

THE STRATEGIC VALUE OF RETAINING A YOUNG ENTREPRENEURIAL IPO FIRMS ORIGINAL INSIDERS: APPLYING RESOURCE-BASED VIEW IN THE AUSTRALIAN IPO CONTEXT

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Abstract

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Australia is an ‘Anglo-Saxon’ Pacific-Rim country that has strong features of both relational (Asian) and economic (Anglo) corporate governance. Extending resource-based view (RBV) into this unique context we predict that safeguarding the pre-initial public offering (IPO) top management team (TMT) members and directors (insiders) firm-specific investments by continuing to retain a few insiders even after an IPO is more important than blindly adopting agency-theory US inspired regulations. To test our predictions, we hand collected a sample of young Australian firms to document whether institutional pressures to adopt board independence and replace the founder, or original, pre-IPO insiders by Australian companies negatively impacts post-IPO financial performance. Consistent with our predictions we find the presence of a few of the original insiders significantly improves post-IPO financial performance. These findings contribute to RBV theory and have implications for Asia Pacific corporate governance.

Keywords: Australia, Corporate Governance, IPO, Insiders, Outsiders, RBV

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1. INTRODUCTION

An institutional convergence in international corporate governance exists, where countries are being encouraged to adopt agency theory (AT) regulations that originate in the USA (Aguilera & Jackson, 2010). Often referred to as the *Anglo-Saxon model*, according to AT the firm represents a nexus

of explicit, formal arms-length contracts, between dispersed shareholders and their insiders (Fama & Jensen, 1983)¹. It has been called an ‘outsider

¹ In this study we define insiders as the original top management team (TMT) members and venture board directors that were part of the initial entrepreneurial venture even before its initial public offering (IPO). We use the terms original, founding, initial, entrepreneurial, and pre-IPO, with insiders interchangeably but the previous definition applies in all cases.

system' because countries like the US and Australia draw on AT to protect the fragmented outside shareholders from 'self-serving' insiders (Filatotchev et al., 2013). AT views intense monitoring by more outside directors and separate chief executive officer (CEO)-Chair roles (pre-initial public offering (IPO) inside director turnover) as a hallmark of corporate governance (Dalton et al., 2007). Although AT does not have a view toward replacing the original top management team (TMT), external shareholders after the IPO can pressure a company to replace their original founders with more experienced TMT members (Kroll et al., 2007; Le et al., 2017). Studies note that agency conflicts are accentuated when a young firm goes public because their original, pre-IPO TMT members and venture board directors' (henceforth the insiders) interests may not be aligned with the outside shareholders (Walter et al., 2015; Garg, 2020). Thus, AT regulations and shareholder pressures can result in original insiders departing from young IPO companies to make way for new TMT members and directors (Nguyen & Faff, 2007; Christensen et al., 2015).

However, research overlooks the institutional differences that exist between the US and Australian corporate governance systems that we speculate may limit the value of using AT in the Australian IPO context (Kriaa & Hamza, 2019). Australia like the US has features of an 'outsider system'; a common law, a liquid IPO market, strong shareholder protections, and single-tier boards (Nadeem et al., 2020). Yet, Australia also has elements of an 'insider system', like Japan and Germany, where insiders enjoy 'private benefits of control' over corporate governance (Setia-Atmaja et al., 2009). For example, public-sector unions and powerful block-holders nominate TMT members and directors with a lengthier time horizon; and transient investors who push insiders to beat analyst forecasts are weaker in Australia than in the US (Mees & Smith, 2019). In contrast to AT, we speculate that insiders in Australia may be less self-interested, and their motives better aligned with the long-term interests of the shareholders (Kroll et al., 2007). While new TMT members and directors are brought in by venture capitalists to encourage shareholders to invest in a company's IPO, they often lack the psychological ownership and tacit knowledge of a firm's pre-IPO insiders (Arthurs et al., 2008; Garg, 2013, 2020). Therefore, we posit that regulatory pressures to hastily replace a young firm's original insiders may be associated with poor post-IPO firm performance (Redding, 2004; Miglani et al., 2015).

We draw on the institutional differences between Australia and the US to extend resource-based view (RBV) into the Australian IPO context (Peteraf & Barney, 2003; Kim & Mahoney, 2005; Zica et al., 2016; Hoskisson et al., 2018; Klein et al., 2019). We assert that Australian firms are embedded within a nexus of implicit, relational contracts, where empowering the original insiders is better than prematurely adopting AT regulations (Wang et al., 2009). According to RBV, sustained firm performance results from the inability of competitors to replicate your most thinly traded, tacit, and firm-specific knowledge resources (Barney, 1991, 2018). We assert that insiders possess tacit knowledge regarding a firm's original strategy, and

strong stewardship motives, which are causally ambiguous sources of competitive advantage (Harris & Helfat, 1997; Faleye, 2017). Bringing in new outsiders as a firm matures does foster organizational change amongst top executives. However, we maintain that no amount of professional industry experience by the TMT and directors can substitute for the tacit knowledge and psychological ownership of a firm's original insiders (Kor, 2003; Zorn et al., 2017). Thus, we expect that retaining even a few of the original insiders after the IPO will help the TMT and the board of directors make more informed strategic decisions (Nelson, 2003; Joseph et al., 2014).

We hand-collected a unique sample of 40 young Australian firms that conducted an IPO in the 2001-2007 period and rely on panel-data techniques to investigate whether insider turnover negatively impacts post-IPO financial performance (Walter et al., 2015). We find that retaining a few of the original insiders is in fact associated with positive post-IPO financial performance (Garg et al., 2018). These results have implications for both RBV theory and managerial practice in Australia. Theoretically, our extension of RBV highlights that providing residual control to some of the original insiders does not result in them using their 'private benefits of control' to misappropriate co-created stakeholder rents as an agency cost (Coff, 1999, 2010). Instead, we find that protecting the co-specialized investments of the insiders mitigates information asymmetries for the new outsiders, helping them generate more post-IPO profits. Practically, our results provide evidence that AT corporate governance practices prematurely adopted by a market-based economy like Australia can unexpectedly backfire (Chen et al., 2011).

2. THEORETICAL AND INSTITUTIONAL BACKGROUND

2.1. Institutional context of Australia

Australia remains a unique country with strong features of both formal *contractual* and informal *communitarian* forms of corporate governance (Zhou & Peng, 2010). Suchard (2009) notes that Australian companies have board structures that are like the US and UK, but market activity is comparable to countries with a longer-term stakeholder orientation (Pham et al., 2011). Interestingly, while Australia lacks the uniquely 'bank-based' communal systems of Japan and Germany or their two-tier board structures, strong societal safeguards exist for workers because of state-regulated public pension funds (Mees & Smith, 2019). Also, a weak market for corporate control combined with fewer transient institutional investors (mutual funds) all place limits on shareholder activism (La Porta et al., 2000). Thus, scholars note the potential for incurring agency costs for external minority shareholders is higher for IPO companies in Australia due to the insiders 'private benefits of control' (Fleming et al., 2005; Henry, 2010).

When a company lists its IPO agency problems are amplified due to a separation between the CEO, his/her TMT, and the outside directors who represent the new shareholders (Walter et al., 2015).

We draw on the institutional differences between Australian and US corporate governance to investigate whether AT regulations and shareholder pressures that result in TMT and inside director turnover truly benefit post-IPO financial performance (Migliani et al., 2015). Despite stark differences, Australian corporate governance often takes the US context as normative, adopting similar regulations without appreciating Australia's unique context (Henry, 2010). The Australia Stock Exchange Act (ASX) of 2003 and recent amendments to the Act are mirrored after the Sarbanes-Oxley-Act (SOX) of 2002 promulgated in the US (ASX Corporate Governance Council, 2003, 2007; Christensen et al., 2015). Principle 1 of the most recent revision asks firms to 'lay solid foundations for management and oversight' (ASX Corporate Governance Council, 2019). The TMT is responsible for implementing the overall strategy of the company, whereas the board ensures the TMT upholds its fiduciary responsibility to the company's stakeholders. Principle 2 of the ASX Corporate Governance Council (2019) strongly recommends composing the board with a majority of independent outside directors, which includes an independent Chair who is not the CEO. The ASX Corporate Governance Council (2019) does not provide detailed rules for TMT composition, but venture capitalists and shareholders can pressure to replace the original TMT members with more experienced executives to effectively abate the 'liability of newness'.

Neither AT nor recently promulgated ASX legislation, ever endorses removing all the insiders from the boardroom or the TMT (Dalton et al., 2007). In fact, the ASX adopts a 'comply or explain' approach, which, unlike the US, does not obligate Australian firms to follow 'best practices' regarding board independence (ASX Corporate Governance Council, 2014, 2019). This extra flexibility provides young IPO companies with the discretion to retain more inside directors to 'independent' outsiders than comparable US IPO companies (Kang et al., 2007; Kiel & Nicholson, 2003; Pham et al., 2011). Therefore, insiders in Australia enjoy 'private benefits of control' because of more amenable listing requirements, strong block-holders, the weaker market for corporate control, etc. (Dignam & Galanis, 2004; Setia-Atmaja et al., 2009; Monem, 2013).

2.2. RBV theory and stakeholder bargaining

RBV proposes that competitive advantage results from the most casually ambiguous, thinly traded, firm-specific investments of an organization's insiders (Barney, 1991). When insiders lack the ability to appropriate a fair return on their co-specialized investments, they may *underinvest* in acquiring or deploying their tacit entrepreneurial knowledge to enhance future competitive advantage (Wang & Barney, 2006). Thus, we need to ensure a young Australian IPO firm's initial insiders can appropriate their firm-specific resources; otherwise, they may lack the intrinsic motivation to lead the complicated post-IPO firm (Barney, 2018). However, because the insiders' firm-specific resources are casually ambiguous and non-replicable, this generates acute information asymmetries between the outside principals that also resonate with AT (Arthurs et al., 2009).

