

MARKET EFFECTS OF PRIVATE INVESTMENTS IN PUBLIC EQUITY: EVIDENCE FROM CANADIAN BOUGHT DEALS AND MARKETED BEST EFFORT OFFERS.

Arturo Rubalcava, University of Regina, Canada

[dx.doi.org/10.18374/JIFE-23-4.5](https://doi.org/10.18374/JIFE-23-4.5)**ABSTRACT**

This study examines the market effects to announcements of private placements of two types of equity offers by Canadian public companies: bought deals and marketed best efforts. These types of offers are only sold to qualified investors (e.g., pension funds, insurance companies, mutual funds, hedge funds) in private deals, and not open to the public market. It finds the market reaction is favorable for both offer types but not statistically different between them. The favorable market effects associates to determinants that reduce information asymmetry among market participants, including firm fundamentals, certainty of earnings, and quality of financial information by the Big-4 accounting firms. From the positive market reaction and significance on the expected determinants for both, bought deals and marketed best efforts offers, this study infers that investors that buy both offer types are well-informed and active. That is, they are, willing to engage in business decisions as board members, such as pension funds. The favorable price response is a welcome signal to the issuing firm, and active investors for monitoring and certifying the quality of the firm and equity offerings.

Keywords: Market Effects, Private Investment in Public Equity, Bought Deals, Marketed Best Efforts.

1. INTRODUCTION

The purpose of this paper is to examine the market reaction and expected determinants of private investment in public equity (PIPEs from now on) of Canadian bought deals, and marketed best offers, respectively. In addition, to explore the type of investor that is more likely to buy the PIPEs. A PIPE is a private transaction de shares of commons stock negotiated between an issuing company and group of accredited investors (Meidan, 2006) and not available in the open market. Bought deals (BDs) and marketed best offers (MBEs) are two method of choice by issuing companies to get financing by accredited private investors (e.g., pension funds, insurance companies, hedge funds, private equity funds). Investment banks or placement agents usually sell both offer types in support of issuers. On a bought deal, the investment bank buys the shares directly from the issuing firm and sell them to potential investors. In a marketed best efforts offer, the investment bank does not commit to buy the offer; it only does its best efforts to the sell the shares to potential investors. The issuer uses the funds for working capital, capital investment projects, reducing debt and others. The market reaction to announcements of PIPEs is positive around 4.5 percent (Wruck, 1989); unlike seasoned equity offerings (SEOs), which is negative around two to three percent (Lee and Masulis, 2009). A seasoned equity offering is an equity offering following an initial public offering and sold in the open market.

Most documented hypotheses explaining the positive market reaction of PIPEs are the monitoring hypothesis by Wruck (1989), the monitoring and governance hypothesis by Wruck and Wu (2009), the certification hypothesis by Hertz and Smith (1993) and the entrenchment hypothesis by Barclay, Holderness and Sheehan (2007). These studies reveal that active investors (those that want to be play an important role on major financial decisions of issuing company, or certify the offer is not overvalued) drive the positive market reaction. The active investors guarantee the quality of the private offering (e.g., quality of offering disclosure and firm's financial information, and reducing information asymmetry between the issuer and outside investors).

Contributions of this research are as follows: First, it is the first study that examines the market reaction to Canadian bought deals and marketed best offers of PIPEs, respectively. It would be of interest to find out whether the market reaction differs between both offer types. Second, it tries to find whether common