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Why do firms switch underwriters? ☆

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Abstract

In the mid-1990s, 30% of firms completing an SEO within three years of their IPO switched lead underwriter. This article provides evidence on why they switched. Contrary to predictions of prior research, there is little evidence that firms switch due to dissatisfaction with underwriter performance at the time of the IPO. A surprising result is that switchers' IPOs were significantly less underpriced than non-switchers' IPOs. However, switchers raised fewer proceeds than expected, compared to the mid-point of the filing range, while non-switchers raised significantly more proceeds. There are two main reasons for switching. Firms graduate to higher reputation underwriters, and they strategically buy additional and influential analyst coverage from the new lead underwriter. Survey results support these conclusions.

Section snippets

Hypotheses about underwriter choice and switching

Our primary objective is to examine the reasons that IPO issuers switch underwriters. We use two datasets to try to infer this reasoning process. The first data set contains market-based information, including prices, earnings estimates, and trading patterns observed at the time of the IPO until the follow-on offering. The second data set contains the direct opinions we elicited from a questionnaire mailed to and from telephone conversations with corporate executives responsible for the…

Data and sample selection

The data used in this study come from several sources. Firms that conducted an initial public offering between January 1993 and December 1995, which then returned to the capital market for a seasoned equity offering (SEO) within three years following the IPO, are identified using the Securities Data Company (SDC) New Issues Database. We define a year as 252 trading days. Thus, our sample includes all IPO firms that returned to the equity market within 756 trading days of the IPO. SDC reports a…

Empirical results

Our tests include both univariate comparisons of the switching and non-switching groups, and multivariate probit estimations corroborating the important univariate conclusions.…

Executive opinions from switching firms

Our second approach to determining why firms switch lead underwriter is more frequently used in marketing research than finance. We asked executives, using a survey questionnaire, why they decided to switch. Our goal was to construct a survey with both content validity and pragmatic validity. That is, the survey should adequately cover each important aspect of the issue under analysis, and it should be predictive of future actions. To this end, we gave respondents several opportunities to add…

Market valuation of the switching decision

We have presented consistent evidence that equity-issuing firms value the post-IPO services provided by the lead underwriter. We have not addressed whether the value of the services translates into shareholder wealth. If firms value sell-side equity analyst research and the reputation of the investment banker, the underlying theoretical reason is the maximization of shareholder wealth. Thus, our final analysis is an examination of whether the market recognizes the value of the decision to…

Conclusions

So, why do issuing firms switch underwriters? Before attempting to finalize this central question, two preliminaries should be mentioned. First, firms that issue follow–on equity within 3 years of their IPO have had higher returns than the typical IPO. The stocks in our sample appreciate, on average, more than 120% in the first year after the IPO. The distributions of returns for switching and non-switching firms are approximately identical for this measure of long-term stock price performance. …

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