According to AT the insiders of a young IPO firm are self-interested and take decisions at the expense of the outsiders (Dalton et al., 2007). Therefore, the acquisition and deployment of different firm-specific investments by retaining brand-new TMT members and outside directors may help abate IPO-related agency costs and improve post-IPO financial performance (Mahoney & Kor, 2015). To date, research on Australian IPO companies fails to demonstrate whether the private benefits insiders provide for rent generation through their tacit knowledge will overshadow the potential agency costs that may result from their 'insider entrenchment' (Christensen et al., 2010; Kang et al., 2007).

According to RBV, value creation, and appropriation are required to achieve superior post-IPO financial performance, but achieving a balance is difficult due to the competing claims of the multiple stakeholders (Barney, 2018; Hoskisson et al., 2018). When the insider has a superior bargaining position versus the other stakeholders (outsiders) within the 'nexus of contracts', it may result in rent extraction and a 'mutual hold up' problem (Coff, 1999, 2010). For instance, insiders can sometimes use their privileged knowledge to manipulate stock prices and engage in share-buybacks, primarily enriching the insiders and their short-term shareholders at the expense of the other stakeholders (Ahuja et al., 2005; Lazonick, 2014). RBV underscores the value of honoring the implicit claims of the outside stakeholders, such as the taxpayers, middle-managers, customers, employees, etc. who likewise make irreversible investments into the success of a company (Amis et al., 2020). Thus, RBV emphasizes the importance of developing effective monitoring mechanisms to ensure the entrenched insiders of a young company do not appropriate co-created quasi-rents only for themselves (He & Wang, 2009; Qian et al., 2017).

In our context, the insiders of a new venture are intimately involved with formulating and implementing the original entrepreneurial strategy and vision of their company before its IPO (Garg & Furr, 2017; Kor, 2003). Insiders possess key insights that help abate the information asymmetries between the TMT and outside directors regarding strategies that perpetuate agency conflicts in firms (Garg, 2013, 2020; Wasserman, 2006). RBV emphasizes a 'Penrose effect' where ventures are constrained in their ability to grow if they only rely on the insider's co-specialized investments (Kor & Mahoney, 2005). Thus, because going public is a new stage in a firm's life cycle it requires hiring new TMT members and directors with experience managing mature companies (Mahoney & Kor, 2015). Put clearly, former insiders are usually asked to leave their firm entirely, or if retained are significantly sidelined from executive decision-making after a young firm goes public. Still, we claim that newly listed Australian firms that retain the tacit experience, or co-specialized knowledge resources of *at least a few* of their firm's original insiders will experience improved post-IPO financial performance (Le et al., 2013, 2017). Against this backdrop, we elaborate on the reasons and mechanisms by which retaining a young Australian IPO firm's original insiders will enhance post-IPO financial performance.

3. HYPOTHESES

3.1. Original TMT members and post-IPO performance

According to AT, IPO companies in Australia should experience acute agency risks due to the TMT members' private benefits of control' that arise from Australia's more flexible corporate governance system (Fama & Jensen, 1983). In addition, investing in a young company in Australia is risky because the IPO market is not as liquid as Silicon Valley in the US, but the potential rewards can incentivize external investors to incur higher agency risks (Dimovski et al., 2011). While not a part of AT (ASX Corporate Governance Council, 2019) based regulations outside investors in Australia often push for the removal of the original founder TMT members (CEO, chief information officer (CIO), etc.) to enhance TMT dynamism (Shen & Cannella, 2002). Therefore, a new TMT with actual experience managing mature companies can substitute for the costlier and intense board monitoring required by AT regulations (Certo et al., 2007).

Yet, leaning on RBV we submit that only the original TMT members possess the irreplaceable and non-substitutable entrepreneurial resources that are required for sustained competitive advantage (Zahra & Filatotchev, 2004). First, the original TMT members are involved with the company from day one and are intimately knowledgeable about the initial entrepreneurial vision, business plan, and product (Le et al., 2017). As a young public company listed on the ASX the new TMT transitions to meeting the short-term expectations of the immediate shareholders, and this may deflect from the original customer focus and value proposition (Kang et al., 2007). Thus, we posit that retaining a few of the original TMT members will help 'imprint' the initial start-up culture on the new TMT (Nelson, 2003; Arthurs et al., 2008).

Also, AT recommends bonding the TMT's motives with the long-term interests of the shareholders through TMT's financial ownership (Dalton et al., 2007). Likewise, Australian corporate governance proposes using TMT equity rewards when a young company lists its IPO (Christensen et al., 2015). In contrast, we contend that there is really no substitute for the psychological ownership the insiders bring to a young public company (Beatty & Zajac, 1994). Pre-IPO TMT members are traditionally intrinsically motivated stewards who are concerned with realizing their entrepreneurial vision at all costs (Wasserman, 2006). While the IPO does financially enrich the original insiders, the intrinsic passion of seeing your new venture reach scale remains inimitable by the newly appointed TMT members (Amabile & Pratt, 2016). In effect, the enthusiasm the pre-IPO insiders bring to the new TMT can help motivate the other executives not to jeopardize the long-term success of their company (He & Wang, 2009).

Accordingly, we predict that young IPO companies in Australia that disregard shareholders' pressures to replace their pre-IPO TMT members will experience better post-IPO financial performance. In brief, while we see no problem with hiring more seasoned top managers to abate the 'liability

of newness', we project that the presence of a few of the original TMT members may benefit post-IPO financial performance. This leads to the following:

H1: Ceteris paribus, a positive relationship exists between the presence of original TMT members and post-IPO financial performance.

3.2. Original venture board directors and post-IPO performance

Most young firms have corporate boards even before their IPO, but three key differences exist between a venture (pre-IPO board) and a newly listed public (post-IPO company) board that is relevant to our study (Garg & Furr, 2017). First, venture boards lack formal board structures and committees that are usually recommended by AT in Australia as a 'best practice' for public boards (Garg, 2020). The insiders of a venture board meet frequently with the outside directors and informally guide the board about long-term entrepreneurial strategy (Arthurs & Busenitz, 2003). Information asymmetries between the insiders and outside directors are further alleviated pre-IPO because the outside directors are venture capitalists or founders with tacit knowledge regarding their specific industry (Suchard, 2009). Two, the CEO and TMT's (insiders) motives are often better aligned with the company than the outside directors who may be motivated to exit after an IPO or mergers and acquisitions (M&A) (Gerasymenko & Arthurs, 2014). The principal-agency roles are therefore often reversed on a venture board because the insiders monitor the risk-averse outside venture directors from leaving after the IPO (Garg & Eisenhardt, 2017). Three, a venture board usually has a customer and innovation focus, whereas, unlike a public company, board meetings seldom revolve around maximizing quarterly earnings targets for short-term shareholders (Faleye et al., 2011). In sum, the insiders of a venture board play a key monitoring and resource provision (guidance) role in corporate governance for a young pre-IPO firm (Garg, 2013).

According to AT, when Australian firms list their IPO on the Australian Stock Exchange agency problems are amplified due to a separation between the original insiders and the new outside directors who represent the dispersed shareholders (Walter et al., 2015). In this way, following the ASX Corporate Governance Council guidelines (2003; 2014; 2019) investors in Australia can push to remove a venture board's inside directors with a supermajority of 'independent' outside directors (Certo et al., 2007, 2009). Thus, after a young firm goes public the monitoring role of the outside directors overshadows the resource provision role of the original venture board's inside directors (Fama & Jensen, 1983; Dalton et al., 2007).

By contrast, we claim that the resource provision and monitoring responsibilities of the pre-IPO venture board members (inside directors) will continue to be important post-IPO (Shaikh et al., 2018). Drawing on RBV, we assert that the push by Australian regulators for more board independence may have negative consequences for young, newly listed public companies (Shekhar & Stapledon, 2007). RBV highlights the benefits of relying on the board of directors to mediate major disputes that arise

when multiple agents have competing claims over a firm's co-specialized resources (Hoskisson et al., 2018; Klein et al., 2019). As a young firm grows new stakeholders invest their firm-specific resources into a growing venture that inevitably augments agency conflicts (Arthurs et al., 2009). Therefore, according to RBV, the board helps ensure no one party appropriates co-created quasi-rents for their own self-interest (Amis et al., 2020; Coff, 2010). On the surface, this aligns with AT's call for more intense board monitoring to limit the opportunism of insiders, who can use their tacit knowledge of internal affairs to appropriate co-created rents at the expense of the outside shareholders (Ahuja et al., 2005).

Yet, strong public-pension funds combined with Australia's less shareholder-centric corporate culture ensures relational controls that reinforce trust may be a more effective means of monitoring a firm's insiders even after an IPO (He & Wang, 2006; Walter et al., 2010). For instance, excessive monitoring by new outside directors can crowd out the intrinsic motivation of a firm's original insiders (Faleye, et al., 2011; Garg, 2013). In fact, we project that the negative influence of retaining too many outside directors may be even more acute in the context of Australia (Collett & Hraskey, 2005). Interestingly, directors in Australia can be held legally liable for a breach of fiduciary duty because unlike the US 'poison pills', dual-shares, and other mechanisms to entrench the inside directors are typically illegal (du Plessis & Meaney, 2012). Accordingly, we claim that the 'independent' outside directors may push the inside directors of a new public board to become risk-averse to deploying their firm-specific resources (Kor, 2003; Coles et al., 2008).

