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RESOURCE-BASED BARGAINING AND UNDERPRICING IN INITIAL PUBLIC OFFERINGS (SUMMARY)

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RESOURCES-BASED BARGAINING AND UNDERPRICING IN INITIAL PUBLIC OFFERINGS

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Principal Topic

In new venture capitalization processes, Initial Public Offerings (IPOs) provide a significant source of financial capital for high growth ventures while simultaneously offering exit liquidity for early-stage investors (Daily, Certo, Dalton, & Roengpitya, 2003). However, the pervasiveness of underpricing across markets around the world – reflected in the average difference between the offer price and the closing price on the first day of trading of 18% -- results in many ventures leaving substantial amounts of money on the table for others to appropriate (Ritter & Welsh, 2002). In this study, building upon the resource-based bargaining literature in resource-based theory (Coff, 1997; Coff, 1999; Townsend & Busenitz, 2008), we explore the extent to which the ability of issuers (underwriters) to negotiate a higher (lower) offer price is derived from the relative strength of the issuer’s resource endowment relative to the underwriter (cf., Lippman & Rumelt, 2003). Our central arguments hinge on the premise that issuers with stronger resource endowments relative to their underwriters will be able to negotiate higher offer prices and will tolerate less underpricing, thereby capturing a greater proportion of the IPO proceeds.

Method

To test these arguments, we utilize a sample of firms from multiple industries that conducted an IPO between May 1991 and June 1998. Following the data collection methods of Ljungqvist and Wilhelm (2003), our final sample included 237 firms matched with 66 lead underwriters (during this time period, these underwriters controlled 92.6% of the IPO market in the US).

Results and Implications

Based on these theoretical arguments our analysis indicates that relative issuer bargaining power significantly increases both the initial value ($B = .222, p<.000, \Delta R^2 = .046$) and the final value of the issue ($B = .172, p<.000, \Delta R^2 = .027$). Furthermore, consistent with our theoretical arguments, we find that the relative bargaining power of the issuer also reduces the extent of underpricing during the first day of trading ($B = -0.153, p<.05, \Delta R^2 = .019$). Overall, these results provide strong support for our central contention that firms leveraging stronger resource endowments will be able to negotiate higher offer prices and will tolerate less underpricing, thereby leaving less money on the table for others to appropriate.

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