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# Shell companies as IPO alternatives: an analysis of trading activity around reverse mergers

Pages 1335-1347 | Published online: 07 Nov 2007

“Cite this article”  <https://doi.org/10.1080/09603100600993752>


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While shell companies are convenient vehicles for small private firms to go public via a reverse merger, they are also often mentioned in the popular press in conjunction with stock price manipulation. Recently the Securities and Exchange Commission (SEC) has imposed stricter rules on these companies to speed up disclosure of financial



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## Acknowledgements

We would like to thank Guarav Jain and Peter DiMartino for their research assistance. We also thank attendees at The Australian Finance and Banking Conference, Sydney, 2004.

## Notes

<sup>1</sup> The term ‘blank check’ is the result of shell companies making primary offerings with no specified goals as to how the proceeds would be used, essentially asking the investors for a ‘blank check’.

<sup>2</sup> ‘Moving the market: SEC may impose stricter rules on behaviour of shell companies’, WSJ, 14 April 2004; ‘Regulators suspend trading in 26 stocks’, Reuters, 8 June 2004.

<sup>3</sup> See SEC Release No. 33-8407, ‘Proposed Rule: Use of Form S-8 and Form 8-K by Shell Companies’.

<sup>4</sup> ‘Companies Opting for Easy Way to Go Public Still Remain Rare’, The Wall Street Journal, 26 June 2002, Section B15F.

<sup>5</sup> They also list the typical steps in a reverse merger—actively searching for a shell, possibly through a law or an accounting firm, followed by contacting the shareholders of the shell to determine their willingness to sell, and to determine the post-merger ownership structure of the ‘operational’ company, due diligence, especially on liabilities of the shell.

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<sup>8</sup> Effective 23 August 2004, this is reduced to four business days after the event. See SEC Release No. 33-8400, 'Final Rule: Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date'. The window period was modified in the March 2004 Final Rule to 71 calendar days. This coupled with the proposed four business days makes it ~75 days till investors see the financial statements, similar to the previously allowed 15 plus 60 days.

<sup>9</sup> See footnote 32, SEC Release No: 33-8407.

<sup>10</sup> <http://www.fool.com/EveningNews/1995/EveningNews951201.htm> 'Magellan Manager Playing Market Games?'

<sup>11</sup> Wall Street Journal, 4/14/2004, Vol. 243, Issue 73, pC3, 'SEC May Impose Stricter Rules on Behavior of Shell Companies'.

<sup>12</sup> We chose this window to cover the required time allowed between the merger agreement and Item 2 filing (15 calendar days) and the required time for filing the Item 7 after the Item 2 filing (60 calendar days).

<sup>13</sup> However, the merger can be perceived as bad news: if there is no disclosure regarding the private company, the investor does not know if the company is an asset or liability.

<sup>14</sup> WORLD ASSOCIATES INC/NV/(WAIV)'s price drops from \$0.90 on 24 October 2000 to \$0.03125 on 25 October 2000.

<sup>15</sup> DECORIZE INC (DCZ)'s price increases from \$\$0.03 on 6 July 2000 to \$3.25 on 9 July 2000.

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