



MIMETIC ISOMORPHISM IN THE GOVERNANCE OF IPO COMPANIES IN ITALY

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Abstract

In order to comply with listing requirements and overcome information asymmetries, listing companies may be encouraged to adapt themselves with market standards ('isomorphism') in the setting of governance devices in order to reduce the perceived uncertainty and obtain legitimacy towards investors. In this work we evaluate the isomorphism of IPO companies with respect to the board characteristics (i.e. board size and members' age). By analyzing a sample of 121 companies listed from 1999 to 2008 on the Italian Exchange, we find that mimetic strategies are frequent in IPO companies, and that the majority of them exhibit a reduction in the differences of board characteristics in the year after the flotation, compared to listed firms in the same sector. The percentage of mimicking companies is even larger if we consider only companies that introduce changes in the board composition. Multivariate analyses suggest that isomorphism strategies are targeted to signal the IPO firm's quality, and are an alternative to issuing underpriced shares.

Keywords: corporate governance, isomorphism, board of directors

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1. Introduction

Behavioral mechanisms aimed at conforming to the external environment are important determinants in the evolution of corporate governance settings (Hung, 1998). Assuming that information asymmetries and uncertainty characterise the market, companies aim at legitimating towards financial investors by imitating their comparable counterparts, and minimising differences in their governance characteristics. Such

strategy is known as 'isomorphism' (DiMaggio and Powell, 1983; Thorsell, 1998).

This paper analyzes isomorphism strategies implemented by companies newly listed on a stock exchange, related to the characteristics of the board of directors. The admission to trading on an exchange is an important stage in the lifecycle of a company, because the latter has to attract outside investors. The company must comply with listing requirements imposed by public authorities, mostly aimed at

assuring more transparency and protection for small retail investors. The lack of track records and past price information generates uncertainty, this forcing listing companies to find adequate mechanisms to signal their quality (Allen and Faulhaber, 1989). Therefore, isomorphism strategies should be particularly important for newly listed companies.

We evaluate isomorphism with respect to the characteristics of the board of directors, namely the number of seats and the age of the members. The research sample is made up by 121 companies listed on the Italian Exchange from 1999 to 2008 after an IPO (initial public offering). The benchmark sample is made up by listed companies in the same business sector.

We find that 66.1% and 52.1% of the sample IPOs exhibit a reduction in the differences related to the board size and members' age respectively. Such percentages grow up to 86.8% and 67.9% respectively, considering only companies that change the composition of the board after the IPO.

Multivariate analyses show that isomorphism strategies are more likely to be implemented in the short run after the IPO (this confirming that the flotation determines an incentive to adapt to current standards in the board governance in the same business sector) and suggest that changes in the board characteristics are an alternative option to other costly signals such as underpricing IPO shares.

The paper is organised as follows. Section 2 deals with the literature on mimetic isomorphism in IPO companies. Section 3 introduces the research hypotheses. Section 4 contains the empirical analysis. Finally Section 5 concludes.

2. Board characteristics and mimetic isomorphism

Several researches explore the characteristics of boards of directors in listed companies. Conyon and Peck (1998) and Eisenberg (1998) examined the effects of board size on corporate performance across a number of European companies. Raheja (2005) attempts to determine the optimal composition and size of a board, determined by the tradeoff between maximizing the incentive for insiders to reveal their private information, minimizing the cost to outsiders to verify projects, and maximizing outsiders' capability to reject inefficient projects. Boone et al. (2007) analyze a sample of IPOs and find that board size and independence increase as firms grow and diversify over time. Moreover, the board size reflects a tradeoff between firm-specific benefits and costs of monitoring.

A piece of the literature focuses on institutional theories investigating the causes of changes in the size and composition of boards. Such theories consider the external environment of the firm as causes of most governance changes, specifically institutionalized

pressures, such as normative frameworks and social influences (Thorsell, 2008).

