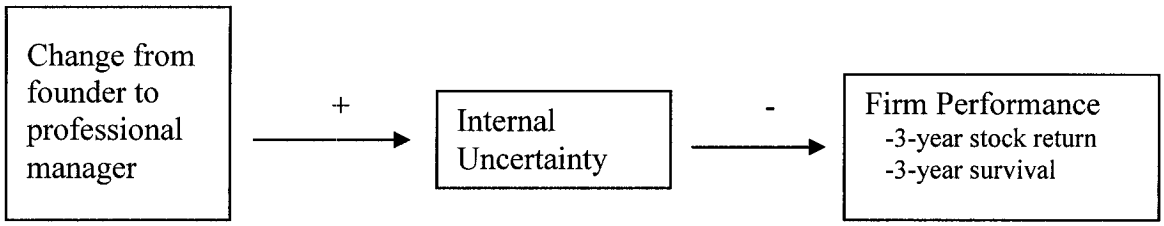
Context of proposed research:

Along with founder succession, the Initial Public Offering is one of the first very critical processes by which the firm is transformed (Martens 2004). The IPO process is an institutionalized process and new important stakeholders appear in the organizational environment. These new stakeholders, such as investment banks and venture capitalists, might obtain large power depending on different factors such as the percentage of the firm that is being sold on the market and the size of the stake venture capitalists have in the firm. It is found that these stakeholders often put pressure on the founder to leave his function as CEO, in order to replace him by a professional manager. As mentioned before, Tashakori (1980) shows that venture capitalists themselves would agree that they put pressure on founders to leave their CEO position and that they have no empirical reasons to do so. The fact that this type of succession occurs is very particular and its effects have not been studied. It is important to understand that the IPO in itself is a kind of corporate restructuring (Martens 2004) and therefore it is the interaction between the IPO and founder succession that makes it an interesting context to study.

The timing of such a succession is of interest because the IPO is a crucial point in a firm's life cycle (Nelson 2003). The scrutiny of the new stakeholders, investors or regulators, puts pressure for changes on management style. Quarterly results become much more important as they have a direct influence on stock price and longer-term performance may become somewhat less important because of the new shorter-term focus. Daily procedures are also likely to change because of the regulations that public firms must follow. It is also likely that new personnel will join the organization, such as chartered accountants or new middle managers brought in by the new stakeholders because they believe more experience is needed. These organizational changes that are likely to occur in the context of the IPO may cause much confusion and uncertainty to existing employees of the firm.

The change from a founder-managed to a professionally managed firm prior to the initial public offering will only increase the normal consequences of organizational change and this is why it is believed that founder succession at the time of the IPO will have a negative impact on firm performance. The temporary crisis created by the succession (Fizel & D'Itri 1997; Koch 1978; Grusky 1963,1964; Gouldner 1954), the unplanned arrival of an outsider in a young firm (Friedman & Saul 1991) and consequently, the diminished employees' moral and the overall disruptive effect of these changes are likely to decrease firm performance in the years following the IPO (see Model 4).

Model 4:



Hypothesis 3a:

> *Replacing the founder-CEO with professional manager-CEO prior to the IPO will lead to lower levels of firm performance in the three-year period following the Initial Public Offering.*

In the event the founder stays within the firm in another role than the one of CEO, it is believed that the state of crisis (Fizel & D'Itri 1997) described earlier may be diminished. The change in the founder's role should allow for a smoother transition by preserving the organizational blueprints (Carroll 1984) that are crucial to the organizational structure and its employees. A smoother transition should have a direct effect on firm performance, and therefore two other hypotheses can be stated to complement Hypothesis 3a.

Hypothesis 3b:

> *Compared to the average performance of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.*

Hypothesis 3c:

Compared to the average performance of IPO firms, having the founder remain only as a member of the board of directors at the time of the IPO will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.

Succession and Firm Survival:

It is expected that the firm's survival rate will be similar to its 3-year stock performance. For the exact same reasons, the survival rate should be affected by the internal uncertainty created by the founder's departure at the time of the Initial Public Offering. Once again, the state of crisis described earlier creates many disturbances in the firm's operation which could decrease its survival chances. On the other hand, I argue that if the founder stays within the firm in a different position, the changes will take place in a smoother way, and thus the firm's survival rate should be increased. Three additional hypotheses can thus be stated to test the 3-year survival of IPO firms.

Hypothesis 4a:

Replacing the founder-CEO with professional manager-CEO prior to the IPO will lower levels of firm survival rate in the three-year period following the Initial Public Offering.

Hypothesis 4b:

Compared to the average firm survival rate of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to a higher firm survival rate in the three-year period following the Initial Public Offering.

Hypothesis 4c:

Compared to the average firm survival rate of IPO firms, having the founder remain only as a member of the board of directors at the time of the IPO will lead to a higher firm survival rate in the three-year period following the Initial Public Offering.

IPO Performance and Firm Future Performance

Model 1, put forth at the beginning of this research, emphasizes two different effects of founder departure at the time of an IPO, first on the IPO performance and second on the firm's long-term performance. Moreover, the perception of investors, and therefore the performance of the IPO in terms of both the valuation and the underpricing of the issue must be related to the future performance of the firm. This is because investors regard the IPO as an investment opportunity characterized by a particular return in the future. Firms that gather less money from their IPO are likely to face a higher rate of death than firms that are capable of gathering more money from their IPO (Ritter 1991). This link is further reinforced by the simple fact that the higher the valuation of the IPO, the more money is gathered and the stronger the firm is in facing the liability of newness (Stinchcombe 1965). In particular, more money means a longer period of time during which the firm can survive strictly on its own resources. Many IPO firms in the sample collected were not profitable at the time of their IPO, and thus the resources gathered from the IPO could help them improve their profitability and thus survive longer. However, it is important to mention that controlling for the size of the firms is essential in order to sustain this argument.

Hypothesis 5a:

IPO firms with higher valuations, controlling for all other factors, will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.

Hypothesis 5b:

IPO firms with higher valuations, controlling for all other factors, will lead to higher levels of firm survival in the three-year period following the Initial Public Offering.

The underpricing level of the IPO should also be related to the future performance of the firm. I contend that investors perceive the founder CEO as less capable of competent management once their firm becomes public. This lack of legitimacy, as explained before, should lead to a higher level of underpricing for founder-led IPOs (Certo et al. 2001). Assuming that investors are right in their perception of the founders' inadequacy, then the performance of professional-managed firms should be better than that of founder-led firms. The higher underpricing for founder-led firms should therefore be a counterbalance for the lower return that investors will receive on their investment. It is therefore believed that the difference in underpricing between founder and professional-led IPOs should be related to the difference in future performance of the IPOs managed by their founder or by a professional manager.

Hypothesis 6a:

IPO firms with higher underpricing, controlling for all other factors, will lead to lower levels of firm performance in the three-year period following the Initial Public Offering.

Hypothesis 6b:

IPO firms with higher underpricing, controlling for all other factors, will lead to lower levels of firm survival in the three-year period following the Initial Public Offering.

Table 2: Hypotheses Summary

	Underpricing	Valuation	3-year stock return	3-year survival
Founder CEO	**Hypothesis 1a:** A change in the CEO from a founder to a professional manager prior to the IPO will lead to lower levels of underpricing.	**Hypothesis 2a:** A change from a founder to a professional managed IPO firm will increase the valuation of the issue.	**Hypothesis 3a:** Replacing the founder-CEO with professional manager-CEO prior to the IPO will lead to lower levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 4a:** Replacing the founder-CEO with professional manager-CEO prior to the IPO will lower levels of firm survival rate in the three-year period following the Initial Public Offering.
Founder on Top Management Team	**Hypothesis 1b:** Compared to the average underpricing level of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to lower levels of underpricing.	**Hypothesis 2b:** Compared to the average valuation of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to higher levels of valuation.	**Hypothesis 3b:** Compared to the average performance of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 4b:** Compared to the average firm survival rate of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to a higher firm survival rate in the three-year period following the Initial Public Offering.
Founder on the Board of Directors	**Hypothesis 1c:** Compared to the average underpricing level of IPO firms, having the founder remain only as a member of the board of directors will lead to lower levels of underpricing.	**Hypothesis 2c:** Compared to the average valuation of IPO firms, having the founder remain only as a member of the board of directors will lead to a higher IPO valuation.	**Hypothesis 3c:** Compared to the average performance of IPO firms, having the founder remain only as a member of the board of directors at the time of the IPO will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 4c:** Compared to the average firm survival rate of IPO firms, having the founder remain only as a member of the board of directors at the time of the IPO will lead to a higher firm survival rate in the three-year period following the Initial Public Offering.

Table 3: Hypotheses Summary

	3-year stock return	3-year survival
IPO Valuation	**Hypothesis 5a:** IPO firms with higher valuations, controlling for all other factors, will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 5b:** IPO firms with higher valuations, controlling for all other factors, will lead to higher levels of firm survival in the three-year period following the Initial Public Offering.
IPO Underpricing	**Hypothesis 6a**: IPO firms with higher underpricing, controlling for all other factors, will lead to lower levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 6b:** IPO firms with higher underpricing, controlling for all other factors, will lead to lower levels of firm survival in the three-year period following the Initial Public Offering.

Methodology

Data:

The dataset is composed of 439 firms that issued their Initial Public Offerings between 1996 and 2000 on the U.S. stock exchanges. This period was chosen because of the large number of IPOs issued, which makes it an interesting period to explore. Indeed, in this "hot" IPO period, around 2,000 firms made their Initial Public Offerings (Ritter & Welch 2002). Moreover, from 1996 onward, the Securities Exchange Commission's website gives access to all the prospectuses of the companies going public. Among all the firms that prepared an S-1 filing in this period, I excluded all financial institutions, the spin-offs and those that withdrew their offerings before completion. The remaining IPOs were separated following the industry classification of Breeden et al. (1989). The service industry was chosen because it contained the largest number of IPOs during the chosen period of time (439). All the firms included in this sample are from the SIC 2-digit classification 73 (Business Services) and 75% of them are from 737x (Computer Software). With the exception of the stock price performance data, all the variables included in this research were retrieved from the prospectuses that are publicly available on the Securities Exchange Commission's website. Finally, stock price performance data were collected from the CRSP database.