Specifically, based on RBV, we claim that the inside directors have both a resource provision (guidance) and monitoring role that remains non-replicable by the newly appointed post-IPO directors (Coles et al., 2008). First, the tacit knowledge acquired from being with the company from its origins helps abate the information asymmetries for the dispersed outside directors (Nelson, 2003). For instance, no amount of outsider experience, even in the same industry, can truly substitute for the strategic advice provided by an insider who has been with the company from its genesis (Baysinger et al., 1991; Kor, 2003). In effect, the detached outsiders of a public company board rely on the inside directors for guidance when signing off on major strategic decisions (Joseph et al., 2014). Also, inside directors are typically the first person to succeed a CEO because they have significant board capital already invested in their company (Mobbs, 2013). Thus, inside directors could be even more strongly motivated to monitor a CEO who tries to appropriate quasi-rents, over the detached outside directors who meet infrequently with the CEO (Shaikh et al., 2018). In short, outside directors face a steep learning curve that makes it difficult for them to fulfill their fiduciary responsibilities without the inside directors on the board (Faleye, 2017; Zorn et al., 2017).

Consequently, we predict that the presence of some of the original inside directors on the board of a young public company in Australia may be

associated with a positive post-IPO financial performance. This results in the following:

H2: Ceteris paribus, a positive relationship exists between the presence of original board members and post-IPO financial performance.

3.3. The moderating role of CEO-Chair duality

Australian scholars were some of the first to document how *CEO-Chair duality* can insulate a board from institutional pressures that may result in shareholders selfishly appropriating the bulk of co-created stakeholder rents (Muth & Donaldson, 1998). To date, their advice has been neglected within the Australian setting because most public companies follow AT regulations (ASX Corporate Governance Council, 2014, 2019) that strongly recommend separating the CEO-Chair roles (Christensen et al., 2015). Admittedly, although financial markets in Australia are less frenzied than in the US, institutional shareholder pressures can still incent the TMT and board (insiders) towards maximizing immediate shareholder returns (Kang et al., 2007; Pham et al., 2011). Therefore, even when insiders have 'private benefits of control' short-term investors can misappropriate shared value (Coff, 1999, 2010). RBV highlights how *explicitly* providing residual control to one party, in our case the insiders who possess the most thinly traded knowledge assets, permits the TMT and board to effectively mediate major resource disputes (Barney, 2018; Amis et al., 2020).

Specifically, *CEO-Chair duality* can provide the 'unity of command' at the top that empowers the insiders to take critical decisions that may require going against the short-term shareholders (Krause & Semadeni, 2014). It is easier to trust the fiduciary judgment of the original TMT members when there is a powerful CEO-Chair because a supportive CEO is willing to tolerate honest failures and is more prone to harness the co-specialized resources of less experienced pre-IPO insiders (Manso, 2017). Likewise, it may become difficult to override the strategic preferences of the CEO when he/she is also the Chair of the board (Tuggle et al., 2010). For example, because research and development (R&D) is usually considered a short-term expense by the outside directors an original inside director stands a better chance of convincing outside directors to focus on long-term strategic investments when they are accompanied by a powerful CEO-Chair committed to long-term value (Nelson, 2003; Kor, 2006). Therefore, combining both CEO-Chair roles in Australia may augment the positive relationship we predict exists between a young firm's insiders and post-IPO financial performance. This discussion results in the following interaction effects:

H3a: Ceteris paribus, CEO-Chair duality will strengthen the positive relationship that exists between the presence of original TMT members and post-IPO financial performance.

H3b: Ceteris paribus, CEO-Chair duality will strengthen the positive relationship that exists between the presence of original board members and post-IPO financial performance.

4. EMPIRICAL STRATEGY

4.1. Sample and data

Based on previous studies we considered young IPO firms as those that were less than 10 years of age at the time of IPO, and independently operated (i.e., firms that are not spin-offs or subsidiaries of other firms) (Eisenhardt & Schoonhoven, 1990; Daily & Dalton, 1995; Kroll et al., 2007; Walters et al., 2010, 2015). A firm is considered young if it is founded within the previous 10-year period. Thus, to ensure that all firms were still in their young entrepreneurial stage, IPO firms founded from 1991 onwards only are included in this study. The sample for this study consisted of firms that went public in 2001. Data on these firms is for the period of 2001–2007. A 5-year window for IPO studies is a common practice in the corporate governance literature (Moore et al., 2012); therefore, this six-year window should provide sufficient time to see changes in original insider turnover on firm performance following the IPO. While most of the change in insider turnover does occur in the first few years post-IPO (Figure 1), it can take a few years for these changes to influence a firm's financial performance (Figures 2 & 3).

The sample for this study consists of firms that went public in 2001 and were in operation at least until 2007. We focus on this time frame mainly for three reasons: a) to avoid the 'dot com' related wave of IPO activities during late 1999 and 2000; b) to avoid the impact of the global financial crisis (GFC) of 2008–09; and c) to focus on the enactment of AT-based corporate governance regulations in Australia in the early 2000s². Thus, self-selection issues are less likely to be present because the "dot-com bubble" and the "GFC" occurred during the sample period (2001–2007). Underwriters became very discriminating investors, and it became relatively difficult to bring an IPO to market because the earlier IPOs of various 'dot-coms' failed during this difficult period. Thus, given the skepticism surrounding IPOs during the sample time frame, and the fact that these IPOs survived the vetting process and were able to successfully go to market, we feel ensures that they were solid businesses at launch.

IPO prospectuses were obtained from the Osiris database. IPO prospectus information contains information on board and TMT characteristics (age, CEO duality, outside directors, insiders), and ownership data were collected manually through annual reports published in Osiris and cross-checked with the Aspect Financial Analysis and the Morningstar Data Analysis databases. Financial data to compute return on assets (*ROA*), *Tobin's Q*, *annual stock returns*, and measures of firm risk are obtained from the Datastream database. Financial sector companies, real estate funds, and energy companies were eliminated as the legal and regulatory requirements for these firms are significantly different from most new ventures. Also, firms that are delisted, acquired, or merged within

the sample period, and firms with less than 2 years of consecutive financial data are excluded. Using this rigorous criterion our initial sample had 48 IPO firms, but we also exclude 8 firms for which we could not find the relevant prospectus. By only including companies that are in the entrepreneurial stage of development we ensure firms that have been delisted or acquired by another company within the six-year period do not bias our findings. These restrictions result in a final sample of 40 companies, equivalent to 240 firm-year observations³.

4.2. Variable description

In this section, we discuss how we measure the variables and the corresponding data sources.

4.2.1. Dependent variables

We use *ROA*, an accounting-based measure of a firm financial performance because prior research documents market to book ratios are often susceptible to investor expectations (Bhagat & Bolton, 2008). If investors anticipate the effect of insider turnover on post-IPO financial performance, long-term stock returns will not be significantly correlated with corporate governance. However, abnormal operating performance associated with *ROA* is largely exogenous with respect to subsequent corporate governance changes (Hermalin & Weisbach, 2003)⁴. Also, accounting-based measures are considered more reliable for IPO-based studies (Jain & Kini, 1994). *ROA*, obtained by the ratio of earnings before interest, taxes, depreciation, and amortization (EBITDA) on the book value of assets is an accounting-based measure of financial performance used in prior research (Coles et al., 2008). We focus on EBITDA, rather than net income, as EBITDA is a good way to compare companies within and across industries. We also use two alternative market-based financial performance measures: *annual stock returns* and *Tobin's Q*. *Annual stock returns* is computed as a percentage change in stock price for a given year and *Tobin's Q* is measured as the book value of assets minus book equity plus the market value of equity all divided by the book value of total assets (Adams & Ferreira, 2009).

4.2.2. Explanatory variables

We describe the three primary explanatory variables that we use to test our extension of RBV. Specifically, we use two different measures to proxy for original insider turnover post-IPO. First, to test *H1* we create the variable *original TMT members* which are calculated as the number of pre-IPO TMT members divided by the current number of TMT members. In line with the existing literature, the TMT members are the key executive decision

² For example, the Australian Securities and Investments Commission Act, and the Corporations Act were enacted in 2001; the ASX Corporate Governance Council was established in 2002 to develop and deliver an industry-wide framework for corporate governance (ASX Corporate Governance Council, 2003).

³ IPO firms in the sectors of communication services, consumer discretionary, consumer staples, health care, industrials, information technology, and materials are examined. Our industry classification is based on the Global Industry Classification Standard (GICS standard) which is an enhanced industry classification system jointly developed by Standard & Poor's and Morgan Stanley Capital International (MSCI) in 1991 to meet the needs of the investment community for a classification system that reflects a company's financial performance and financial analysis (Standard and Poor's, 2002).

⁴ See Wintoki et al. (2012) for more on endogeneity problems in corporate governance research.

makers at the helm of power, such as the CEO, chief operating officer (COO), chief financial officer (CFO), chief technology officer (CTO), etc. (Nelson, 2003; Cohen & Dean, 2005; Kor, 2006). The TMT membership data was hand collected from each company's annual reports. To test *H2* we create the variable *original board members* by hand collecting data from the prospectus and proxy statements of our sample of companies. Our measure of the change in board membership is calculated as the number of original inside directors divided by the current number of directors. It should be noted that our measure of original inside directors slightly differs from the extant literature (Joseph et al., 2014; Zorn et al., 2017). Here, original directors who may also have been outsiders on the pre-IPO venture board are considered inside directors because of their previous proximity to the company's original founders and entrepreneurial strategy. Consistent with changes in TMT composition, changes in board compositions are collected for the IPO date and the six years following the IPO date. Lastly, to test *H3a* and *H3b*, we create the variable *CEO-Chair duality*, which is a dummy variable that equals one if the chairman of the board is the CEO of a firm, and zero otherwise (Braun & Sharma, 2007). We then interact *CEO-Chair duality* with the *original TMT members* and *original board members* variables (Krause et al., 2014).