DiMaggio and Powell (1983) posit that there are many external formal and informal pressures that may influence companies in defining the size and the composition of boards, in the direction of reducing cross-sectional differences ('isomorphism'). Yet in order to reduce information asymmetry and signal a firm's quality, there is also an incentive to a 'mimetic isomorphism', which does not depend from any external authority, but it is only related to the internal strategic choice to minimize differences with other comparable firms related to governance devices. Mimetic transformations are targeted to a progressive change in the board structure so as to comply with industry 'standards', and may be particularly important for IPO companies. Indeed, when a firm lists on a stock exchange for the first time, uncertainty and asymmetric information between the market and the company are particularly intense, and the IPO firm is willing to signal its quality to potential IPO investors. Coherently, Thorsell and Cornelius (2009) consider the case of Swedish IPOs and detect three different types of isomorphism: coercive (i.e. adapting to national regulation related to listing companies), mimetic (i.e. IPO companies copy the standards generally adopted by other listed companies) and normative (i.e. within the same industry the education and experience of the board directors tend to be similar).

3. Research hypotheses

Our research hypotheses focus on isomorphism of IPO companies related to the size of the boards and directors' age, being the most important publicly available characteristics of governance indicators at the board level.

The first research hypothesis posits that mimetic isomorphism involves newly listed companies because, differently from already listed counterparts, they must spend a greater effort to reduce the information asymmetry, and signal their quality to potential investors. First, we focus on the size of the board:

H1. *IPO companies are characterized by a mimetic behavior and, during the first year after the listing, they increase or decrease the board size in order to align themselves with the average of their industry.*

Several studies (see the previous Section) highlight that the board size influences firms' performance, and therefore we expect that IPO companies 'adjust' the number of seats in the board in order to comply with the regulation (for example by adding independent directors) and to minimize differences with their listed counterparts.

The second hypothesis focuses on the age of the directors. The age is a proxy of the experience, and also in this case we expect that IPO companies tend to

substitute members of the board in order to get closer to the average members' age, compared to comparable listed companies.

H2. *IPO companies, during the first year after the listing, modify the composition of the board in order to get closer to the average members' age within their industry.*

The third hypothesis attempts to explain isomorphism as a signaling device. In a framework characterized by information asymmetries, Allen and Faulhaber (1989) predict that IPO companies may signal their quality to investors in a number of ways, for example by offering shares at a discount (underpricing). Isomorphism strategies may be an alternative to underpricing IPO shares.

H3. *IPO companies signal their quality to investors by adapting the board characteristics to the average standard of comparable listed firms, as an alternative to underpricing IPO shares.*

To test the hypotheses ahead, we collected data about all initial public offerings of companies listed on the Italian Exchange from 1999 to 2008. The sample is made up by 121 observations.

From the offering prospectuses we hand-collected information about the board composition. We divided the sample by business sectors, adopting the taxonomy of the Italian Exchange. The changes in the board members are tracked after the listing examining the annual balance sheets.

We measure isomorphism through the absolute percentage 'difference' that each IPO company exhibits from the average of its industry, from the year of the listing up to three years later, related to the number of seats in the board, and to the age of the members. This methodology is characterized by a limit: we track changes only after the listing (and not in previous years) since such data are not available for all companies.

4. Empirical analysis

In the first year after the listing, 66.1% of the sample IPO companies (80 among 121) reduced their percentage 'distance' from the average of their industry, in term of number of seats.

We distinguish between firms that changed the composition of the boards of directors from those that did not. In fact, we may assume that many companies wait for the expiration of the mandate of the board before introducing any change. Moreover, a reduction in the difference between an IPO company and their counterparts may be related either to a change in the average figures for the sector (with no change for the IPO company) or to a change decided by the IPO company. This latter event is the more interesting for our analysis, and directly related to hypotheses H1 and H2.

Table 1 reports the complete descriptive statistics.

Table 1 about here

We find that 53 companies changed the composition of the board immediately within the first year from the listing, and 46 of these (86.8%) increased or reduced the number of directors in order to get closer to the average of the sector. It is interesting to note that if we adopt the average number of directors for all listed companies as a benchmark, we find isomorphism only for 34 companies, this indicating sector peculiarities in the composition of the board. Secondly, if we extend the observation period up to three years from the listing, the isomorphism change is significantly less frequent, this indicating that such strategy is common immediately after the flotation.