Measures:

Dependent Variables:

Three main dependent variables will be examined in this study. The first one is the amount of capital raised by the Offering (# of shares * offering price). This amount, the valuation of the issue, represents the ability of the issuing firm to raise capital from external and primarily institutional investors. Since the variable was highly skewed to the left, it was required to use the natural log of the valuation. The second important dependent variable is the level of underpricing of the IPO {(first day closing price – offering price) / offering price}. This level, as argued before, is an indication of the ex ante uncertainty of the issue (Clarkson & Merkley 1994). Underpricing is also used as a measure of legitimacy (Zuckerman 1999; Pollock & Rindova 2003). As underpricing may be negative, a z-score had to be created and its natural log was taken to resolve the skewness of the data. Finally, the third dependent variable tested is the long-term performance of the IPO firm. In order to have a better view of the firm's performance, the 3-year stock return (closing price first day – 3-year closing price/closing price first day) and the 3-year survival of the firms (0/1 dichotomous variable) were used. A firm did not survive if its stock no longer exists after 3 years of public operation. In order to account for the firm that were acquired, which does not constitute a failure of the firm, all firms that were traded above $2 after two years of public operation were examined to verify the reason for the removal of the stock from the market. If it was acquired the firm was classified as "1" which mean that the firm survived. The choice of the 3-year period to measure stock return and survival was affected by the fact that it was the longest

available stock performance for the firms in the sample that issued their stock in 2000. In terms of survival, the 3-year period was chosen because it was found that a significant number of IPO firms survive for the first 2 years of public operation but fail in the third year (MacCrimmon & Martens 2001). For the same reasons as for the underpricing, 3-year stock returns needed adjustment using a z-score and the natural log to normalize the variable. In order to analyse the IPO valuation, underpricing and 3-year stock return, OLS regression analysis was used. Logit regression analysis was used for the 3-year survival.

Independent Variables:

The primary independent variable of this research is the presence or absence of the founder as CEO of IPO firms. The founder CEO variable is dichotomous (1/0), where "1" indicates the presence of the founder as CEO. In the total sample of 439 firms, 245 firms were still managed by their founders at the time of the IPO. This condition clearly compares the founder-led versus the professional-led IPOs. It is also important to mention that the influence of founders also extends to their presence on either the top management team or the board of directors. The influence of the founder when holding these positions are examined in comparison of the entire set of IPO firm. This analysis comes as a complement to the main conditions (founder CEO) and intends to show the possible impact of founders on IPO firms outside from their influence as the firm leader. The analysis will therefore be focused on three different conditions. The main condition compares firms led by the founder as CEO to firms led by a professional manager. The last two conditions are composed of firms in which the founder is a non-CEO member of the top management team compared to the average IPO firms, and firms in which the

founder is a member of the board of directors compared to the average IPO firms. These distinctions between the different positions founders may hold will allow testing thoroughly the extent of their influence on an entrepreneurial firm.

Market-Level Control Variables:

It is necessary in this analysis to account for the market as it may have a significant influence on the dependant variables. Three market controls were therefore added to the regression models. Variables such as underpricing are often said to have a momentum effect and be subject to non-rational enthusiasm over the possible future return of IPOs (Ljungqvist & Jenkinson 2001). The *Hot IPO Period*, calculated as the number of IPO in the month in which an IPO was issued, is used as a variable to control for this factor. The *NASDAQ prior 30 days return* is to control for the overall market performance that could influence the IPO performance and especially underpricing. The NASDAQ is chosen for this control because the large majority of the issues were made on this exchange. *IPO Fraud* is the last market control, used to take into account a particular irregularity in the IPO process. There was a class action lawsuit in 2003 against 309 IPO firms that issued their stock between 1990 and 2000 (Milberg, Weiss, Bershad, Hynes & Lerach 2003). Out of these firm 309 firms, 129 firms were included in my sample. A dichotomous variable (1/0) was therefore added to control for those firms, "1" representing the firms named in the lawsuit.

Firm-Level Control Variables:

There are several firm-level controls to take into consideration as they may influence IPO and firm performance. *Firm age* at the time of the IPO is controlled for since, as younger firms are more fragile, older firms tend to perform better both before and after the IPO (Ritter 1998). *Firm size* is also taken into account as it may influence variables such as valuation. It is measured as the natural log of the number of employees at the time of the IPO because of the skewness of the data. *Auditor reputation* is measured as a dichotomous variable (1/0) differentiating the auditing firms in terms of size (Big 6 vs. non-big 6). Ritter and Loughran's (2004) calculation of underwriter prestige is used for the *underwriter reputation* variable. Both auditor and underwriter reputations tend to influence the valuation and underpricing of IPOs (Carter & Manaster 1990; Carter, Dark, Singh, 1998; Ritter & Loughran 2004).

Founder-CEO Level Control Variables:

There are a number of important variables to take into account as they can be predictors of founder departure. During the IPO period, an important confrontation of power occurs between the underwriter, the venture capitalists and the original shareholders. Ownership is the source of this confrontation and is an important determinant of power. Ownership is also an important predictor of founder departure (Fredrickson, Hambrick & Baumrin 1998; Certo et al. 2001). *Retained Equity* is available in prospectuses of IPO firms and represents the percentage of ownership of the CEO after the IPO. Moreover, it is important to create different controls for the models which target the founder as member of the top management team or as member of the board of directors. In these models, the

CEO's retained equity is not appropriate, and therefore *Retained Equity of Founders on T.M.T.* and *Retained Equity of Founders on B.o.D.* are calculated. The amount of time the CEO had been with the firm may also have significant implications on departure. A CEO who has been with the firm for a long period may have more allegiance from the board members and may have more control over certain resources important to the firm, which may decrease the likelihood of departure (Frederickson, Hambrick & Baumrin 1988). Finally *CEO age,* calculated as the age at the time of the IPO, and *Prior Industry Experience,* a dichotomous variable, are taken into account in this research. These two variables can be seen as an indication of IPO quality (Certo et al. 2001).

Method of Analysis:

The first analysis is a simple One-Way ANOVA. This method allows an examination of the differences in mean value of the variables between founder and professional-led IPOs. An OLS regression analysis is also used. In order to verify the influence of each control variable, the difference in R square is compared between different models. In total, 38 different models are used to fully understand the effect of each type of control variables and of the primary independent variable, which is the presence or absence of the founder as CEO of the firm. Logistic regressions are also used in order to analyze the 3-year survival of the firm as it is a binary variable. Finally, correlation, collinearity and the distribution of the residuals are examined to avoid possible statistical problems.

Table 4: Descriptive Statistics

		Mean	Std. Deviation	Std. Error
CEO Age*	Professional CEO	**45.29**	6.91	0.50
	Founder CEO	**41.86**	8.24	0.53
	Total	**43.38**	7.86	0.38
Retained Equity*	Professional CEO	**6.52**	9.59	0.69
	Founder CEO	**20.43**	17.22	1.10
	Total	**14.25**	15.91	0.76
Firm Age*	Professional CEO	**7.84**	6.67	0.48
	Founder CEO	**6.62**	5.08	0.33
	Total	**7.16**	5.86	0.28
Employees	Professional CEO	**345.55**	567.59	40.65
	Founder CEO	**348.09**	579.12	37.07
	Total	**346.96**	573.37	27.37
Valuation*	Professional CEO	**75.77**	76.36	5.48
	Founder CEO	**63.26**	76.49	4.90
	Total	**68.80**	76.60	3.66
Underpricing	Professional CEO	**71%**	0.92	0.07
	Founder CEO	**62%**	0.88	0.06
	Total	**66%**	0.90	0.04
3 Year Return (%)*	Professional CEO	**-60.36**	127.61	9.14
	Founder CEO	**-15.96**	286.40	18.34
	Total	**-35.68**	230.67	11.01
3 Year Survival*	Professional CEO	**66%**	0.47	0.03
	Founder CEO	**76%**	0.43	0.03
	Total	**72%**	0.45	0.02

