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

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Abstract

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 information and curb potential abuses. Our article looks at the trading activity around reverse mergers. Clearly, the merger is taken as significant news as the trading activity increases immediately following the merger announcement. This observation suggests that the SEC may have had good reason to speed up the required filings and provide timely information to the public. We find sporadic, but statistically significant positive returns surrounding the merger reflecting the increase in value of the shell companies that is also evidenced in the (statistically insignificant) positive CARs following merger announcements. However, our results do not show

any evidence of persistent insider trading or price manipulation in these stocks.

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