Disaggregating the data reported in Table 1, in the three years after the listing, 57 companies enlarged their boards (47.1% of the sample), while 33 changed only members, holding constant the size (27.3%) and 23 reduced the number of board seats (19.0%). 8 companies did not exhibit any change in the board (6.6%).

Considering the average age of the members, we found a mimetic behavior in 62 IPOs (51.2% of the sample, see Table 2). If we analyze only those companies that changed their boards during the first year of listing, we obtain a percentage of 67.9% (36 companies among 53). Therefore isomorphism is more common in the number of seats in the board, compared to the age of the members.

Table 2 about here

In order to point out the determinants of the isomorphism behavior, we considered a set of possible explanatory variables. First, we introduce the number of years occurred after the listing (we assume that isomorphism changes are more likely to occur in the short run after the IPO, in order to signal the firm's quality to investors). Then we consider the company relative size, measured by a dummy variable which is equal to 1 if the company is smaller than other listed companies comparable by business sector. We hypothesise that smaller companies are characterised by larger uncertainty, this increasing the incentive to isomorphism.

In order to control for the shareholding structure, we introduce another dummy variable which is equal to 1 if the main shareholder owns more than 50% of the equity capital after the IPO. We also consider the relative offer size, as the fraction of shares outstanding offered in the IPO. Larger offerings should be associated with greater uncertainty for investors about the prospect value of the firm.

Introducing the IPO initial underpricing (defined as the first-day share return compared to the offer price) allows us to test hypothesis H3; if isomorphism is a signalling device alternative to discounting IPO shares, we expect a negative correlation.

We run a logistic model as follows:

Mimetic isomorphism = f (year, relative size, main shareholder ownership, relative offer size, underpricing)

The dependent variable is equal to 1 if the company engaged in changes in the number of seats in the board after the IPO, in the direction of isomorphism, and zero otherwise.

Table 3 summarizes the results of the econometric model. We propose alternative models in order to check the robustness of estimations.

Table 3 about here

The timing of the change is significantly related to the isomorphism strategy, confirming that immediately after the IPO there is an incentive to adjust the board composition in order to get closer to the average of the sector. This incentive is lower in the medium and long run.

Companies smaller than their listed counterparts are more likely to change the board structure and reduce differences. Yet when we control for other variables the coefficient is not significantly different from zero.

The coefficient of the ownership concentration is significant as well. The more concentrated the ownership, the more likely the isomorphism strategy. We may explain this evidence assuming that companies closely held by a controlling shareholder are characterised by larger agency costs (Jensen and Meckling, 1976) and thus the marginal benefit of isomorphism is larger.

The relative offer size is positively correlated with the probability of isomorphism, and has a better explanatory power than the company assets. Information asymmetries and uncertainty in valuation are larger if the company is placing a significant fraction of the equity capital.

The first day IPO share return is negatively correlated with isomorphism strategies, this supporting Hypothesis H3: underpricing IPO share is substitutive of other signalling mechanisms, say the mimetic behaviour in designing board characteristics.

5. Conclusions

IPO companies engage in isomorphism strategies aimed at winning legitimacy towards investors. Indeed, by analyzing a sample of 121 companies listed on the Italian Exchange from 1999 to 2008, we found that in the short run the majority of such companies (66.1%, or 86.8% if we exclude companies that leave the board unchanged) get closer to the 'average' figures of comparable listed companies, in the same business sectors. Examining the average age of the board members, the percentage of 'mimicking' companies is lower but always larger than 50% (52.1%, or 67.9% considering companies that

introduce changes in the board). We also show that the benchmark of mimetic strategies is not the average of all listed companies, but the average of companies in the same business sector.

The multivariate analysis highlights that changes are more likely to occur in the short run (this confirming that the listing is a relevant incentive towards isomorphism), and that companies with more concentrated ownership and larger offering size have more incentives to mimetic behavior. We also highlight that isomorphism may be considered as a further signal to assess the quality of an IPO company, alternative to the initial underpricing. In other words, when information asymmetry is significant, listing companies may signal their superior quality by 'costly' decisions, i.e. issuing shares at a discount, or potentially deviating from the optimal composition of the board size in order to mimic the governance framework of comparable listed companies.