	N:
Professional CEO	195
Founder	244
Total	439

* Mean difference is significant

Table 5: Correlations

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
1	Firm Age	1.00																								
2	Employees	0.33	1.00																							
3	Log_Employees	0.34	0.78	1.00																						
4	Auditor Reputation	-0.09	0.00	0.12	1.00																					
5	Underwriter Reputation	-0.12	0.11	0.30	0.43	1.00																				
6	AMEX	0.02	-0.12	-0.12	-0.38	-0.15	1.00																			
7	NASQ	-0.15	-0.22	-0.22	0.11	-0.10	-0.36	1.00																		
8	Valuation	0.04	0.27	0.29	0.07	0.23	-0.14	-0.17	1.00																	
9	Log_Valuation	-0.10	0.27	0.34	0.17	0.48	-0.14	-0.17	0.76	1.00																
10	Underpricing	-0.21	-0.08	-0.06	0.05	0.24	-0.04	0.15	0.13	0.30	1.00															
11	Log_Underpricing	-0.18	-0.06	-0.06	0.03	0.25	-0.04	0.15	0.11	0.27	0.82	1.00														
12	3 Years Return (%)	0.03	0.04	0.00	-0.03	-0.02	-0.01	-0.13	-0.06	-0.09	-0.08	-0.11	1.00													
13	Log_3 Years Return	0.17	0.13	0.10	0.08	0.08	-0.01	-0.13	-0.02	-0.08	-0.06	-0.06	0.49	1.00												
14	3 Years Survival	0.10	0.11	0.11	0.12	0.06	-0.01	-0.03	-0.03	-0.03	0.12	0.12	0.71	0.71	1.00											
15	CEO Age	0.27	0.20	0.11	-0.13	-0.07	0.03	-0.10	0.07	-0.02	-0.11	-0.09	-0.06	0.07	-0.01	1.00										
16	Founder CEO	-0.08	0.04	0.04	-0.03	0.01	-0.09	0.05	-0.15	-0.15	-0.05	-0.05	0.11	0.11	0.11	-0.24	1.00									
17	Founder on TMT	-0.07	-0.15	-0.15	0.01	0.06	-0.03	0.09	0.15	0.15	0.14	0.14	-0.09	-0.09	-0.11	0.08	-0.45	1.00								
18	Founder on BoD	-0.01	0.00	0.00	0.06	0.06	-0.03	0.03	0.01	0.01	0.04	0.04	-0.03	-0.03	-0.04	0.13	-0.44	-0.14	1.00							
19	CEO prior Industry Experience	-0.20	-0.12	-0.09	0.08	0.18	-0.03	0.09	0.04	0.09	0.10	0.10	-0.15	-0.13	-0.09	0.05	-0.21	0.15	0.05	1.00						
20	Retained Equity	0.16	0.13	0.08	-0.11	-0.15	-0.02	0.07	-0.13	-0.20	-0.12	-0.09	0.13	0.19	0.14	-0.05	0.58	-0.27	-0.27	-0.20	1.00					
21	Retained Equity of Founder on TMT	-0.03	-0.08	-0.08	-0.01	0.01	-0.03	0.08	-0.01	0.05	0.05	0.08	-0.05	0.00	-0.07	0.12	-0.40	0.88	-0.12	0.09	-0.12	1.00				
22	Retained Equity of Founder on BoD	0.07	-0.02	0.05	0.04	0.01	-0.03	0.04	-0.02	-0.01	0.00	0.02	0.03	0.04	-0.03	0.06	-0.39	-0.14	0.89	-0.04	-0.08	-0.07	1.00			
23	IPO Fraud	-0.21	-0.02	-0.02	0.09	0.26	-0.05	0.13	0.34	0.34	0.59	0.59	-0.06	-0.06	0.16	-0.12	-0.05	0.17	0.00	0.16	-0.06	0.15	-0.02	1.00		
24	Hot IPO Period	-0.09	-0.11	-0.06	0.08	0.03	-0.05	0.09	0.06	0.14	0.00	-0.01	-0.28	-0.21	-0.16	0.04	-0.12	0.10	-0.03	0.14	-0.08	-0.03	-0.08	0.13	1.00	
25	NASD Prior 30 Days Return	-0.07	-0.07	-0.06	-0.02	0.01	0.00	0.02	0.19	0.18	0.23	0.17	0.02	-0.09	-0.06	-0.10	0.01	0.06	-0.01	0.02	-0.08	0.01	0.05	0.15	0.12	1.00

Note: correlations above |.11| are significant at p<.01; above |.10| are significant at p<.05

Table 6: ANOVA

	Mean		Sum of Squares	df	Mean Square	F	Sig.
CEO Age	43.38	Between Groups	1279.39	1.00	1279.39	21.70	P<.01
		Within Groups	25770.32	437.00	58.97		
		Total	27049.71	438.00			
Retained Equity	14.25	Between Groups	20953.33	1.00	20953.33	101.88	P<.01
		Within Groups	89873.58	437.00	205.66		
		Total	110826.91	438.00			
Firm Age	7.16	Between Groups	160.81	1.00	160.81	4.72	P<.05
		Within Groups	14895.38	437.00	34.09		
		Total	15056.19	438.00			
Employees	346.96	Between Groups	694.96	1.00	694.96	0.00	0.96
		Within Groups	143994445.38	437.00	329506.74		
		Total	143995140.34	438.00			
Valuation	68.80	Between Groups	16916.99	1.00	16916.99	2.90	P<.1
		Within Groups	2547050.73	437.00	5841.86		
		Total	2563967.72	438.00			
Underpricing	0.66	Between Groups	1.06	1.00	1.06	1.32	0.25
		Within Groups	353.21	437.00	0.81		
		Total	354.27	438.00			
3 Years Return (%)	-35.68	Between Groups	213654.24	1.00	213654.24	4.04	P<.05
		Within Groups	23091487.42	437.00	52840.93		
		Total	23305141.66	438.00			
3 Years Survival	0.72	Between Groups	1.01	1.00	1.01	5.01	P<.05
		Within Groups	88.40	437.00	0.20		
		Total	89.41	438.00			

Results

Table 4, 5 and 6 present descriptive statistics and correlations between variables. Out of the 439 IPO firms in the sample, the average firm age is 7 years, the average number of employees is 346, the average size of the IPO is $69 million and the average underpricing of the issues is 66%. The performance following the IPOs is shown by an average 3-year return of -36% and a 3-year survival rate of 72%. The CEOs of the firms were on average 43 years old and retained, on average, 14% of the equity of the firms after the issue. It is possible to see some significant differences between the means obtained for founder-managed firms and the means obtained for professionally managed firms. On average, founders seem to retain significantly more equity after the IPO (20.4%) than professional managers do (6.5%). There are also some significant differences in age (founders are younger). The firms managed by their founders seem to be slightly younger on average and their capacity at gathering money seems lower with an average valuation of $63 million for founder-led IPOs and of $76 million for professional-managed IPOs. Average post-IPO performance also reflects some noticeable differences between founder and professional-led firms. The average 3-year return is significantly better for founder-led IPOs (-16%) than for professional led IPOs (-60%). Moreover, the 3-year survival rate is better for founder-led firms at 76% compared to 66% for professionally managed firms.

Dependant Variables – IPO Underpricing:

The first analysis, for which OLS regression results are shown in Table 7, tests the influence of the founder as CEO on the underpricing of the IPO. We can see that the founder-CEO has no effect on the underpricing level of the issue. This result was unexpected as it is inconsistent with the general findings in the literature (Certo et al. 2001). This result does not support Hypothesis 1a, which stated that the founder-CEO would increase the underpricing level of the IPO.

Table 8 and Table 9 show similar results as Table 7. Both tables show that the presence of the founder on the top management team or on the board of directors has no influence on the level of underpricing of the initial public offering. Once again, this finding goes against hypotheses 1b and 1c which stated that the presence of the founder on either the top management team or the board of directors would decrease the level of underpricing of an issue.

Table 7: OLS Regression Results. Dependent Variable – IPO Underpricing

	Model 1 Market Controls			Model 2 Firm Controls			Model 3 CEO Controls			Model 4 Founder CEO		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	-0.153	0.074	0.040	-0.285	0.170	0.095	-0.276	0.194	0.156	-0.260	0.198	0.190
AMEX	0.045	0.175	0.796	0.174	0.193	0.370	0.171	0.195	0.381	0.164	0.196	0.402
NASD	0.086	0.067	0.197	0.085	0.071	0.232	0.087	0.072	0.225	0.087	0.072	0.229
IPO Fraud	0.371	0.030	0.000	0.335	0.031	0.000	0.335	0.032	0.000	0.334	0.032	0.000
Hot IPO Period	-0.003	0.001	0.014	-0.003	0.001	0.014	-0.003	0.001	0.016	-0.003	0.001	0.015
NASD Prior 30 Days Return	0.004	0.002	0.020	0.004	0.002	0.021	0.004	0.002	0.024	0.004	0.002	0.024
Firm Age				-0.002	0.003	0.347	-0.002	0.003	0.374	-0.003	0.003	0.340
Firm Size				-0.042	0.040	0.300	-0.041	0.041	0.313	-0.041	0.041	0.317
Auditor Reputation				-0.167	0.108	0.123	-0.169	0.109	0.121	-0.172	0.109	0.117
Underwriter Rank				0.051	0.013	0.000	0.051	0.013	0.000	0.051	0.013	0.000
CEO Age							0.000	0.002	0.999	0.000	0.002	0.944
CEO Prior Industry Experience							-0.006	0.035	0.857	-0.009	0.035	0.804
Retained Equity							0.000	0.001	0.737	0.000	0.001	0.908
Founder CEO										-0.014	0.031	**0.655**
R^2	0.287			0.316			0.316			0.316		
ΔR^2	0.287			0.029			0.000			0.000		
F	34.84			21.98			16.385			15.11		
Sig. F	P<0.01			P<0.01			P<0.01			P<0.01		

Table 8: OLS Regression Results. Dependent Variable – IPO Underpricing

	Model 1 Market Controls			Model 2 Firm Controls			Model 5 Founder Controls			Model 6 Founder on Top Management Team		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	-0.153	0.074	0.040	-0.285	0.170	0.095	-0.291	0.170	0.089	-0.291	0.171	0.089
AMEX	0.045	0.175	0.796	0.174	0.193	0.370	0.176	0.194	0.365	0.176	0.194	0.365
NASD	0.086	0.067	0.197	0.085	0.071	0.232	0.084	0.071	0.238	0.084	0.071	0.238
IPO Fraud	0.371	0.030	0.000	0.335	0.031	0.000	0.333	0.031	0.000	0.333	0.032	0.000
Hot IPO Period	-0.003	0.001	0.014	-0.003	0.001	0.014	-0.003	0.001	0.016	-0.003	0.001	0.017
NASD Prior 30 Days Return	0.004	0.002	0.020	0.004	0.002	0.021	0.004	0.002	0.022	0.004	0.002	0.022
Firm Age				-0.002	0.003	0.347	-0.002	0.003	0.340	-0.002	0.003	0.341
Firm Size				-0.042	0.040	0.300	-0.040	0.040	0.323	-0.040	0.041	0.324
Auditor Reputation				-0.167	0.108	0.123	-0.166	0.108	0.125	-0.166	0.108	0.126
Underwriter Rank				0.051	0.013	0.000	0.051	0.013	0.000	0.051	0.013	0.000
Retained Equity of Founder on T.M.T.							0.002	0.003	0.520	0.002	0.004	0.614
Founder On T.M.T.										-0.001	0.051	**0.986**
R^2	0.287			0.316			0.316			0.316		
ΔR^2	0.287			0.029			0.001			0.000		
F	34.840			21.978			19.795			17.954		
Sig. F	p<0.01			p<0.01			p<0.01			p<0.01		