4.2.3. Control variables

Our analysis includes several control variables that potentially affect firm performance. With reference to the board and TMT, or governance characteristics,

we include the following control variables: *TMT size*, *board size*, *director age*, and *non-executive directors*. In line with the existing literature, the number of TMT members and the number of total directors is used to account for the possible influence of *TMT size* and *board size* on post-IPO financial performance (Coles et al., 2008; Walters et al., 2010). Previous research provides evidence that demographic variables such as *director age* impact financial performance (Higgins & Gulati, 2006). We control for *director age* because a seasoned director brings more experience and external connections onto the board (Kor & Misangyi, 2008). Lastly, we control for *non-executive directors* who are the 'independent' directors that are brought onto the board after the company does its IPO (Kor, 2006).

With reference to firm characteristics, we include the following variables: *firm size*, *dividend payout ratio*, *leverage*, and *firm risk*. Research suggests that *firm size* may be related to firm performance (Haniffa & Hudaib, 2006); thus, we employ the natural log of total assets to control for *firm size* (Bhagat & Bolton, 2008; Adams & Ferreira, 2009). The *dividend payout ratio* controls the cash payouts to shareholders that are often used by the TMT and board to signal the success of a young company (La Porta et al., 2000). We control for *leverage* because a firm's capital structure acts to discipline managerial discretion and serves as another internal governance device (O'Brien & Folta, 2009). Also, we account for *firm risk* calculated as the standard deviation of monthly stock returns. We include year dummies in all regressions. Table 1 presents the sources and definitions of all variables.

Table 1. Variables, definitions, and data sources.

Variables	Definition	Years available	Sample size	Data source
Panel A: Financial performance variables				
Firm performance	Return on assets (ROA) = Earnings before interest, taxes, depreciation, and amortization / Total assets	2002-2007	240	Datastream
	Annual stock return (R) = Annual percentage change in stock price = $(P_t - P_{t-1}) / P_{t-1}$	2002-2007	240	Datastream
	Tobin's Q = Total assets + market value of equity - book value of equity / Total assets	2002-2007	240	Datastream
Panel B: Governance characteristics				
Original TMT members	Proportion of original TMT members t = number of original TMT at time t / number of TMT at time t	2002-2007	240	Annual reports
Original board members	Proportion of original board members at time t = number of original directors at time t / number of directors at time t	2002-2007	240	Annual reports
Non-executive directors	The percentage of non-executive directors on the board	2002-2007	240	Annual reports
CEO-Chair duality	A dummy variable that equals one if the chairman of the board is also the CEO of a firm and zeroes otherwise	2002-2007	240	Annual reports
TMT size	Top management team members are those included in the top executives' list of the corporate structures as reported on the corresponding documents	2002-2007	240	Annual reports
Board size	The number of executive and non-executive directors on the board	2002-2007	240	Annual reports
Director age	Average age of board members	2002-2007	154	Annual reports
Panel C: Firm characteristics				
Firm size	Natural log of total assets	2002-2007	240	Datastream
Dividend payout ratio	The annual dividends per share divided by the earnings per share	2002-2007	240	Datastream
Leverage	Total liabilities over total assets	2002-2007	240	Datastream
Firm risk	Standard deviation of previous 12-month stock returns.	2002-2007	235	Datastream
Year dummies	We include year dummies			

4.3. Methodology

We specify the following model to examine the potential impact of the change in insider turnover on post-IPO firm performance:

$$\text{Firm Performance}_{i,t} = \alpha_0 + \sum_j \beta_j \text{governance variables}_{i,j,t} + \sum_k \gamma_k \text{controls}_{i,k,t} + \varepsilon_{i,t} \quad (1)$$

where, $\text{Firm Performance}_{i,t}$ is either return on assets ($\text{ROA}_{i,t}$), Tobin's Q , or *annual stock returns* for the company i , at time t ; the β_j parameters capture the potential impacts of the change in governance variables ($j = 1, \dots, J$) such as *original TMT* and *original board members* on firm performance; $\text{controls}_{i,t}$ comprise of *non-executive directors ratio*, *CEO-Chair duality*, *TMT size*, *board size*, *firm size*, *director age*, *dividend payout ratio*, *leverage*, *firm risk* and $\varepsilon_{i,t}$ are error terms. We examine the relationship between performance and insider turnover using ordinary least squares (OLS), but OLS results can be biased because they ignore the panel structure of the data (Gujarati & Porter, 2009). We address this issue by controlling for unobserved firm heterogeneity, or omitted variable bias, and employ the panel regression techniques with a random-effects regression model (King & Santor, 2008). Fixed effects are less appropriate in our case because most of the sample variation arises in the cross-section instead of the time series. In the random effects model, the variation across entities is assumed to be random and uncorrelated with the independent variables included in the model (Wooldridge, 2012). A Hausman test confirms that a random effects model is better than the fixed effects model in dealing with the data. We address the possibility of bias in the standard errors by using clustered standard errors to account for residual dependence of the firm effects (Petersen, 2009). Due to the small sample size, we do not have enough observations to construct 2-way cluster standard errors to account for both time-series and cross-sectional dependences, therefore, we run OLS using the firm-

level clustered standard errors. Thus, we run all our estimations with the random effects model and capture time effects by including year dummies.

5. RESULTS

Table 2 presents the descriptive statistics for the variables used in this study. Panel A in the table shows significant differences exist in both accounting and market-based performance measures. The mean *ROA* is -0.43, and the median *ROA* is -0.17, implying that firms demonstrate a substantial negative performance. However, the market-based measures show mixed average performance. While the mean *annual stock returns* for the sample is 0.25, the median annual stock return is -0.01. Both mean and median values of *Tobin's Q* are greater than 1 for the sample firms which indicates that the stock market places a premium on young public companies (Kor, 2006; Coles et al., 2008). Panel B provides descriptive statistics for the governance variables. The average rate of change in *original TMT members* and *original board members* is 56% and 54% respectively. These results suggest that over 50% of the original insiders depart during the post-IPO stage. The average *TMT size* of Australian young firms is approximately 3, while Carpenter et al. (2003) report that the average *TMT size* for young firms in the US is 6 executives. Therefore, retaining a few more insiders at the top remains even more important for effective corporate governance in Australia than in the US. Similar to other jurisdictions, the average *board size* is 4, which is consistent with previous studies in Australia (Chancharat et al., 2012). Australia has a high proportion of outside directors (63%), while, the percentage of *non-executive directors* in the UK and US firms ranges between 50% and 67% (Xie et al., 2003; De Andres et al., 2005). On average, 26% of our sample of young firms have a board where the CEO-Chair is the same person. The mean *director age* of Australian IPO firms is 50. The mean *dividend payout ratio* and the mean *leverage* ratio are 16.47% and 39% respectively.

Table 2. Descriptive statistics

Variables	Mean	Median	Std. dev.	Min	Max	25th percentile	75th percentile
Panel A: Performance variables							
<i>Return on assets</i>	-0.43	-0.17	0.96	-4.78	0.68	-0.54	0.06
<i>Annual stock returns</i>	0.25	-0.01	1.20	-0.99	9.08	-0.32	43.70
<i>Tobin's Q</i>	4.51	2.42	6.26	0.23	35.79	1.56	4.74
Panel B: Governance characteristics							
<i>Original TMT members</i>	0.56	0.61	0.33	0.00	1.00	0.33	0.81
<i>Original board members</i>	0.54	0.50	0.25	0.03	1.00	0.38	0.74
<i>Non-executive directors</i>	0.63	0.67	0.12	0.43	0.86	0.55	0.72
<i>CEO-Chair duality</i>	0.26	0.00	0.36	0.00	1.00	0.00	0.50
<i>TMT size</i>	2.26	2.33	0.59	1.00	3.17	2.00	2.58
<i>Board size</i>	4.45	4.25	0.77	3.50	6.50	3.83	5.00
<i>Director age</i>	50.28	48.29	5.17	43.00	63.00	46.76	53.33
Panel C: Firm characteristics							
<i>Firm size (Ln assets)</i>	9.39	9.55	1.29	6.32	12.14	8.45	10.10
<i>Dividend payout ratio</i>	16.47	0.00	31.78	0.00	98.66	0.00	6.11
<i>Leverage</i>	0.39	0.24	0.52	0.02	3.08	0.12	0.49
<i>Firm risk</i>	0.18	0.18	0.08	0.04	0.41	0.12	0.22

Note: Std. dev., Min, and Max refer to standard deviation, minimum, and maximum respectively.

