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EARNING WHAT YOU KEEP? RESOURCE DEPENDENCIES AND POWER ASYMMETRIES BETWEEN ISSUERS AND UNDERWRITERS IN IPO MARKETS (INTERACTIVE PAPER)

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≈ INTERACTIVE PAPER ≈

**EARNING WHAT YOU KEEP? RESOURCE DEPENDENCIES AND POWER
ASYMMETRIES BETWEEN ISSUERS AND UNDERWRITERS IN IPO MARKETS**

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Principal Topic

Asymmetric information theories argue that underwriters utilize underpricing as a means to incentivize investors to be more forthcoming about their investment preferences and to cover any trading losses stemming from firm valuation errors (Derrien, 2005). Although information asymmetries undoubtedly lead to some underpricing, a growing volume of research contends that these perspectives are limited at best in explaining why underpricing is so pervasive (Ljungqvist, 2007; Ritter & Welch, 2002). In this study, we extend recent work in Resource Dependence Theory (Hillman, Withers, & Collins, 2009; Casciaro & Piskorski, 2005) and research on entrepreneurial power (Santos & Eisenhardt, 2009) to explore how the use of power by issuers and underwriters impacts the amount of IPO proceeds appropriated by issuers.

Method

To test our hypotheses we develop a random sample of 230 firms that conducted an IPO between 2003 and 2012. Collectively, our sample spans 42 different industry sectors thereby increasing the generalizability of our findings. Our first set of hypotheses predicts that the structural power of the underwriter will be negatively associated with pre-IPO price revisions and positively associated with IPO underpricing. Conversely, our second set of hypotheses predicts that the soft power of the issuer will be positively associated with pre-IPO price revisions and negatively associated with IPO underpricing.

Results and Implications

Consistent with these hypotheses, we find that the structural power of the underwriters appears to have a negligible impact on pre-IPO price revisions and post-IPO underpricing. Conversely, our analyses indicate broad support for the ability of organizations to utilize soft power to improve capital market outcomes for the firm through positive pre-IPO price revisions. However, these models also indicate that these same firms also must tolerate higher levels of underpricing. Collectively, these results suggest that a paradox regarding the use of soft power by issuers to improve capital market outcomes. On one hand, the use of soft power increases firm value pre-IPO but these issues must still tolerate higher levels of underpricing post-IPO.

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