Table 9: OLS Regression Results. Dependent Variable – IPO Underpricing

	Model 1 Market Controls			Model 2 Firm Controls			Model 7 Founder Controls			Model 8 Founder on Board of Directors		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	-0.153	0.074	0.040	-0.285	0.170	0.095	-0.283	0.170	0.097	-0.285	0.170	0.095
AMEX	0.045	0.175	0.796	0.174	0.193	0.370	0.173	0.193	0.371	0.173	0.194	0.371
NASD	0.086	0.067	0.197	0.085	0.071	0.232	0.084	0.071	0.240	0.084	0.071	0.237
IPO Fraud	0.371	0.030	0.000	0.335	0.031	0.000	0.335	0.031	0.000	0.335	0.031	0.000
Hot IPO Period	-0.003	0.001	0.014	-0.003	0.001	0.014	-0.003	0.001	0.017	-0.003	0.001	0.016
NASD Prior 30 Days Return	0.004	0.002	0.020	0.004	0.002	0.021	0.003	0.002	0.025	0.004	0.002	0.022
Firm Age				-0.002	0.003	0.347	-0.002	0.003	0.328	-0.002	0.003	0.351
Firm Size				-0.042	0.040	0.300	-0.042	0.040	0.293	-0.040	0.040	0.319
Auditor Reputation				-0.167	0.108	0.123	-0.170	0.108	0.116	-0.170	0.108	0.116
Underwriter Rank				0.051	0.013	0.000	0.051	0.013	0.000	0.050	0.013	0.000
Retained Equity of Founder on Board of Directors							0.001	0.002	0.509	0.000	0.002	0.956
Founder on Board of Directors										0.041	0.056	**0.464**
R^2	0.287			0.316			0.316			0.317		
ΔR^2	0.287			0.029			0.001			0.001		
F	34.840			21.978			19.798			18.028		
Sig. F	p<0.01			p<0.01			p<0.01			p<0.01		

Dependant Variables - IPO Valuation:

Table 10 shows the OLS regression results for the IPO valuation in relation to the founder- CEO variable. Hypothesis 2a, which argued that the presence of the founder as CEO in an IPO firm reduces the valuation of the issue is supported. Controlling for the market, the firm and the CEO's characteristics ($F=5.275$, $p<.05$), the results show that the founder-CEO has a negative impact on the ability of his firm to raise capital in the financial markets when compared with firms managed by a professional CEO. With a mean of $63.80 million for founder-led firms, versus $75.77 million for professional-led firms and, considering the significance of the founder-CEO variable ($p=0.022$) the data indicates that a penalty of, on average, almost $12 million exists when the founder holds the top seat of his organization at the time of the IPO. We can also see from Model 12 that a larger firm is able to attract more resources and that a bull market is favourable for IPOs to raise more capital.

Table 11 shows both Models 13 and 14, which analyzes the IPO valuation when the founder has left the CEO seat but is still within the company as a member of the top management team. The OLS regression results indicate that, as opposed to the founder-CEO variable, the founder on the top management team increases the amount the firm can raise with its IPO when compared to the average amount raised by IPO firms. This result supports Hypothesis 2b which stated that the presence of the founder as part of the top management team would be a positive sign for investors, and would thus increase the valuation of the issue. Model 14 also shows that retained equity of the founder is not a

significant variable, and therefore does not predict IPO valuation. Model 14 is significant and explains 41% of the IPO valuation fluctuations (R^2=0.403).

In the last OLS regression analysis with IPO valuation as the dependant variable (Table 12), it is found that the presence of the founder on the board of directors has no effect on the valuation of the IPO. The variable turns out to be insignificant, just like the retained equity of founders on the board of directors. This result does not support Hypothesis 2c which stated that the valuation of the IPO would be increased by the presence of the founder on the board of directors.

Table 10: OLS Regression Results. Dependent Variable – IPO Valuation

	Model 9 Market Controls			Model10 Firm Controls			Model 11 CEO Controls			Model 12 Founder CEO		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	2.025	0.062	0.000	1.129	0.130	0.000	1.187	0.147	0.000	1.250	0.148	0.000
AMEX	-1.068	0.147	0.000	-0.566	0.148	0.000	-0.596	0.147	0.000	-0.623	0.147	0.000
NASD	-0.449	0.056	0.000	-0.304	0.054	0.000	-0.291	0.054	0.000	-0.293	0.054	0.000
IPO Fraud	0.168	0.026	0.000	0.107	0.024	0.000	0.105	0.024	0.000	0.103	0.024	0.000
Hot IPO Period	0.002	0.001	0.023	0.002	0.001	0.007	0.002	0.001	0.009	0.002	0.001	0.016
NASD Prior 30 Days Return	0.004	0.001	0.001	0.005	0.001	0.000	0.004	0.001	0.000	0.004	0.001	0.000
Firm Age				-0.006	0.002	0.003	-0.005	0.002	0.009	-0.006	0.002	0.003
Firm Size				0.153	0.031	0.000	0.162	0.031	0.000	0.163	0.030	0.000
Auditor Reputation				-0.136	0.082	0.100	-0.157	0.082	0.058	-0.166	0.082	0.044
Underwriter Rank				0.071	0.010	0.000	0.068	0.010	0.000	0.069	0.010	0.000
CEO Age							0.000	0.001	0.999	0.000	0.001	0.720
CEO Prior Industry Experience							-0.012	0.026	0.638	-0.022	0.026	0.407
Retained Equity							-0.002	0.001	0.001	-0.002	0.001	0.033
Founder CEO										**-0.054**	0.024	**0.022**
R^2	0.257			0.410			0.425			0.433		
ΔR^2	0.257			0.152			0.016			0.007		
F	29.951			32.992			26.229			24.861		
Sig. F	p<0.01			p<0.01			p<0.01			p<0.01		

Table 11: OLS Regression Results. Dependent Variable – IPO Valuation

	Model 9 Market Controls			Model10 Firm Controls			Model 13 Founder Controls			Model 14 Founder on Top Management Team		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	2.025	0.062	0.000	1.129	0.130	0.000	1.118	0.130	0.000	1.117	0.130	0.000
AMEX	-1.068	0.147	0.000	-0.566	0.148	0.000	-0.562	0.148	0.000	-0.561	0.147	0.000
NASD	-0.449	0.056	0.000	-0.304	0.054	0.000	-0.306	0.054	0.000	-0.307	0.054	0.000
IPO Fraud	0.168	0.026	0.000	0.107	0.024	0.000	0.104	0.024	0.000	0.100	0.024	0.000
Hot IPO Period	0.002	0.001	0.023	0.002	0.001	0.007	0.002	0.001	0.005	0.002	0.001	0.011
NASD Prior 30 Days Return	0.004	0.001	0.001	0.005	0.001	0.000	0.005	0.001	0.000	0.005	0.001	0.000
Firm Age				-0.006	0.002	0.003	-0.006	0.002	0.003	-0.006	0.002	0.003
Firm Size				0.153	0.031	0.000	0.156	0.031	0.000	0.162	0.031	0.000
Auditor Reputation				-0.136	0.082	0.100	-0.134	0.082	0.104	-0.131	0.082	0.113
Underwriter Rank				0.071	0.010	0.000	0.071	0.010	0.000	0.069	0.010	0.000
Retained Equity of Founder on T.M.T.							0.003	0.002	0.144	0.000	0.003	0.896
Founder On T.M.T.										**0.076**	0.039	**0.050**
R^2	0.257			0.410			0.413			0.418		
ΔR^2	0.257			0.152			0.003			0.005		
F	29.951			32.992			29.987			27.793		
Sig. F	p<0.01			p<0.01			p<0.01			p<0.01		

Table 12: OLS Regression Results. Dependent Variable – IPO Valuation

	Model 9 Market Controls			Model 10 Firm Controls			Model 15 Founder Controls			Model 16 Founder on Board of Directors		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	2.025	0.062	0.000	1.129	0.130	0.000	1.129	0.130	0.000	1.129	0.130	0.000
AMEX	-1.068	0.147	0.000	-0.566	0.148	0.000	-0.565	0.148	0.000	-0.565	0.148	0.000
NASD	-0.449	0.056	0.000	-0.304	0.054	0.000	-0.304	0.054	0.000	-0.304	0.055	0.000
IPO Fraud	0.168	0.026	0.000	0.107	0.024	0.000	0.107	0.024	0.000	0.107	0.024	0.000
Hot IPO Period	0.002	0.001	0.023	0.002	0.001	0.007	0.002	0.001	0.007	0.002	0.001	0.007
NASD Prior 30 Days Return	0.004	0.001	0.001	0.005	0.001	0.000	0.005	0.001	0.000	0.005	0.001	0.000
Firm Age				-0.006	0.002	0.003	-0.006	0.002	0.003	-0.006	0.002	0.003
Firm Size				0.153	0.031	0.000	0.153	0.031	0.000	0.153	0.031	0.000
Auditor Reputation				-0.136	0.082	0.100	-0.136	0.083	0.102	-0.135	0.083	0.102
Underwriter Rank				0.071	0.010	0.000	0.071	0.010	0.000	0.071	0.010	0.000
Retained Equity of Founder on Board of Directors							0.000	0.001	0.927	0.000	0.002	0.940
Founder on Board of Directors										-0.008	0.043	**0.844**
R^2	0.257			0.410			0.410			0.410		
ΔR^2	0.257			0.152			0.000			0.000		
F	29.951			32.992			29.624			26.874		
Sig. F	p<0.01			p<0.01			p<0.01			p<0.01		

Dependant Variable – 3-Year Stock Return:

Table 13 shows the OLS regression results for the 3-year stock performance of the IPO firm when the founder is the CEO. Model 20 shows a significant and positive relationship between the presence of the founder as CEO and the 3-year stock performance. With a coefficient of 0.295, this relationship influences very significantly the stock performance of IPO firms. Although this relationship becomes insignificant when retained equity is added to the regression analysis (Model 21), it can be argued that the retained equity and founder-CEO variables are highly correlated, which may have caused statistical errors. Based on Model 20, which takes into account all the other market, firm and CEO controls, and based on the mean comparison, which shows a very significant difference in return between IPO firms managed by their founders (-16%) and IPO firms managed by professional managers (-60%), we can conclude that, in our sample, the founder-CEO has a positive and strong influence on the 3-year stock return of an issue. This clearly supports Hypothesis 3a which stated that a change from a founder to a professional CEO would be detrimental to the future stock performance of the issuing firm.