Figure 1. Change in insider turnover during the post-IPO stage (%)

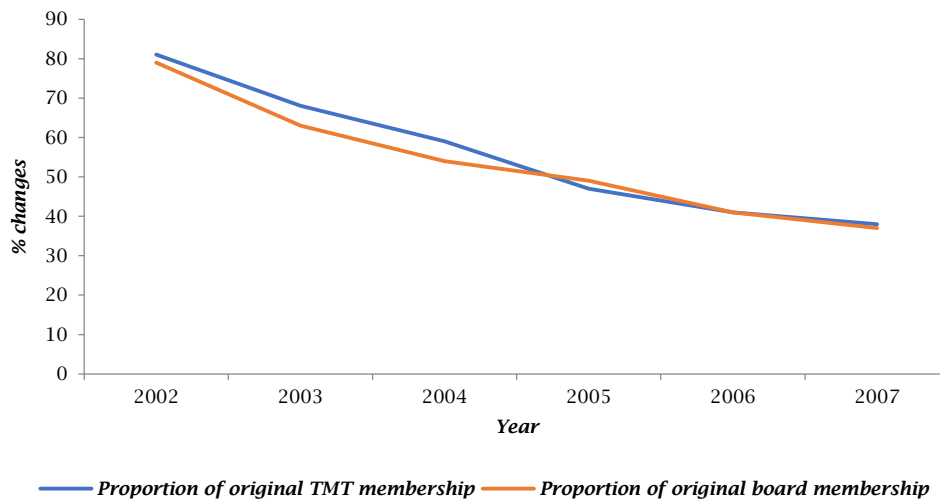


Table 3 presents the difference in original insider turnover over time for our sample of young public firms. The mean of the change in *original TMT members* has decreased from 81% to 38% and the mean of the change in *original board members* has decreased from 79% to 37%. *Non-executive directors'* ratio (outside directors) has increased from 60% to 66%, and *CEO-Chair duality* has decreased from 28% to 20%. This trend reflects the introduction and gradual adoption of the Australian Stock Exchange's corporate governance

principles, which advocate board independence by replacing a firm's pre-IPO insiders (ASX Corporate Governance Council, 2003, 2014). Overall, the evidence suggests that once investors become interested in these companies, some of these investors will acquire block-holder ownership status that gives them the power to replace the insiders (Dignam & Galanis, 2004). Thus, following an IPO, companies can expect to see changes in their TMT structure and board compositions due to the push to comply with agency-theory regulations.

Table 3. Descriptive statistics for selected variables in 2002 and in 2007

Variables	2002					2007				
	Mean	Med.	Std. dev.	Min	Max	Mean	Med.	Std. dev.	Min	Max
Governance characteristics										
<i>Original TMT members</i>	0.81	1.00	0.31	0.00	1.00	0.38	0.33	0.41	0.00	1.00
<i>Original board members</i>	0.79	0.82	0.23	0.17	1.00	0.37	0.40	0.30	0.00	1.00
<i>TMT size</i>	2.43	2.00	0.78	1.00	4.00	2.20	2.00	0.72	1.00	4.00
<i>Board size</i>	4.60	4.00	1.17	3.00	8.00	4.53	4.50	1.15	3.00	8.00
<i>Non-executive directors</i>	0.60	0.60	0.19	0.25	1.00	0.66	0.67	0.13	0.40	1.00
<i>CEO-Chair duality</i>	0.28	0.00	0.45	0.00	1.00	0.20	0.00	0.41	0.00	1.00
<i>Director age</i>	47.96	47.50	6.35	38.00	61.25	52.68	51.17	5.31	44.67	64.30

Note: Med, Std. dev., Min, and Max refer to the median, standard deviation, minimum, and maximum respectively.

Figure 1 shows the time trend of change in insider turnover from 2002-2007. This figure illustrates a downward trend in the average percentage of change in both the *original TMT* and *original board members* over 2002-2007. This evidence suggests that following an IPO, young public companies in Australia experience a significant turnover in their entrepreneurial TMT members and original new venture inside directors that is attributable to external shareholders pushing for pre-IPO insider turnover (Kang et al., 2007; Christensen et al., 2010; Garg, 2020)⁵. Table 4

presents the results from panel random effect regressions where the dependent variable is ROA. Columns 1-3 test our *H1* and present estimates from the regressions of ROA on changes in the *original TMT members*, as well as the control variables. In *H1* we predicted that replacing the *original TMT members* during IPO will hurt post-IPO financial performance. We find support for *H1* that retaining some *original TMT members* has a significantly positive relationship with ROA across columns 1-3, for at least six years. Therefore, for a young public company in Australia, this indicates that retaining the prior TMT members has a positive influence on the firm financial performance well into the future.

⁵ Figure 1 documents that the proportion of insiders in our sample fell over time, but this may be influenced by more outsiders being added to the TMT or board in the denominator. Therefore, our results from Figure 1 must be interpreted in conjunction with our findings from Table 3. Table 3 shows the average *TMT size* and *board size* have been relatively stable from 2002, to 2007. By contrast, following an IPO in 2002 the number of *original TMT members* and *original board members* decreases substantially from 2002 to 2007. Thus, we can confidently conclude that the use of ratio measures to proxy for the different types of insiders is accurate and will not lead to unstable or biased findings. We thank an anonymous reviewer for pointing this out.

Table 4. Regression results — ROA as a dependent variable

Explanatory variables	Dependent variable = ROA							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Original TMT members	0.570*	0.398**	0.220*	0.106				
	(0.320)	(0.172)	(0.140)	(0.157)				
Original TMT members × CEO-Chair duality				0.577**				
				(0.251)				
Original board members					0.256	0.449*	0.368*	0.361*
					(0.263)	(0.260)	(0.204)	(0.219)
Original board members × CEO-Chair duality								0.0356
								(0.407)
Non-executive directors	0.251	-0.604	-0.332	-0.388	0.085	-0.557	-0.255	-0.256
	(0.592)	(0.489)	(0.425)	(0.414)	(0.571)	(0.449)	(0.430)	(0.426)
CEO-Chair duality	-0.0443	0.256**	0.484***	0.148	-0.023	0.278	0.511***	0.483
	(0.185)	(0.111)	(0.152)	(0.139)	(0.183)	(0.186)	(0.149)	(0.307)
TMT size	0.257	0.010	0.032	0.023	0.217	0.002	0.043	0.0424
	(0.158)	(0.129)	(0.104)	(0.104)	(0.158)	(0.120)	(0.112)	(0.111)
Board size	0.190**	0.083	-0.013	0.006	0.177*	0.044	-0.053	-0.052
	(0.0884)	(0.059)	(0.045)	(0.049)	(0.093)	(0.067)	(0.050)	(0.048)
Director age		-0.002	-0.021*	-0.027**		0.004	-0.019*	-0.019*
		(0.013)	(0.011)	(0.013)		(0.013)	(0.011)	(0.011)
Firm size (Ln assets)			0.281***	0.288***			0.283***	0.283***
			(0.058)	(0.056)			(0.058)	(0.058)
Dividend payout ratio			0.002	0.002			0.001	0.001
			(0.001)	(0.001)			(0.001)	(0.001)
Leverage			-0.340	-0.361			-0.331	-0.336
			(0.295)	(0.294)			(0.277)	(0.276)
Firm risk			0.307	0.243			0.141	0.135
			(0.534)	(0.496)			(0.578)	(0.513)
Year dummies	no	yes	yes	yes	no	yes	yes	yes
Cons	-2.320**	-0.751	-2.135***	-1.829**	-1.893*	-0.915	-2.261***	-2.240***
	(1.140)	(0.860)	(0.777)	(0.795)	(1.004)	(0.758)	(0.748)	(0.758)
N	240	154	150	150	240	154	150	150
R-squared	0.12	0.11	0.39	0.39	0.10	0.11	0.39	0.39

Note: This table presents the results from panel regression-random effects between firm performance (ROA) and governance variables. See Table 1 for variable definitions. Robust standard errors are displayed in parentheses below the coefficients. The asterisks *, **, and *** indicate the significance at the 10%, 5%, and 1% levels, respectively.

Table 4, columns 5, 6, and 7 test *H2* and present estimates from the regressions of ROA on changes in *original board members*, as well as the control variables. We follow the same piecemeal approach and gradually enter the control variables to determine if they are driving our results. *H2* predicts a positive relationship between the proportion of *original board members* and ROA over the post-IPO period. The change in *original board members* shows a positive and statistically significant relationship with ROA in columns 6 and 7. Thus, these results provide support for *H2*.

Table 4, columns 4, and 8 reports the interaction terms we use to test *H3a* and *H3b*. *Original TMT members* × *CEO-Chair duality* and *original board members* × *CEO-Chair duality*, respectively. We predicted a positive relationship in front of both interaction terms. We find *CEO-Chair duality* does in fact further strengthen the relationship between the original TMT and post-IPO financial performance, but in column 8, the estimate is not significant at the conventional levels. Therefore, based on these findings we only find support for *H3a*.