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Appendices

Table 1. Descriptive statistics about isomorphism in IPO companies. Percentage of companies introducing changes in the characteristics of the board of directors (number of seats) in the first year after the listing, reducing the differences with respect to the business sector average. Sample: 121 IPO companies listed on the Italian Exchange from 1999 to 2008.

Sector	Total sample			Only IPO companies changing the composition of the board		
	Companies with isomorphism	IPO companies considered	Percentage	Companies with isomorphism	IPO companies considered	Percentage
Retail goods	19	28	67.9%	6	8	75.0%
Raw materials and chemicals	2	2	100.0%	2	2	100.0%
Energy	2	2	100.0%	1	1	100.0%
Finance	12	15	80.0%	6	6	100.0%
Manufacturing	14	25	56.0%	8	10	80.0%
Health	4	6	66.7%	3	3	100.0%
Consumer	7	13	53.9%	5	6	83.3%
Utilities	9	12	75.0%	8	10	80.0%
Technology	8	14	57.1%	7	7	100.0%
Telecom	3	4	75.0%	-	-	-
Total	80	121	66.1%	46	53	86.8%

Table 2. Descriptive statistics about isomorphism in IPO companies. Percentage of companies introducing changes in the characteristics of the board of directors (age of the members) in the first year after the listing, reducing the differences with respect to the business sector average. Sample: 121 IPO companies listed on the Italian Exchange from 1999 to 2008.

Sector	Total sample			Only IPO companies changing the composition of the board		
	Companies with isomorphism	IPO companies considered	Percentage	Companies with isomorphism	IPO companies considered	Percentage
Retail goods	14	28	50.0%	5	8	62.5%
Raw materials and chemicals	2	2	100.0%	2	2	100.0%
Energy	1	2	50.0%	1	1	100.0%
Finance	10	15	66.7%	4	6	66.7%
Manufacturing	11	25	44.0%	7	10	70.0%
Health	3	6	50.0%	2	3	66.7%
Consumer	6	13	46.2%	4	6	66.7%
Utilities	7	12	58.3%	6	10	60.0%
Technology	6	14	42.9%	5	7	71.4%
Telecom	2	4	50.0%	-	-	-
Total	62	121	51.2%	36	53	67.9%

Table 3. Estimation of the logistic model. The dependent variable is a dummy variable equal to 1 if the company engaged in changes in the board characteristics after the IPO, in the direction of isomorphism, and zero otherwise. The independent variables are: year (the number of years after the listing in which the changes eventually occurs), relative size (a dummy variable equal to 1 if the company consolidated assets are larger than the average of the comparable listed companies in the same business sector), main shareholder ownership (a dummy variable equal to 1 if the main shareholder owns more than 50% of the equity after the listing), relative offer size (the fraction of IPO share compared to shares outstanding before the offering), underpricing (the IPO first-day return, compared to the offer price). Sample: 121 IPO companies listed on the Italian Exchange from 1999 to 2008.

Sector	Total sample			Only IPO companies changing the composition of the board		
	Companies with isomorphism	IPO companies considered	Percentage	Companies with isomorphism	IPO companies considered	Percentage
Retail goods	14	28	50.0%	5	8	62.5%
Raw materials and chemicals	2	2	100.0%	2	2	100.0%
Energy	1	2	50.0%	1	1	100.0%
Finance	10	15	66.7%	4	6	66.7%
Manufacturing	11	25	44.0%	7	10	70.0%
Health	3	6	50.0%	2	3	66.7%
Consumer	6	13	46.2%	4	6	66.7%
Utilities	7	12	58.3%	6	10	60.0%
Technology	6	14	42.9%	5	7	71.4%
Telecom	2	4	50.0%	-	-	-
Total	62	121	51.2%	36	53	67.9%

*, **, *** significant at the 90%, 95%, 99% levels respectively