Table 14 and 15 present the OLS regression results for the same dependant variable but in the event where the founder is on the top management team or on the board of directors. It would be interesting to discuss the negative coefficients that these two models show, but both variables (founder on the top management team in Model 23 and founder on the board of directors in Model 25) are not significant, and therefore no conclusion can be drawn from them. These results do not support hypotheses 3b and 3c,

which put forward the idea that the presence of the founder as either a member of the top management team or a member of the board of directors would increase the future performance of the firm.

Table 13: OLS Regression Results. Dependent Variable – 3-Year Return of IPO Firms

	Model 17			Model 18			Model 19			Model 20			Model 21 Founder CEO controlling for Retained Equity		
	Market Controls			Firm Controls			CEO Controls			Founder CEO					
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	1.93	0.33	0.00	0.31	0.75	0.68	-0.02	0.84	0.98	-0.50	0.86	0.56	-0.66	0.85	0.44
AMEX	-0.98	0.77	0.20	-0.05	0.85	0.95	0.08	0.85	0.93	0.28	0.85	0.75	0.34	0.85	0.69
NASD	-0.75	0.29	0.01	-0.56	0.31	0.08	-0.51	0.31	0.11	-0.51	0.31	0.10	-0.57	0.31	0.07
IPO Fraud	0.02	0.13	0.89	0.04	0.14	0.78	0.06	0.14	0.64	0.08	0.14	0.57	0.08	0.14	0.54
Hot IPO Period	-0.02	0.01	0.00	-0.02	0.01	0.00	-0.02	0.01	0.00	-0.02	0.01	0.00	-0.02	0.01	0.00
NASD Prior 30 Days Return	-0.01	0.01	0.20	-0.01	0.01	0.26	-0.01	0.01	0.28	-0.01	0.01	0.31	-0.01	0.01	0.41
Firm Age				0.04	0.01	0.00	0.03	0.01	0.01	0.03	0.01	0.00	0.03	0.01	0.02
Firm Size				-0.10	0.18	0.57	-0.13	0.18	0.48	-0.15	0.18	0.40	-0.18	0.18	0.29
Auditor Reputation				0.85	0.48	0.08	0.91	0.48	0.06	1.00	0.48	0.04	1.08	0.47	0.02
Underwriter Rank				0.07	0.06	0.23	0.09	0.06	0.13	0.09	0.06	0.12	0.11	0.06	0.06
CEO Age							0.01	0.01	0.28	0.01	0.01	0.13	0.01	0.01	0.11
CEO Prior Industry Experience							-0.32	0.15	0.03	-0.25	0.15	0.10	-0.23	0.15	0.14
Founder CEO										**0.30**	0.12	**0.02**	0.12	0.14	**0.36**
Retained Equity													0.01	0.00	0.00
R^2	0.062			0.094			0.140			0.140			0.125		
ΔR^2	0.06			0.03			0.01			0.01			0.02		
F	5.685			4.945			5.309			4.919			4.688		
Sig. F	p<0.01			p<0.01			p<0.01			p<0.01			p<0.01		

Table 14: OLS Regression Results. Dependent Variable – 3-Year Return of IPO Firms

	Model 17 Market Controls			Model 18 Firm Controls			Model 22 Founder Controls			Model 23 Founder on Top Management Team		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	1.929	0.327	0.000	0.312	0.751	0.678	0.313	0.753	0.678	0.317	0.752	0.673
AMEX	-0.981	0.770	0.203	-0.052	0.854	0.952	-0.052	0.856	0.952	-0.057	0.855	0.946
NASD	-0.747	0.293	0.011	-0.558	0.314	0.076	-0.558	0.314	0.077	-0.553	0.314	0.079
IPO Fraud	0.019	0.134	0.887	0.038	0.138	0.784	0.038	0.139	0.783	0.056	0.139	0.690
Hot IPO Period	-0.019	0.005	0.000	-0.019	0.005	0.000	-0.019	0.005	0.000	-0.018	0.005	0.000
NASD Prior 30 Days Return	-0.009	0.007	0.199	-0.008	0.007	0.257	-0.008	0.007	0.258	-0.007	0.007	0.289
Firm Age				0.035	0.011	0.002	0.035	0.011	0.002	0.035	0.011	0.002
Firm Size				-0.101	0.178	0.570	-0.101	0.178	0.570	-0.123	0.179	0.491
Auditor Reputation				0.851	0.476	0.075	0.850	0.477	0.075	0.835	0.476	0.080
Underwriter Rank				0.069	0.058	0.230	0.069	0.058	0.231	0.075	0.058	0.195
Retained Equity of Founder on T.M.T.							0.000	0.013	0.984	0.015	0.016	0.365
Founder On T.M.T.										-0.323	0.225	**0.152**
R^2	0.062			0.094			0.094			0.098		
ΔR^2	0.062			0.032			0.000			0.004		
F	5.685			4.945			4.441			4.234		
Sig. F	p<0.01			p<0.01			p<0.01			p<0.01		

Table 15: OLS Regression Results. Dependent Variable – 3-Year Return of IPO Firms

	Model 17 Market Controls			Model 18 Firm Controls			Model 24 Founder Controls			Model 25 Founder on Board of Directors		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	1.929	0.327	0.000	0.312	0.751	0.678	0.317	0.752	0.674	0.335	0.752	0.656
AMEX	-0.981	0.770	0.203	-0.052	0.854	0.952	-0.053	0.855	0.951	-0.054	0.854	0.950
NASD	-0.747	0.293	0.011	-0.558	0.314	0.076	-0.561	0.314	0.075	-0.566	0.314	0.072
IPO Fraud	0.019	0.134	0.887	0.038	0.138	0.784	0.039	0.139	0.776	0.040	0.138	0.774
Hot IPO Period	-0.019	0.005	0.000	-0.019	0.005	0.000	-0.019	0.005	0.000	-0.019	0.005	0.000
NASD Prior 30 Days Return	-0.009	0.007	0.199	-0.008	0.007	0.257	-0.008	0.007	0.247	-0.009	0.007	0.214
Firm Age				0.035	0.011	0.002	0.035	0.011	0.002	0.034	0.011	0.002
Firm Size				-0.101	0.178	0.570	-0.103	0.178	0.564	-0.120	0.178	0.501
Auditor Reputation				0.851	0.476	0.075	0.843	0.477	0.078	0.845	0.477	0.077
Underwriter Rank				0.069	0.058	0.230	0.069	0.058	0.231	0.075	0.058	0.197
Retained Equity of Founder on Board of Directors							0.003	0.008	0.703	0.013	0.011	0.209
Founder on Board of Directors										-0.342	0.246	**0.164**
R^2	0.062			0.094			0.094			0.098		
ΔR^2	0.062			0.032			0.000			0.004		
F	5.685			4.945			4.457			4.237		
Sig. F	p<0.01			p<0.01			p<0.01			p<0.01		

Dependant Variables – 3-Year Survival:

Table 16 shows the OLS regression results for the 3-year survival of the IPO firms. The results are very similar to those of Table 13 where the founder-CEO variable is significant and positive. This result supports Hypothesis 4a, and thus we can conclude that, in the sample analysed, the firms managed by their founders have a better chance of survival after the issue than professionally managed firms. As we can see in the descriptive statistics table (Table 4), professionally managed firms have a survival rate of 66% compared to a 76% survival rate for founder-managed firms. However, when we look at Model 31, we see that controlling for retained equity has the same impact on the founder-CEO variable than in Model 21, making it insignificant. It is important to keep in mind that, as mentioned before, the retained equity variable has a high correlation with the founder-CEO variable, and thus, despite Model 31, we can conclude with Model 30 and with the simple mean comparison that the founder-CEO does have a significant positive impact on firm survival.

Model 33 in Table 17 gives unexpected results. It seems indeed that firm survival is negatively affected by the presence of the founder within the firm as a non-CEO member of the top management team. This clearly goes against Hypothesis 4b as changing the founder's role seems to create more problems than to solve them.

Finally, Table 18 shows that the presence of the founder on the board of directors does not appear to influence the survival of the firm, and thus, Hypothesis 4c is not supported by regression Model 35.