Table 5. Regression results — annual stock returns as a dependent variable

Explanatory variables	Dependent variable = Annual stock returns							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Original TMT members	0.350*	0.293*	0.364	0.455*				
	(0.184)	(0.181)	(0.262)	(0.314)				
Original TMT members × CEO-Chair duality				0.411				
				(0.625)				
Original board members					0.330	0.742**	0.560*	0.802*
					(0.236)	(0.324)	(0.350)	(0.435)
Original board members × CEO-Chair duality								1.354*
								(0.778)
Non-executive directors	0.854	0.764	0.823	0.829	0.593	1.033	1.147	1.222
	(0.692)	(0.623)	(1.204)	(1.209)	(0.600)	(0.673)	(0.789)	(0.803)
CEO-Chair duality	0.220	0.248	-0.138	0.045	0.280	0.336	0.239	0.979*
	(0.296)	(0.180)	(0.262)	(0.311)	(0.179)	(0.224)	(0.264)	(0.577)
TMT size	0.303*	0.169	0.245	0.252	0.132	0.239	0.230	0.287
	(0.162)	(0.150)	(0.193)	(0.195)	(0.136)	(0.174)	(0.199)	(0.213)
Board size	0.018	0.056	0.035	0.023	0.034	-0.032	-0.026	-0.046
	(0.070)	(0.065)	(0.106)	(0.109)	(0.062)	(0.077)	(0.089)	(0.091)
Director age		-0.001	0.013	0.018		0.003	0.006	0.009
		(0.011)	(0.034)	(0.035)		(0.009)	(0.010)	(0.011)
Firm size			0.173	0.178			0.034	0.028
			(0.103)	(0.106)			(0.072)	(0.069)
Dividend payout ratio			0.001	0.001			0.003**	0.003**
			(0.002)	(0.002)			(0.001)	(0.001)
Leverage			-0.372	-0.358			-0.552***	-0.619***
			(0.249)	(0.248)			(0.167)	(0.173)
Firm risk			1.730	1.778			1.085	1.812*
			(1.398)	(1.409)			(0.964)	(1.087)
Year dummies	no	yes	yes	yes	no	yes	yes	yes
Cons	-1.901**	-1.756*	-1.080	-1.325	-1.398*	-2.269**	-2.049	-2.646
	(0.725)	(0.940)	(1.634)	(1.607)	(0.725)	(1.008)	(1.523)	(1.677)
N	240	154	150	150	240	154	150	150
R-squared	0.11	0.13	0.18	0.18	0.11	0.17	0.22	0.25

Note: This table presents the results from panel regression-random effects between firm performance (annual stock returns) and governance variables. See Table 1 for variable definitions. Robust standard errors are displayed in parentheses below the coefficients. The asterisks *, **, and *** indicate the significance at the 10%, 5%, and 1% levels, respectively.

Table 6. Regression results — Tobin's Q as a dependent variable

Explanatory variables	Dependent variable = Tobin's Q							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Original TMT members	0.532***	0.155	0.157	0.123				
	(0.139)	(0.217)	(0.216)	(0.210)				
Original TMT members × CEO-Chair duality				0.964**				
				(0.379)				
Original board members					0.340**	0.400	0.368	0.481
					(0.140)	(0.297)	(0.375)	(0.293)
Original board members × CEO-Chair duality								0.799
								(0.704)
Non-executive directors	-0.035	-0.307	-0.065	-0.065	-0.064	-0.469	-0.027	0.074
	(0.426)	(0.416)	(0.436)	(0.359)	(0.425)	(0.442)	(0.320)	(0.302)
CEO-Chair duality	0.143	0.235	0.163	0.280	0.124	0.167	0.129	0.251
	(0.288)	(0.266)	(0.341)	(0.325)	(0.288)	(0.194)	(0.276)	(0.519)
TMT size	0.156	0.057	0.020	0.024	0.121	0.018	0.013	0.018
	(0.105)	(0.100)	(0.105)	(0.089)	(0.112)	(0.120)	(0.081)	(0.082)
Board size	0.001	0.007	0.048	0.015	0.005	0.002	0.022	0.022
	(0.068)	(0.058)	(0.073)	(0.053)	(0.070)	(0.063)	(0.068)	(0.061)
Director age		-0.007	-0.033**	-0.018		-0.013	0.005	-0.013
		(0.019)	(0.014)	(0.023)		(0.016)	(0.019)	(0.017)
Firm size (Ln assets)			0.151**	0.159***			0.146***	0.150***
			(0.061)	(0.057)			(0.054)	(0.048)
Dividend payout ratio			0.002	0.002			0.001	0.001
			(0.002)	(0.002)			(0.003)	(0.002)
Leverage			0.166	0.230			0.255	0.230
			(0.228)	(0.233)			(0.207)	(0.208)
Firm risk			0.847	0.814*			0.636	0.857
			(0.905)	(0.485)			(0.521)	(0.614)
Year dummies	no	yes	yes	yes	no	yes	yes	yes
Cons	1.544***	0.835	-0.065	0.761	1.338***	0.400	0.952	0.408
	(0.484)	(0.976)	(0.886)	(0.915)	(0.507)	(0.883)	(0.866)	(0.816)
N	238	152	148	148	238	152	148	148
R-squared	0.08	0.06	0.11	0.10	0.05	0.08	0.12	0.16

Note: This table presents the results from panel regression-random effects between firm performance (Tobin's Q) and governance variables. See Table 1 for variable definitions. Robust standard errors are displayed in parentheses below the coefficients. The asterisks *, **, and *** indicate the significance at the 10%, 5%, and 1% levels, respectively.

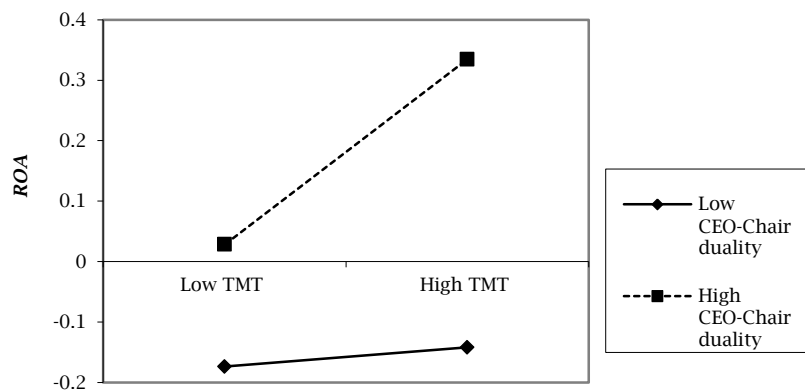
Table 5 employs a market-based measure, the stock returns as a dependent variable, and re-runs all our regressions with the same controls to see if our results continue to hold. As columns 1 and 2 of Table 5 reveal we find that the market values higher fractions of *original TMT members* after a firm's IPO. Also, columns 6 and 7 of Table 5 show the market values when firms continue to retain their *original board members* (inside directors) after an IPO. We find that investors also welcome more *non-executive directors* and *CEO-Chair duality* when the terms are entered individually. Likewise, the market values when a dual CEO-Chair role combines with more TMT members (column 4) and inside directors (column 8), but only the last is significant.

Table 6 uses the *Tobin's Q* as our dependent variable and then re-runs our regressions with all the preceding controls included as another market-based measure of firm performance. Table 6 shows that when we use the *Tobin's Q*, governance changes do not affect post IPO-financial performance. Unlike the results with *ROA* and *annual stock returns*, we only find support in column 1 and column 5 for the relationship between the presence of *original TMT members* and the *original board members* on the *Tobin's Q*. We do, however, find support for the interaction between *original TMT members* \times *CEO-Chair duality* in column 4. The lack of predictive power for the *Tobin's Q* is not surprising; in fact, Hermalin and Weisbach (1998) claim that this is exactly as the theory predicts. Accounting measures of firm performance reflect the decisions of current top managers, while stock market-based measures of performance reflect the expectations of future managers. We were already cautious about using the *Tobin's Q* because previous studies have found the *Tobin's Q* is more susceptible to biases arising from accounting

artifacts than *ROA* (Demsetz & Villalonga, 2001). This shows the market may not fully understand the future prospect of a young firm and may undervalue the role of the original insiders as they struggle to create a future strategy and vision for the company post-IPO (Kor & Misangyi, 2008).

Overall, our results support our *H1* and *H2*, that the *original TMT members* and directors play a significant role in Australian IPO companies. We find that the presence of these insiders does indeed have a significantly positive impact on post-IPO firm financial performance. The impact of retaining more insiders on newly listed young firms on financial performance is not only statistically significant but also economically impactful. Practically, an increase in the presence of *original TMT members* by 1% point is associated with an increase in *ROA* of roughly 0.22% points (column 3 of Table 4). Likewise, an increase in the presence of *original board members* by 1 percentage point increases *ROA* by approximately 0.37 percentage points (column 7 of Table 4). Finally, while we only find support for *H3a* in Table 4, the results suggest that *CEO-Chair duality* when combined with *original TMT members* strengthens the positive relationship between the *original TMT members* and *ROA*. To ease interpretation, we plot this interaction effect in Figure 2. Using the approach developed by Dawson (2014) we plot the terms ± 1 standard deviation from their respective mean values, and controls are constant. The mean value of *ROA* is -0.43 (Table 2), but *CEO-Chair duality* results in an economically impactful increase of *ROA* to 0.40. In fact, firms that separate both roles do still experience an increase in *ROA* when they have more *original TMT members*, but *ROA* remains in the negative range. Thus, *CEO-Chair duality* substantially increases the value of the *original TMT members* on *ROA*.

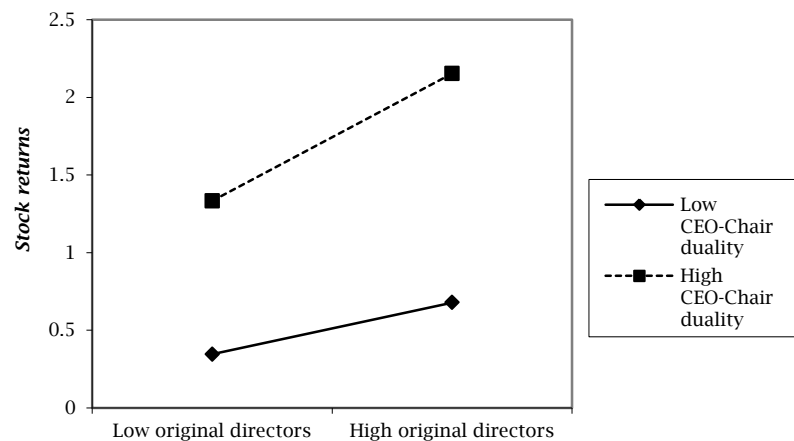
Figure 2. Interaction between the *original TMT members* and *CEO-Chair duality* on firm performance



Note: For all panels: This diagram plots the interaction between the *original TMT members* and *CEO-Chair duality* on *ROA* from column 4 of Table 4. Interaction effects are plotted at ± 1 standard deviations from their respective means, while all independent variables are held constant. Low *CEO-Chair duality* means a separate *CEO-Chair* role and high *CEO-Chair duality* denotes *CEO-Chair duality*.

