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A Comparison of Penny Stock Initial Public Offerings and Reverse Mergers as Alternative Mechanisms to Going Public

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Abstract


We compare firms that go public using penny stock initial public offerings (PSIPOs) to those using reverse mergers (RMs). Firms using RMs tend to be highly information asymmetric in contrast with the existing going public theory. Firms tend to opt for the RM path with the intent to acquire a greater market share using stock as a medium of payment. When compared to PSIPOs, RMs are small, have low profitability, are in the development stage with limited operating history, and plan high research and development expenditures. RM firms hoard cash, which they get through Private Investments in Public Equity (PIPEs) that are consummated concurrently with the RM. PIPE investors and insiders maintain a high ownership stake following a RM. Managers of firms engaging in PSIPOs are more likely to cash out.

Keywords: Reverse mergers, reverse takeovers, penny stock IPOs, shell companies, going public, PIPEs

JEL Classification: G19, G32, G34

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