Table 16: Logistic Regression Results. Dependent Variable - 3-Year Firm Survival

	Model 26				Model 27				Model 28				Model 29				Model 30				Model 31			
	Market Controls				Firm Controls				IPO Controls				CEO Controls				Founder CEO				Founder CEO controlling for R. E.			
	b	s.e.	Chi2	sig.	b	s.e.	Chi2	sig.	b	s.e.	Chi2	sig.	b	s.e.	Chi2	sig.	b	s.e.	Chi2	sig.	b	s.e.	Chi2	sig.
Intercept	2.50	0.67	13.86	0.00	-0.60	1.54	0.15	0.69	-0.61	1.56	0.15	0.70	-1.10	1.75	0.39	0.53	-1.66	1.82	0.83	0.36	-2.57	1.94	1.75	0.19
AMEX	-0.59	1.36	0.19	0.66	1.14	1.68	0.46	0.50	1.15	1.68	0.46	0.50	1.41	1.74	0.66	0.42	1.85	1.76	1.11	0.29	1.98	1.81	1.20	0.27
NASD	-0.53	0.59	0.82	0.36	-0.11	0.64	0.03	0.86	-0.11	0.64	0.03	0.86	-0.07	0.66	0.01	0.92	-0.09	0.67	0.02	0.90	-0.19	0.69	0.08	0.78
IPO Fraud	1.13	0.28	16.74	0.00	1.22	0.29	17.75	0.00	1.22	0.29	17.28	0.00	1.28	0.30	18.67	0.00	1.32	0.30	19.52	0.00	1.32	0.30	19.54	0.00
Hot IPO Period	-0.03	0.01	11.74	0.00	-0.03	0.01	12.14	0.00	-0.03	0.01	12.14	0.00	-0.03	0.01	11.36	0.00	-0.03	0.01	10.49	0.00	-0.03	0.01	10.66	0.00
NASD Prior 30 Days Return	-0.02	0.01	2.81	0.09	-0.02	0.01	2.14	0.14	-0.02	0.01	2.14	0.14	-0.02	0.01	2.04	0.15	-0.02	0.01	1.91	0.17	-0.02	0.01	1.64	0.20
Firm Age					0.05	0.02	3.93	0.05	0.05	0.02	3.92	0.05	0.04	0.02	2.27	0.13	0.04	0.02	3.35	0.07	0.04	0.02	2.52	0.11
Firm Size					0.25	0.34	0.53	0.46	0.25	0.35	0.53	0.47	0.21	0.35	0.36	0.55	0.17	0.36	0.24	0.63	0.11	0.37	0.10	0.75
Auditor Reputation					2.37	0.98	5.86	0.02	2.37	0.98	5.86	0.02	2.48	1.01	5.98	0.01	2.74	1.04	6.98	0.01	2.93	1.08	7.41	0.01
Underwriter Rank					-0.06	0.11	0.31	0.58	-0.06	0.11	0.31	0.58	-0.02	0.11	0.03	0.87	-0.02	0.11	0.03	0.87	0.00	0.12	0.00	0.99
Valuation of IPO									0.01	0.24	0.00	0.98	0.00	0.24	0.00	1.00	0.06	0.29	0.04	0.84	0.09	0.35	0.07	0.79
CEO Age													0.01	0.02	0.90	0.34	0.02	0.02	2.05	0.15	0.02	0.02	2.17	0.14
CEO Prior Industry Experience													-0.63	0.32	3.98	0.05	-0.49	0.32	2.26	0.13	-0.48	0.33	2.16	0.14
Founder CEO																	**0.61**	0.24	6.27	**0.01**	0.38	0.27	2.03	**0.15**
Retained Equity																					0.02	0.01	3.68	0.06
Pseudo-R^2	0.07				0.09				0.09				0.10				0.11				0.12			
Chi^2	30.14				43.02				43.02				47.74				54.10				58.16			
Model probability	0.00				0.00				0.00				0.00				0.00				0.00			

Table 17: Logistic Regression Results. Dependent Variable - 3-Year Firm Survival

	Model 26 Market Controls				Model 27 Firm Controls				Model 28 IPO Controls				Model 32 Founder Controls				Model 33 Founder on Top Management Team			
	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.
Intercept	2.50	0.67	13.86	0.00	-0.60	1.54	0.15	0.69	-0.61	1.56	0.15	0.70	-0.59	1.57	0.14	0.71	-0.65	1.58	0.17	0.68
AMEX	-0.59	1.36	0.19	0.66	1.14	1.68	0.46	0.50	1.15	1.68	0.46	0.50	1.14	1.69	0.46	0.50	1.17	1.68	0.48	0.49
NASD	-0.53	0.59	0.82	0.36	-0.11	0.64	0.03	0.86	-0.11	0.64	0.03	0.86	-0.11	0.64	0.03	0.87	-0.07	0.65	0.01	0.92
IPO Fraud	1.13	0.28	16.74	0.00	1.22	0.29	17.75	0.00	1.22	0.29	17.28	0.00	1.23	0.29	17.45	0.00	1.32	0.30	19.09	0.00
Hot IPO Period	-0.03	0.01	11.74	0.00	-0.03	0.01	12.14	0.00	-0.03	0.01	12.14	0.00	-0.03	0.01	12.29	0.00	-0.03	0.01	10.13	0.00
NASD Prior 30 Days Return	-0.02	0.01	2.81	0.09	-0.02	0.01	2.14	0.14	-0.02	0.01	2.14	0.14	-0.02	0.01	2.15	0.14	-0.02	0.01	1.76	0.18
Firm Age					0.05	0.02	3.93	0.05	0.05	0.02	3.92	0.05	0.05	0.02	3.97	0.05	0.04	0.02	3.77	0.05
Firm Size					0.25	0.34	0.53	0.46	0.25	0.35	0.53	0.47	0.24	0.35	0.47	0.49	0.16	0.35	0.20	0.65
Auditor Reputation					2.37	0.98	5.86	0.02	2.37	0.98	5.86	0.02	2.37	0.98	5.85	0.02	2.32	0.97	5.68	0.02
Underwriter Rank					-0.06	0.11	0.31	0.58	-0.06	0.11	0.31	0.58	-0.06	0.11	0.29	0.59	-0.04	0.11	0.11	0.74
Valuation of IPO									0.01	0.24	0.00	0.98	0.01	0.24	0.00	0.97	0.03	0.28	0.02	0.90
Retained Equity of Founder on T.M.T.													-0.01	0.02	0.21	0.65	0.04	0.04	1.51	0.22
Founder On T.M.T.																	**-1.11**	0.42	6.97	**0.01**
Pseudo-R^2	0.07				0.09				0.09				0.09				0.11			
Chi^2	30.14				43.02				43.02				43.22				50.35			
Model probability	0.00				0.00				0.00				0.00				0.00			

Table 18: Logistic Regression Results. Dependent Variable - 3-Year Firm Survival

	Model 26 Market Controls				Model 27 Firm Controls				Model 28 IPO Controls				Model 34 Founder Controls				Model 35 Founder on Board of Directors			
	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.
Intercept	2.50	0.67	13.86	0.00	-0.60	1.54	0.15	0.69	-0.61	1.56	0.15	0.70	-0.62	1.57	0.15	0.70	-0.60	1.57	0.15	0.70
AMEX	-0.59	1.36	0.19	0.66	1.14	1.68	0.46	0.50	1.15	1.68	0.46	0.50	1.15	1.69	0.46	0.50	1.15	1.69	0.46	0.50
NASD	-0.53	0.59	0.82	0.36	-0.11	0.64	0.03	0.86	-0.11	0.64	0.03	0.86	-0.11	0.65	0.03	0.87	-0.11	0.64	0.03	0.87
IPO Fraud	1.13	0.28	16.74	0.00	1.22	0.29	17.75	0.00	1.22	0.29	17.28	0.00	1.22	0.29	17.28	0.00	1.22	0.29	17.27	0.00
Hot IPO Period	-0.03	0.01	11.74	0.00	-0.03	0.01	12.14	0.00	-0.03	0.01	12.14	0.00	-0.03	0.01	12.57	0.00	-0.03	0.01	12.36	0.00
NASD Prior 30 Days Return	-0.02	0.01	2.81	0.09	-0.02	0.01	2.14	0.14	-0.02	0.01	2.14	0.14	-0.02	0.01	1.96	0.16	-0.02	0.01	2.04	0.15
Firm Age					0.05	0.02	3.93	0.05	0.05	0.02	3.92	0.05	0.05	0.02	4.10	0.04	0.05	0.02	3.95	0.05
Firm Size					0.25	0.34	0.53	0.46	0.25	0.35	0.53	0.47	0.26	0.35	0.57	0.45	0.25	0.35	0.51	0.47
Auditor Reputation					2.37	0.98	5.86	0.02	2.37	0.98	5.86	0.02	2.42	0.98	6.04	0.01	2.41	0.98	6.04	0.01
Underwriter Rank					-0.06	0.11	0.31	0.58	-0.06	0.11	0.31	0.58	-0.06	0.11	0.33	0.56	-0.06	0.11	0.29	0.59
Valuation of IPO									0.01	0.24	0.00	0.98	0.00	0.24	0.00	0.99	0.00	0.24	0.00	0.99
Retained Equity of Founder on Board of Directors													-0.01	0.01	0.74	0.39	0.00	0.02	0.05	0.83
Founder on Board of Directors																	-0.24	0.45	0.29	**0.59**
Pseudo-R^2	0.07				0.09				0.09				0.09				0.09			
Chi^2	30.14				43.02				43.02				43.72				44.01			
Model probability	0.00				0.00				0.00				0.00				0.00			

Influence of IPO Valuation on 3-year stock return and on 3-year survival rate:

The valuation of the Initial Public Offering was thought to have a positive influence on the future performance of IPO firms. However, Model 36 of Table 19 shows the opposite relationship in which the higher the valuation of an IPO, the lower the future stock performance of the firm. This finding goes against Hypothesis 5a and brings about some questions regarding the ability of investment banks and other institutional investors to value IPO firms.

Hypothesis 5b is also not supported because the OLS regression results from Table 20 show no relationship between the valuation of the IPO and the 3-year firm survival variable.