Further, because we did not find statistical support between *original board members* \times *CEO-Chair duality* on *ROA* in Table 4, we use Table 5 to plot the interaction between *original board members* \times *CEO-Chair duality* on stock returns where we do find strong support. We follow the same methodology above from Dawson (2014) and plot the variables at \pm standard deviation from

their means, controls are held constant. Figure 3 shows that retaining more *original board members* (inside directors) and *CEO-Chair duality* significantly increases post-IPO stock market return. Practically, the mean of stock returns is 0.25 (Table 2), but when the original directors combine with a powerful *CEO-Chair* at the top it leads to an economically meaningful increase in market returns to 2.0.

Figure 3. Interaction between the *original board members* and *CEO-Chair duality* on firm performance

Note: For all panels: This diagram plots the interaction between the original directors and CEO-Chair duality on annual stock returns from column 4 of Table 5. Interaction effects are plotted at ± 1 standard deviations from their respective means, while all independent variables are held constant. Low CEO-Chair duality means a separate CEO-Chair role and high CEO-Chair duality denotes CEO-Chair duality.

We carried out several extra tests to ensure our findings hold up under empirical scrutiny which is provided in the Appendix A. In all, these additional tests provide extra support for our results presented above.

6. DISCUSSION AND CONCLUSION

Global convergence in corporate governance attempts to limit possible agency conflicts that arise from 'selfish' insiders who work against shareholders (Aguilera & Jackson, 2010). Yet, we argued that hastily relying on agency theory, even in a liberal market economy like Australia, may be inappropriate for new IPO companies (Le et al., 2017). We use the unique Australian IPO context to investigate whether the push to replace original TMT members and venture board directors is effective for young public companies (Christensen, et al., 2015). Drawing on RBV we theorize that because the original pre-IPO insiders have access to the most non-replicable, co-specialized resources IPO companies that retain at least a few of the original insiders after their IPO will experience sustained post-IPO financial performance (Garg & Furr, 2017). We find support for most of our predictions even after running several sensitivity tests and these findings contribute to RBV and managerial practice in the following ways.

6.1. Contributions to RBV theory

First, a central concern of RBV is how to protect the most co-specialized and non-replicable investments of a firm's insiders, or strategic leaders (Barney, 1991, 2018). Yet, because an insider's tacit knowledge amplifies information asymmetries it also perpetuates potential principal-agency conflicts (Dalton et al., 2007). As such, RBV emphasizes the importance of effective corporate governance to ensure the insiders do not appropriate quasi-rents at the expense of the remote outside stakeholders (Coff, 2010). Thus, Australian shareholders push to replace the entrepreneurial TMT members to ensure potential agency conflicts do not result in

diminished post-IPO performance (Kang et al., 2007). Conversely, we find that empowering the TMT by retaining at least a few of the earliest TMT members (*H1*) after the IPO is much more important than following the advice of shareholders to remove the original founders from the new TMT. This extends RBV, it is indeed true some TMT members of public firms in the US do use their casually ambiguous tacit knowledge to extract rents at the expense of the outsiders, such as through insider trading and share-buybacks (Ahuja et al., 2005; Lazonick, 2014). Our findings reveal this is not readily generalized to the young Australian company context. This result suggests that the 'insider entrenchment' of the initial TMT members rather than amplifying agency costs, substantially improves post-IPO financial performance. In short, the innovation focus and intrinsic passion of the insiders empower the new TMT members to make more informed strategic decisions.

Moreover, RBV recognizes the acute challenges that arise when different stakeholders have conflicting motivations and goals regarding rent appropriation (Barney, 2018; Amis et al., 2020). RBV highlights the value of providing ultimate residual control to a democratically elected board that can help mediate major stakeholder disputes over a firm's co-created resources (Klein et al., 2012, 2019). Prior research does indicate young public company directors often feel undervalued by the board and 'jump ship' as their venture reaches its IPO milestone (Garg et al., 2018). Thus, RBV scholars suggest providing the board of director's broader fiduciary powers than at first envisioned by agency-theory, because this insulates the outside directors to challenge the short-term claims of the myopic shareholders (Hoskisson et al., 2018). Our extension of RBV further nuances and clarifies this discussion by highlighting the even more valuable resource provision (guidance) and monitoring responsibilities of a young public firm's pre-IPO inside directors. We find that no amount of outside director experiences can substitute for the co-specialized tacit knowledge and psychological ownership of the pre-IPO inside directors (*H2*).

The inside directors are the only board members who really have access to a company's most intangible knowledge; thus, they help abate informational asymmetries for the largely disengaged outside directors. This result sheds light on the most recent debates in RBV scholarship about who should have 'residual control' over a firm's co-created profits (Barney, 2018; McGahan, 2021). We find that unless shareholders protect the original inside director's firm-specific investments outside directors cannot realistically mediate major stakeholder resource disputes. This further corroborates the positive moderating effect we find between the *original TMT members* and *CEO-Chair duality*, because when the two combine it creates the unity of command at the top that can help insulate the insiders from pressures imposed on them by the short-term, myopic shareholders (*H3a*). In summary, ensuring a company retains a few of the pre-IPO entrepreneurial insiders after the IPO should also be considered a vital aspect of corporate governance.

6.2. Implications for the Asia Pacific region

These findings have implications for the Asia Pacific region. First, because we extend RBV into the Australian IPO context these results are particularly relevant for Australian corporate governance. Because Australia has features of both insider (relational) and outsider (arm-length) forms of corporate governance significant controversy exists about how to design effective IPO corporate governance mechanisms (Christensen et al., 2015). Australia intentionally adopts a flexible 'explain or comply' approach to board independence regulation to accommodate this peculiar institutional context (Kiel & Nicholson, 2003). This leniency notwithstanding, due to the institutional isomorphism for more board 'independence' Australian companies, as our sample attests, can have even more outside directors than publicly listed companies in the US (Kang et al., 2007). Alternatively, our findings show that the relational, firm-specific resources that are acquired and then deployed by the founding pre-IPO insiders really have no substitute. For this reason, we suggest Australian owners at least retain a few original insiders on their TMT and board to ensure outsiders are kept abreast about the long-term entrepreneurial strategy of their company.

Also, while Australian corporate governance is more communitarian than the contractual US system, this study shows that managers outside the US can easily succumb to institutional pressures to conform to AT-based codes of 'good governance'. Our findings document that even the relatively more relational and passive investors in Australia can

push to replace a firm's original insiders; this results in less post-IPO financial performance. Accordingly, we recommend that Australian policymakers ensure any future corporate governance regulations require safeguarding the firm-specific investments of some of the pre-IPO original insiders. Finally, these results apply to other Anglo-Saxon economies in the Asia-Pacific region such as New Zealand because the push for more outside directors remains a critical component of international corporate governance. Thus, generic agency-theory codes of corporate governance may be unsuitable to other Pacific-Rim countries as well.

6.3. Limitations & future research

The primary limitation of this study is the fact that only a small number of Australian companies engaged in an IPO during our sample period, thus our findings are constrained by this empirical reality. Thus, we insist that our results only provide circumstantial evidence that is subject to alternative explanations, and that future research can help to illuminate and refine our contribution. Now that the IPO market in Australia has begun to generate momentum, we call on scholars to test our extension of RBV using more recent IPO data. Likewise, while our archival dataset limits our ability to observe the actual process by which the insiders interact with the outsiders, we encourage scholars to draw on qualitative research methods to test our theory (Garg & Eisenhardt, 2017). We believe the theoretical value our contribution to RBV attributes to the original insiders of a young public company will become even more salient in the future because of path-dependence in institutional corporate governance legislations that favor outsiders (Joseph et al., 2014). In this vein, the neglected importance of the insiders may increase in insider-friendly nations like China and India which are beginning to transition to a more outsider-system, and where outside investors can now more easily invest in emerging start-ups (Zhao & Yuan, 2021). Therefore, we encourage scholars to investigate the influence of insiders over the IPO process in emerging and transitional economies (Zhu et al., 2012).

In conclusion, the theoretical and practical importance of an insider's tacit knowledge and thinly traded firm-specific investments remain a serious, yet understudied aspect of effective corporate governance. We suggest comparative corporate governance scholars continue to build on this study by investigating the previous research avenues. In so doing, we hope the current ritualistic commitment to ad-hoc AT legislation will be replaced with codes of governance that reflect the institutional and economic differences between nations.

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APPENDIX A. ADDITIONAL SUPPLEMENTARY ANALYSIS

To establish the robustness of our results we carried out several supplementary tests. First, we carry out a set of tests to determine if endogeneity is a pressing concern for our study. We report the second stage of our instrumental variables (IV) estimation in Table A1. Our Table A1 includes another set of 2 stage least squares (2SLS)/IV regressions with our interaction terms included from Table 4 of the main text, and the results continue to hold up. We report the second stage of our IV estimation in Table A1 using the lagged governance variables as our instruments. We use these set of IVs because the *original TMT members* and *original board members* variables (insiders) in prior years could not have resulted from firm performance in subsequent years.

