Outside Equity Financing

Stewart C. Myers

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This paper explores the necessary conditions for outside equity financing when insiders, that is managers or entrepreneurs, are self-interested and cash flows are not verifiable. Two control mechanisms are contrasted: a partnership,' in which outside investors can commit assets for a specified period, and a corporation,' in which assets are committed for an indefinite period but insiders can be ejected at any time. The paper also shows how going public to reduce outsiders' power can be efficient if it preserves appropriate incentives for insiders. The concluding section explains how the difficulty of verifying the act of investment leads to monitoring costs and insiders' pursuit of private benefits of control.

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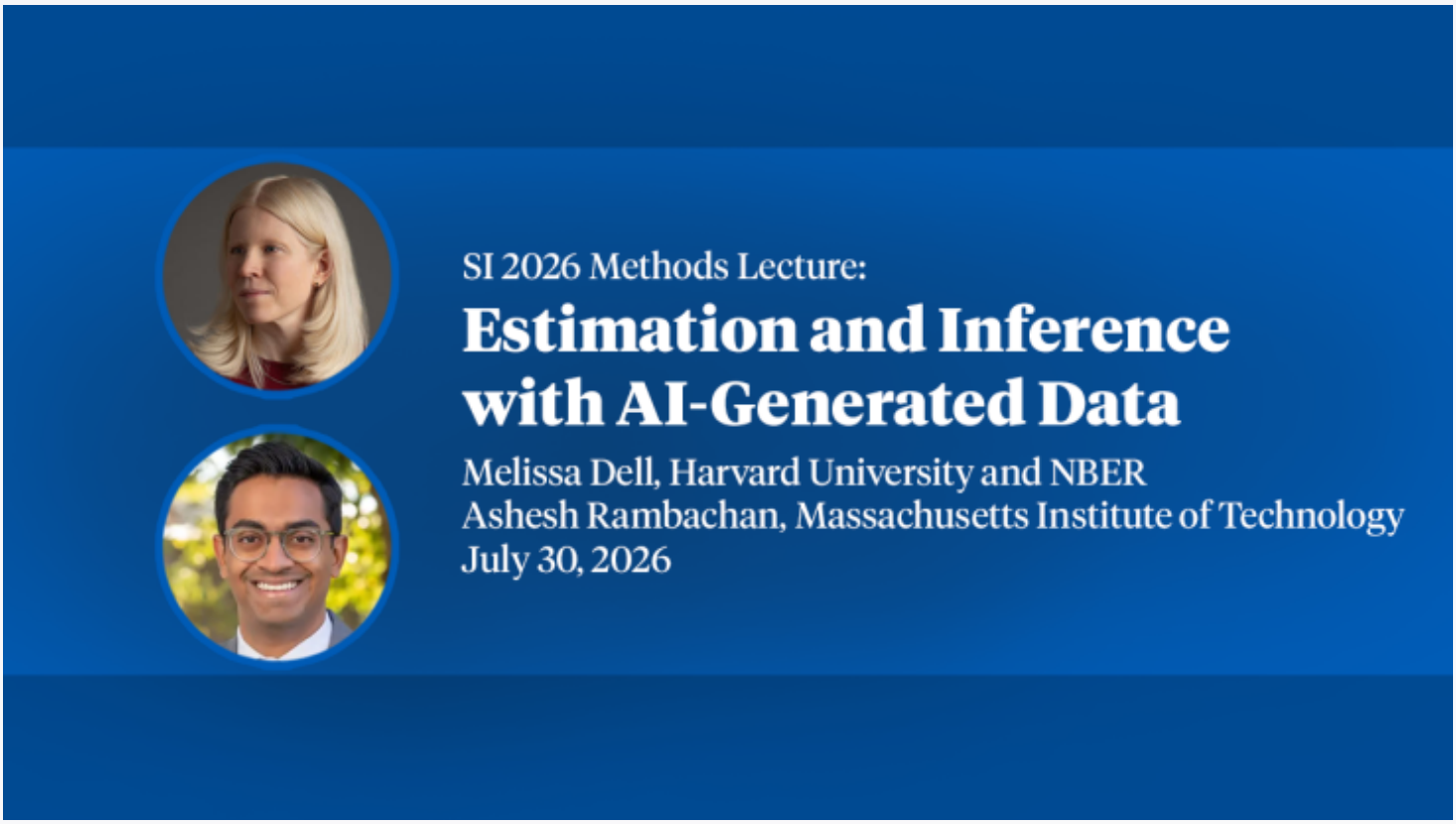


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Contact Us
1050 Massachusetts Avenue
Cambridge, MA 02138

617-868-3900
info@nber.org
webaccessibility@nber.org

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