Table 19: OLS Regression Results. Dependent Variable – 3-Year Return of IPO firms

	Model 17 Market Controls			Model 18 Firm Controls			Model 36 CEO Controls		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	1.930	0.328	0.000	0.315	0.753	0.675	1.135	0.811	0.162
AMEX	-0.981	0.771	0.204	-0.053	0.855	0.951	-0.463	0.864	0.592
NASD	-0.747	0.294	0.011	-0.558	0.314	0.077	-0.779	0.323	0.016
IPO Fraud	0.020	0.134	0.880	0.040	0.139	0.775	0.117	0.141	0.407
Hot IPO Period	-0.019	0.005	0.000	-0.019	0.005	0.000	-0.017	0.005	0.000
NASD Prior 30 Days Return	-0.009	0.007	0.199	-0.008	0.007	0.257	-0.004	0.007	0.526
Firm Age				0.035	0.011	0.002	0.031	0.011	0.006
Firm Size				-0.102	0.178	0.568	0.009	0.182	0.959
Auditor Reputation				0.852	0.477	0.075	0.753	0.475	0.114
Underwriter Rank				0.069	0.058	0.232	0.121	0.061	0.047
Valuation of IPO							**-0.726**	0.278	**0.009**
R^2	0.051			0.075			0.108		
ΔR^2	0.062			0.032			0.032		
F	5.685			3.834			5.188		
Sig. F	p<0.01			p<0.01			p<0.01		

Table 20: Logistic Regression Results. Dependent Variable - 3-Year Firm Survival

	Model 26 Market Controls				Model 27 Firm Controls				Model 28 IPO Controls			
	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.
Intercept	2.505	0.673	13.860	0.000	-0.604	1.535	0.150	0.694	-0.613	1.564	0.150	0.695
AMEX	-0.590	1.357	0.190	0.664	1.142	1.679	0.460	0.496	1.146	1.684	0.460	0.496
NASD	-0.534	0.588	0.820	0.364	-0.114	0.639	0.030	0.858	-0.112	0.644	0.030	0.862
IPO Fraud	1.133	0.277	16.740	0.000	1.217	0.289	17.750	0.000	1.215	0.292	17.280	0.000
Hot IPO Period	-0.031	0.009	11.740	0.001	-0.032	0.009	12.140	0.000	-0.032	0.009	12.140	0.000
NASD Prior 30 Days Return	-0.022	0.013	2.810	0.094	-0.020	0.013	2.140	0.143	-0.020	0.013	2.140	0.144
Firm Age					0.045	0.023	3.930	0.048	0.045	0.023	3.920	0.048
Firm Size					0.251	0.344	0.530	0.465	0.251	0.345	0.530	0.468
Auditor Reputation					2.365	0.977	5.860	0.015	2.366	0.977	5.860	0.015
Underwriter Rank					-0.060	0.109	0.310	0.580	-0.061	0.110	0.310	0.581
Valuation of IPO									0.007	0.237	0.000	**0.976**
Pseudo-R^2	0.065				0.091				0.091			
Chi^2	30.140				43.020				43.020			
Model probability	0.000				0.000				0.000			

Influence of IPO underpricing on 3-year stock return and on 3-year survival rate:

The last set of OLS regressions are presented in Table 21 and 22. They show that the influence of underpricing on the future performance of IPO firms is nonexistent. Both regression models show no significance for the analysed data, and therefore do not support Hypotheses 6a and 6b. On the other hand, firm age and the presence of a hot IPO period both significantly predict the 3-year stock return and the 3-year firm survival. These findings suggest that investors give higher value to older firms and that hot IPO period may coincide with over confidence of investors and the IPO of poorly performing firms.

Table 21: OLS Regression Results. Dependent Variable – 3-Year Return of IPO Firms

	Model 17 Market Controls			Model 18 Firm Controls			Model 37 CEO Controls		
	b	s.e.	Sig.	*b*	s.e.	Sig.	*b*	s.e.	Sig.
Intercept	1.930	0.328	0.000	0.315	0.753	0.675	0.245	0.754	0.746
AMEX	-0.981	0.771	0.204	-0.053	0.855	0.951	-0.011	0.855	0.990
NASD	-0.747	0.294	0.011	-0.558	0.314	0.077	-0.538	0.314	0.088
IPO Fraud	0.020	0.134	0.880	0.040	0.139	0.775	0.117	0.156	0.453
Hot IPO Period	-0.019	0.005	0.000	-0.019	0.005	0.000	-0.020	0.005	0.000
NASD Prior 30 Days Return	-0.009	0.007	0.199	-0.008	0.007	0.257	-0.007	0.007	0.315
Firm Age				0.035	0.011	0.002	0.035	0.011	0.002
Firm Size				-0.102	0.178	0.568	-0.111	0.178	0.533
Auditor Reputation				0.852	0.477	0.075	0.811	0.477	0.090
Underwriter Rank				0.069	0.058	0.232	0.081	0.059	0.167
Underpricing of IPO							-0.236	0.213	**0.269**
R^2	0.062			0.094			0.097		
ΔR^2	0.062			0.032			0.003		
F	5.685			4.945			4.576		
Sig. F	p<0.01			p<0.01			p<0.01		

Table 22: Logistic Regression Results. Dependent Variable - 3-Year Firm Survival

	Model 26 Market Controls				Model 27 Firm Controls				Model 38 IPO Controls			
	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.	b	s.e.	Chi^2	sig.
Intercept	2.505	0.673	13.860	0.000	-0.604	1.535	0.150	0.694	-0.580	1.538	0.140	0.706
AMEX	-0.590	1.357	0.190	0.664	1.142	1.679	0.460	0.496	1.125	1.680	0.450	0.503
NASD	-0.534	0.588	0.820	0.364	-0.114	0.639	0.030	0.858	-0.121	0.640	0.040	0.851
IPO Fraud	1.133	0.277	16.740	0.000	1.217	0.289	17.750	0.000	1.190	0.316	14.140	0.000
Hot IPO Period	-0.031	0.009	11.740	0.001	-0.032	0.009	12.140	0.000	-0.032	0.009	11.840	0.001
NASD Prior 30 Days Return	-0.022	0.013	2.810	0.094	-0.020	0.013	2.140	0.143	-0.020	0.013	2.180	0.140
Firm Age					0.045	0.023	3.930	0.048	0.045	0.023	3.950	0.047
Firm Size					0.251	0.344	0.530	0.465	0.256	0.345	0.550	0.458
Auditor Reputation					2.365	0.977	5.860	0.015	2.376	0.977	5.920	0.015
Underwriter Rank					-0.060	0.109	0.310	0.580	-0.064	0.110	0.340	0.560
Underpricing of IPO									0.079	0.381	0.040	**0.835**
Pseudo-R^2	0.065				0.091				0.091			
Chi^2	30.140				43.020				43.060			
Model probability	0.000				0.000				0.000			

Table 23: Hypotheses Summary

	Underpricing	Valuation	3-year stock return	3-year survival
Founder CEO	**Hypothesis 1a:** A change in the CEO from a founder to a professional manager prior to the IPO will lead to lower levels of underpricing.	**Hypothesis 2a: A change from a founder to a professional managed IPO firm will increase the valuation of the issue.**	**Hypothesis 3a: Replacing the founder-CEO with professional manager-CEO prior to the IPO will lead to lower levels of firm performance in the three-year period following the Initial Public Offering.**	**Hypothesis 4a: Replacing the founder-CEO with professional manager-CEO prior to the IPO will lower levels of firm survival rate in the three-year period following the Initial Public Offering.**
Founder on Top Management Team	**Hypothesis 1b:** Compared to the average underpricing level of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to lower levels of underpricing.	**Hypothesis 2b: Compared to the average valuation of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to higher levels of valuation.**	**Hypothesis 3b:** Compared to the average performance of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 4b:** Compared to the average firm survival rate of IPO firms, having the founder remain as a non-CEO member of the top management team at the time of the IPO will lead to a higher firm survival rate in the three-year period following the Initial Public Offering.
Founder on the Board of Directors	**Hypothesis 1c:** Compared to the average underpricing level of IPO firms, having the founder remain only as a member of the board of directors will lead to lower levels of underpricing.	**Hypothesis 2c:** Compared to the average valuation of IPO firms, having the founder remain only as a member of the board of directors will lead to a higher IPO valuation.	**Hypothesis 3c:** Compared to the average performance of IPO firms, having the founder remain only as a member of the board of directors at the time of the IPO will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 4c:** Compared to the average firm survival rate of IPO firms, having the founder remain only as a member of the board of directors at the time of the IPO will lead to a higher firm survival rate in the three-year period following the Initial Public Offering.

† Hypothesis in bold are supported.

Table 24: Hypotheses Summary

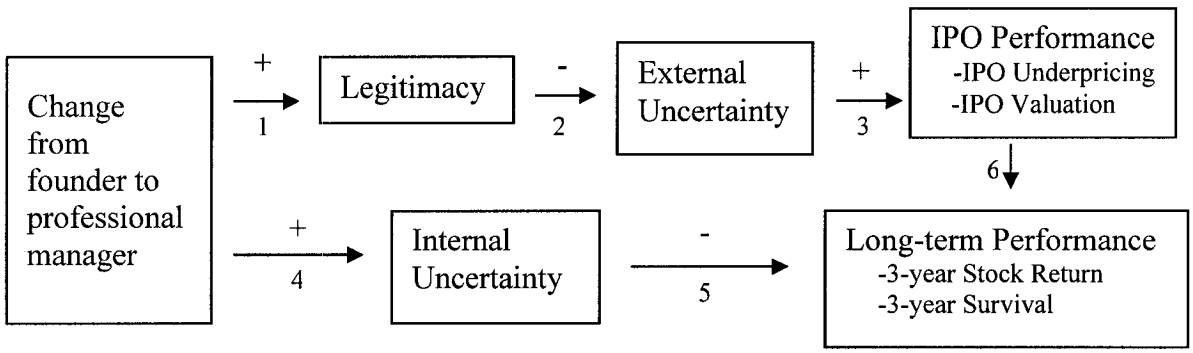
	3-year stock return	3-year survival
IPO Valuation	***Hypothesis 5a:** IPO firms with higher valuations, controlling for all other factors, will lead to higher levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 5b:** IPO firms with higher valuations, controlling for all other factors, will lead to higher levels of firm survival in the three-year period following the Initial Public Offering.
IPO Underpricing	**Hypothesis 6a** : IPO firms with higher underpricing, controlling for all other factors, will lead to lower levels of firm performance in the three-year period following the Initial Public Offering.	**Hypothesis 6b:** IPO firms with higher underpricing, controlling for all other factors, will lead to lower levels of firm survival in the three-year period following the Initial Public Offering.