The results from the 2SLS/IV regressions are qualitatively consistent with those of the OLS regressions. The coefficient for *original TMT members* is positive and statistically significant in models 1, and 4, and the coefficient for *original board members* is positive but lacks statistical significance at conventional levels in column 8. To test whether *original TMT members*, *original board members* and *board size* are correlated with the error term of the performance regression, we perform the Wu-Hausman F-test and the Durbin-Wu-Hausman Chi-sq test. These estimations test the null hypothesis that *original TMT members*, *original board members*, and *board size*, are uncorrelated with the error term. We fail to reject the null hypothesis of no endogeneity in any of the models. Also, our results depend critically on the quality of our choice of instruments. The Sargen-test is not significant in all the models and hence suggests that the instruments are valid. These tests suggest that once we control for governance and firm characteristics in our regressions, as well as firm random-effects, endogeneity of *original TMT members*, *original board members* and *board size* due to reverse causality is not a serious concern in our performance regressions, at least for young firms. In sum, these findings demonstrate that the presence of original directors and top managers (insiders) have a positive influence on *ROA* for at least six years after IPO.

Second, in Table A2 we estimate the post-IPO financial performance over a two-year window in order to compare the results with existing studies (Kroll et al., 2007; Walters et al, 2010, 2015). Overall, our results are qualitatively like those we report in the paper that employs a six-year post-IPO period. However, a direct comparison of Table A2 with Table 4 shows that the estimated coefficients for *original TMT members* and *original board members* are statistically stronger than the results in Table 4. As such, our results show that retaining some of the *original TMT members* and *original board members* have an even more acute impact on immediate post-IPO financial performance (2-years after IPO). One reason may be the new TMT and directors benefit from the critical advice and support of the insiders early in the post-IPO transition.

Lastly, we examine whether our key findings are robust to econometric issues related to multicollinearity. To check whether multicollinearity effects the results, we calculate the variance inflation factor (VIF) for all variables in the study. As a rule of thumb, multicollinearity is likely to exist when the independent variables are highly correlated (i.e., $r = 0.90$ and above) or the VIFs for any of the variables exceed 10 (Gujarati & Porter, 2009). The average VIF is 2.01 and the highest for any regressors is 2.90, which is well below the threshold indicator of 10. The results suggest a lack of evidence for multicollinearity between the variables.

In brief, these results demonstrate that the presence of original venture directors and top managers (collectively insiders) is positively associated with post-IPO performance when we use the accounting measure of performance, *ROA (H1 and H2)*. Also, the coefficients in front of the interaction terms in Table A1 and Table A2 are significant and in the expected directions, although we sometimes lose significance due to our small sample size. Therefore, we fail to reject *H3a* and *H3b*. In other words, pressures placed by Australian shareholders to embrace board independence results in higher insider turnover, and this unexpectedly weakens post-IPO performance. In all, these tests provide additional *circumstantial evidence* that our theory about the original insiders, within the setting of young public firms in Australia, stands up to empirical scrutiny.

Table A.1. Instrumental variable (IV) regressions of firm performance (ROA) on governance mechanisms

Explanatory variables	Dependent variable = ROA							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Original TMT members	0.513*	0.031	0.267	0.369*				
	(0.354)	(0.190)	(0.196)	(0.230)				
Original TMT members × CEO-Chair duality				0.937**				
				(0.476)				
Original board members					0.088	0.037	0.226	0.320
					(0.509)	(0.280)	(0.297)	(0.351)
Original board members × CEO-Chair duality								0.559
								(0.663)
Non-executive directors	0.780	-0.562	-0.141	-0.126	0.574	-0.571	-0.115	-0.151
	(1.033)	(0.536)	(0.316)	(0.463)	(1.066)	(0.591)	(0.507)	(0.522)
CEO-Chair duality	-0.402	0.105	0.650***	0.065	-0.364	0.098	0.607***	0.309
	(0.355)	(0.203)	(0.163)	(0.348)	(0.360)	(0.205)	(0.191)	(0.406)
TMT size	0.466	-0.184	0.031	-0.008	0.413	-0.188	0.022	0.004
	(0.288)	(0.138)	(0.125)	(0.127)	(0.296)	(0.154)	(0.139)	(0.151)
Board size	0.245	0.112	0.010	-0.044	0.297	0.106	-0.003	-0.013
	(0.206)	(0.124)	(0.055)	(0.134)	(0.228)	(0.155)	(0.155)	(0.164)
Director age		-0.001	-0.018	-0.027*		0.001	-0.020	-0.021
		(0.014)	(0.011)	(0.014)		(0.013)	(0.013)	(0.013)
Firm size			0.198***	0.203***			0.216***	0.210***
			(0.055)	(0.066)			(0.070)	(0.073)
Dividend payout ratio			0.005***	0.006***			0.004**	0.005**
			(0.002)	(0.002)			(0.002)	(0.002)
Leverage			-0.068	-0.114			-0.001	0.031
			(0.177)	(0.177)			(0.173)	(0.179)
Firm risk			0.195	0.057			0.170	0.076
			(0.739)	(0.785)			(0.758)	(0.862)
Year dummies	no	yes	yes	yes	no	yes	yes	yes
Cons			-1.121	-0.852			-1.354	-1.135
			(0.719)	(1.074)			(1.091)	(1.195)
N	160	101	100	100	160	101	100	100
Sargan test (Chi-square)	3.962	0.747	0.722	0.662	4.547	0.037	0.19	0.318
p-value	(0.138)	(0.688)	(0.697)	(0.718)	(0.130)	(0.982)	(0.909)	(0.853)
Wu-Hausman (F-statistic)	0.229	0.432	0.875	0.650	0.034	0.225	1.026	1.145
p-value	(0.796)	(0.650)	(0.420)	(0.524)	(0.966)	(0.799)	(0.363)	(0.323)
Durbin-Wu-Hausman (Chi-square)	0.481	0.972	2.065	1.562	0.072	0.509	2.413	2.716
p-value	(0.786)	(0.615)	(0.356)	(0.458)	(0.965)	(0.775)	(0.299)	(0.257)

Note: This table reports the panel 2SLS/IV regressions estimation of the TMT members and original directors on ROA. The dependent variable is the return on assets (ROA). We use 1-year and 2- years lagged of original TMT membership, original board membership and board size as the instruments for original TMT membership, original board membership and board size. Robust Standard errors are displayed in parentheses below the coefficients. The asterisks *, **, and *** indicate the significance at the 10%, 5%, and 1% level, respectively.

Table A.2. Panel regression-Random effects of firm performance (ROA) on governance mechanisms plus controls for two years

Explanatory variables	Dependent variable = ROA							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Original TMT members	0.740*** (0.268)	0.819** (0.332)	0.826** (0.398)	0.971* (0.544)				
Original TMT members × CEO-Chair duality				0.385 (0.658)				
Original board members					0.658 (0.500)	1.575** (0.705)	1.625*** (0.576)	1.937*** (0.699)
Original board members × CEO-Chair duality								0.738 (0.734)
Non-executive directors	0.162 (0.786)	-0.791 (0.659)	-0.872 (0.559)	-0.737 (0.556)	-0.059 (1.068)	-0.579 (0.846)	-0.381 (0.597)	-0.309 (0.617)
CEO-Chair duality	0.449* (0.266)	0.586*** (0.176)	0.541*** (0.181)	0.783* (0.445)	0.393 (0.335)	0.654*** (0.234)	0.721*** (0.179)	1.231** (0.586)
TMT size	0.294 (0.194)	0.124 (0.177)	0.013 (0.165)	0.041 (0.152)	0.223 (0.204)	0.171 (0.158)	0.025 (0.147)	0.056 (0.144)
Board size	0.056 (0.106)	0.119 (0.117)	0.016 (0.081)	-0.001 (0.087)	0.032 (0.152)	-0.004 (0.135)	-0.189** (0.092)	-0.208** (0.091)
Director age		0.019 (0.020)	-0.021 (0.015)	-0.017 (0.017)		0.023 (0.018)	-0.016 (0.011)	-0.011 (0.013)
Firm size			0.327*** (0.110)	0.314** (0.125)			0.370*** (0.087)	0.363*** (0.091)
Dividend payout ratio			0.001 (0.003)	0.001 (0.003)			-0.001 (0.003)	-0.001 (0.003)
Leverage			-0.637** (0.285)	-0.647** (0.277)			-0.275 (0.329)	-0.227 (0.321)
Firm risk			0.196 (0.992)	0.353 (0.914)			-0.420 (1.052)	-0.146 (0.931)
Year dummies	no	yes	yes	yes	no	yes	yes	yes
Cons	-2.068** (0.829)	-2.352** (1.100)	-2.716** (1.139)	-3.008*** (1.125)	-1.561 (1.003)	-2.982*** (1.009)	-3.385*** (0.897)	-3.893*** (1.040)
N	80	53	50	50	80	53	50	50
R-squared	0.17	0.24	0.58	0.58	0.12	0.32	0.60	0.61

Note: This table presents the results from panel regression-random effects between TMT members and original directors on ROA. See Table 1 for variable definitions. Robust standard errors are displayed in parentheses below the coefficients. The asterisks *, **, and *** indicate the significance at the 10%, 5%, and 1% level, respectively⁶.

⁶ We control for other variables that may potentially affect post-IPO firm performance. Consistent with prior studies, we use education (*EDUT*) as a control variable that account for innovation capabilities of a firm (Bantel & Jackson, 1989). Our measure of TMT education (*EDUT*) is calculated as the percentage of top managers who possess advanced degrees (PhDs and Master's or equivalent). For brevity, we do not report the results here.