WHEN IPO SIGNALING BECOMES WINDOW DRESSING, WHO’S MINDING THE STORE? (SUMMARY)

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SUMMARY

WHEN IPO SIGNALING BECOMES WINDOW DRESSING,
WHO’S MINDING THE STORE?

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Principal Topic

Research has shown that investors look for signals of firm quality in the SEC filings and during bookbuilding presentations to evaluate and price shares of initial public offerings. Markers of quality are referred to as signals, and include such things as the amount of retained equity, auditor and underwriter quality, operating history, patent capabilities, and TMT tenure and prestige. Research, however, has yet to differentiate signals that are part of long-term organic growth from ones implemented in the months leading up to the offering that are potentially part of a short-term window dressing strategy. Firms attempting to increase equity proceeds might consider an active signaling approach by bringing on new affiliates and hiring new members of the TMT and BOD to signal quality to investors.

While making these organizational changes may improve investor perceptions, the signaling costs and potential organizational disruption would deter issuers from engaging in such a strategy. Underwriters in a firm-offer setting might prefer that the issuer make such changes because while they benefit from higher valuations, they do not suffer the signaling costs. Therefore one must ask the question, are issuers making organizational changes prior to going public out of choice, or the underwriter influencing the decision?

Methods

We collected measures of issuer quality that would improve the bargaining position of the issuer, and measures of underwriter quality important to issuers to assess the bargaining position of the underwriter. Through factor analysis, we created single measures of bargaining power and used the power differential to predict the incidence of pre-IPO organizational change.

Results And Implications

Our results support the theory that differences in relative bargaining power are significant predictors of pre-IPO organizational change. Academics and issuers should be aware of the underwriter’s independent role and the influence they might exert. It is unclear from this research whether underwriters push issuers to make needed changes for the firm’s long-term health, or for their own short-term profit motives. Regardless, issuers who do not welcome making changes to the top managers prior to going public, and which are potentially costly and disruptive, must choose their underwriters carefully with an eye to finding one that needs them as much as they need the underwriter.

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