* The opposite of H5a was found.

Discussion

The results presented above reveal some predicted relationships, some surprises and, to a certain extent, what I would consider some disturbing findings about the IPO market. Let us look at Model 1 presented at the beginning of this study and discuss it in the light of these results.

Model 1:



External Effect of Founder Succession (Link 1, 2 and 3):

The external effect of a change from founder to professional CEO is supported by a large and significant impact on the IPO valuation. However, the impact of founder succession on IPO underpricing, which has been previously supported in the literature (Certo et al. 2001), was not found in my dataset. There may be several explanations for this unexpected result. As described at the beginning of this research, the underpricing phenomenon is very complex and different academics suggest different reasons for its occurrence. The underpricing variable that was collected for this research is somewhat correlated (0.23) with the prior 30-day return of the NASDAQ, and thus the influence of

the over-optimism surrounding the issue might be too strong to distinguish the fluctuation that founder departure may cause. When looking back at the valuation variable, it could easily be argued that this variable is a better measure for the external impact of founder succession than the underpricing variable. According to the various theories of underpricing presented earlier, it appears indeed that underpricing is subject to the influence of several factors as it may be used for different purposes such as diminishing the likelihood of lawsuits, attracting uninformed investors or even committing fraud. However, strategic reasons for increasing or decreasing valuation are much less likely, and thus valuation might be a more accurate measure of investors' confidence in the company itself. Legitimacy would therefore be better measured, controlling for size, by the IPO valuation than by the IPO underpricing. What is strongly supported in this research is that the presence of the founder has a clear negative impact on the size of the offering. This supports the argument that, for the IPO of an entrepreneurial firm, a change from founder to professional CEO is a marker for legitimacy and thus reduces the uncertainty of the issue and allows the firm to acquire greater resources.

The effect of the founder's presence on the legitimacy of his firm seems to be limited to the CEO position. In light of the results, the founder's presence on the top management team or on the board of directors has no significant effect on three of the four dependant variables. However, the presence of the founder on the top management team seems to be perceived positively by investors as it has a positive impact on the valuation of the IPO. This supports the argument that investors perceive that the founder, as part of the top management team, may be the key to a smooth transition between his leadership and the

professional leadership put in place. They also might consider the founder's technical qualities and qualifications as crucial to the firm, and thus might believe that his presence on the top management team reduces the risk and uncertainty surrounding the issue.

The effect on IPO performance of the founder's presence within the firm, whether as the CEO or as a member of the top management team, is highly supported by this research. What is found is that, from the investors' perceptive, founder-CEOs seem to be a source of risk and uncertainty, which leads to what Zuckerman (1999) calls an illegitimacy cost. This cost, from our sample, seems mostly reflected as a lower valued issue, or the difficulty for founder-led firms to gather as much money from institutional investors as professional-led firms. What is important to evaluate is whether institutional investors should in fact value founder-led IPOs lower than professional-led IPOs. This is what the second part of Model 1, describing the internal effect of founder succession, wishes to evaluate in order to establish the extent to which the differences in IPO performance are commensurate with post-IPO firm performance.

Internal Effect of Founder Succession (Link 4 and 5):

The surprising aspect of the results lies in the fact that the post-IPO firm performance goes against what investors seem to believe should happen. Investors' lower valuation of founder-led firms sends the signal that their confidence in the future success of these firms is lower than their confidence in the success of professionally managed IPO firms. However, the results obtained show that the presence of a founder-CEO has a positive

effect on both the 3-year stock return and the 3-year survival rate of IPO firms. This effect clearly highlights the significant difference between investors' prediction and the actual long-term performance of the firms, which leads to question the accuracy of institutional investors' evaluation of top management teams.

It is argued from various sources (Fizel & D'Itri 1997; Friedman & Saul 1991; Carlson 1961) that founder departure causes important disturbances to a firm. Succession has a tendency to promote instability, which causes deterioration in performance (Baron Hannan & Burton 2001; Fizel & D'Itri 1997). As it was also explained in this research, the IPO process in itself is disturbing for a firm. The fragility of IPO firms can be observed in the data with an average 3-year stock performance of -35.7 % following the IPO. The results of this research tend to support that adding the problems caused by founder departure to the existing disturbances of the IPO process decreases firm performance even more with an average 3-year return for professionally managed IPOs of -60.4%. These results support Nelson's (2003) argument about the importance of the timing of such a succession.

From the dataset examined, and because of what could be a misjudgement by investors regarding the capabilities of founders to manage public firms, it seems that the presence of a professional manager is a taken-for-granted marker for legitimacy. The apparent taken-for-grantedness of this judgement may come from the lack of empirical research supporting the inability of founders to manage public firms and from the finding that founder-CEOs have a positive impact on post-IPO firm performance.

Another result that leads to question institutional investors' evaluation of top management teams is the effect on firm performance of the founder's presence on the top management team. The higher IPO valuation that results from the founder's presence on the top management team may reflect investors' belief in the importance of his technical abilities, knowledge of the firm and contacts with the firm's main suppliers and/or buyers. However, once again, the results of the analysis of post-IPO firm performance do not support the investors' logic. The results of my research suggest that having a founder remain within the firm as part of the top management team creates a negative impact on the firm long-term performance and survival rate. This contradiction could be explained by the confusion involved in having the presence of the founder without the powers that everybody in the organization is used to attributing to him. His presence might thus serve as a distraction more than as an advantage to the firm. Some employees may also feel strongly that the founder should still be managing the firm because they dislike the changes brought about by the professional CEO hired, which may be the cause for conflicts or disagreements between employees. Conflicts may also arise directly between the new CEO and the founder who could disagree with the decisions made as part of daily operations or as part of the firm's strategic direction.

Relationship between IPO Performance and Future Performance (Link 6):

The external and internal effects of founder succession found in this research support the argument that the relationship between the size of the offering and the post-IPO performance of the issuing firm is negative. Based on the sample collected in this research, the negative relationship between the two variables was supported when specifically tested. This finding is another element supporting the argument that the investors' taken-for-granted belief about founders is empirically unjustified. Founder-led firms performed better in the three years following their IPOs than professional-led firms, and thus the investors' concerns that lead them to devalue founder-led IPOs should probably be re-evaluated.

Limitations of the research

Although the results obtained should be considered important, generalization of such research always requires some caution. Probably the most important issue to take into consideration is that the data used comes from a specific time period, and thus might not be consistent over different time periods. The IPO market is indeed influenced, up to a certain extent, by market patterns that are unstable over time (Ritter 1991; Tinic 1988). Variables such as underpricing are also context-specific (Certo et al. 2001), and therefore the results may not hold if tested over different time periods. Another important consideration is that the single industry in which this research was conducted. It is not possible to conclude from this research that the results would hold for other industries. The service industry chosen may present particular characteristics that other industries may not have such as a major reliance on human capital. Investors may also react differently when evaluating firms in different industries. Finally, the results obtained in this research can hardly be extrapolated to firms that are at a different stage of their life cycle. Firms that have not gone through the IPO process or firms that have issued their IPOs a long time ago would most likely present different characteristics and therefore founder succession would likely have a different impact on these firms.

Another limitation of this research lies in the fact that institutional investors are taken as one group, which measures the average IPO investors. However, in reality, there are different types of institutional investors who may react differently towards the founder of the issuing firm. Venture capitalists, underwriters or buy-side analysts may not react the

same when evaluating the appropriateness of a top management team. The taken-for-granted belief that founders should leave the firm in order to comply with institutional expectations may not hold for all categories of investors.

Finally, it is important to point out the limitations related to the collection of archival data, which may result in biases or errors. However, the contribution of multiple individuals to collect and verify the data should have minimized the errors in collection.

Future research

There are different investigations that could be undertaken which would complement the current research on founder management, top management teams' influence on IPO firms or founder succession. First, it would be interesting to test the results of this research with different datasets. Different industries and different time periods could shed light on important differences in investors' behaviour and in founders' influence on IPO performance. It would also be interesting to investigate in more detail the role of venture capitalists in founder departure. The different techniques used by venture capitalists to gain control over an entrepreneurial firm and the performance of venture capital-owned firms could be looked at in particular. Finally, examining the performance of founder and professional-led IPO firms on a longer period might also be interesting. The effect of founder departure after 5 or 10 years might yield interesting results. Many aspects of this field of research are left unexplored and thus, more research is needed to put into a larger context the results exposed in this research.

Conclusion

The data I examined has provided a relatively clearer picture of the impact of founder succession at the time of the Initial Public Offering, and has shown some significant signs of the adequacy of the arguments I put forth in this research. The analysis of the results shows that the presence of the founder as the CEO of the issuing firm appears to be responsible to a certain extent for the lower valuation of its IPOs. It also supports the notion that the founder-CEO has a positive influence on the post-IPO performance of the firm. It is therefore argued that investors have a taken-for-granted negative bias toward founders that are still managing their firms at the time of the complex and much institutionalized initial public offering process. This research thus supports the illegitimacy cost that Zuckerman (1999) discusses since the lower valuation of founder-led IPOs can only be explained by the lack of legitimacy attributed to founders. I argue that this bias should instead be reversed in favor of founders that are still managing their firms at the time of the IPO, and that their presence should therefore increase the legitimacy of their firms rather than decreasing it.

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