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Underwriter competition in accelerated seasoned equity offerings: Evidence from Canada



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ABSTRACT

Accelerated seasoned equity offerings (SEOs) are now the most common form of SEO in the United States, Canada and Europe. Canadian accelerated SEOs do not feature competitive bidding for underwriting mandates. Using field study data from both issuers and underwriters, as well as secondary data, we investigate underwriter competition in this market. We find competition, but not on the basis of underwriting fee. Instead underwriters compete by building, maintaining and defending relationships with issuers. These relationships benefit both parties: underwriters stabilize their deal flow, permitting them to efficiently use their established capacity, and issuers secure reliable access to underwriting services.

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1. Introduction

The use of accelerated seasoned equity offering (SEO) techniques such as US overnight offers and Canadian bought deals now surpasses the use of traditional book built SEOs in the US, Canada and Europe (Autore et al., 2008; Bortolotti et al., 2008; Pandes, 2010). A key reason for the introduction of accelerated SEOs in the US was the desire to increase underwriting competition (Calomiris and Raff, 1995; Bhagat et al., 1985). Recent increases in the use of overnight offers bring competition into question, however, as these very rapid offers do not allow time for a large number of underwriters to engage in competitive bidding for the underwriting mandate.

The same concerns about too-rapid execution and lack of time for activities such as due diligence plagued accelerated SEOs when they were first introduced in Canada more than 30 years ago (Du Val, 1996). Competitive bidding for underwriting contracts was never a feature of the accelerated SEO market in Canada. Yet accelerated SEOs have survived and thrived in Canada, outnumbering traditional marketed (or book built) SEOs. This paper investigates if the Canadian underwriting market is competitive despite the lack of competitive bidding and, if so, how this competition is accomplished.

The apparent success of Canadian accelerated SEOs, despite the lack of competitive bidding, will be of interest in other jurisdictions given the increasing use of increasingly rapid SEO techniques in several countries and the expressed belief (Abrahamson et al., 2011; Bortolotti et al., 2008) that underwriting methods converge over time. Such jurisdictions include Asia and Australia, which Gao and Ritter (2010) note have not yet adopted accelerated offerings, as well as the US, which has

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come to resemble Canada more closely with the adoption of overnight offers and the well known seasoned issuer (WKSJ) system.

We find competition in Canadian accelerated SEO underwriting although the competition is not based on fees. Instead, underwriters engage in non-price competition, building relationships particularly with frequent issuers. In contrast to the usual perception of non-price competition as being wasteful, the competition in the Canadian accelerated SEO market appears to benefit both issuers and underwriters. By building relationships, underwriters stabilize their deal flow, permitting them to efficiently use their established capacity. Underwriting relationships also help issuers, aiding them to secure reliable access to underwriting services in a market that is characterized by occasional bursts of activity during which non-aligned issuers could be unable to get access to overtaxed underwriters.

We use an economic model to derive the hypothesis that underwriters will avoid price (fee) competition and instead compete on the basis of capacity: identifying a portion of the market as their own and devising non-price strategies to defend their segment and use their established capacity most efficiently. We use a mixture of secondary data and data that we collect from a field study to test these hypotheses, as well as hypotheses related to issuers' satisfaction with this competitive strategy. We find evidence consistent with underwriters' quantity-setting and with accelerated issuers' prioritization of issue speed over low fees. We use a Heckman two-step procedure to study issuer–underwriter matching. Our findings confirm the importance of issuer–underwriter relationships in this environment.

We make several contributions. First, the findings provide a more complete picture of Canadian accelerated SEOs by investigating competition in this market. Previous studies examining Canadian accelerated SEOs have focussed on the growth of the method (Bortolotti et al., 2008) and the certification rationale for choosing an accelerated over a traditional SEO (Pandes, 2010). Ellis et al. (2011) investigate competition in SEO underwriting, but they examine traditional SEOs. We add evidence for accelerated issues.

Second, we contribute to the underwriter–issuer matching literature (e.g., Fang, 2005; Fernando et al., 2005; Krigman et al., 2001). In addition to the standard matching on the basis of reputation, we investigate matching on the basis of prior dealings and issue frequency and show that these elements of relationship building are important in predicting matching as well as being helpful to all parties in the relationship. Our paper adds to the literature on the importance and evolution of various forms of investment banking relationships, as explored in Fernando et al. (2012) and Morrison et al. (2014)

Finally, we provide a theoretical rationale and empirical evidence for a new definition of an underwriting firm's capacity: capacity based on the number of deals undertaken per period rather than the usual total dollar value of deals.

Our paper is related to Ellis et al. (2011) in that it looks beyond simple price competition to also consider non-price competition. Similar to Krigman et al. (2001) we use both secondary and field study data. Unlike either of these papers, we study accelerated offerings.

2. Bought deal accelerated SEOs – description and market structure

Table 1 shows the growth of accelerated SEOs in Canada over the last 20 years. For the last 12 years accelerated SEOs have been the dominant form of SEO in Canada.

Table 1

Growth of Accelerated SEOs in Canada. This table reports the annual number of public accelerated SEOs completed on the Toronto Stock Exchange between January 1, 1993 and December 31, 2013, as well as this number as a percentage of all public SEOs completed on the TSX over the same period.

Year	Number of completed accelerated SEOs	Number of accelerated SEOs as % of all SEOs
1993	54	32
1994	42	46
1995	30	46
1996	47	38
1997	73	51
1998	65	69
1999	50	39
2000	46	46
2001	147	65
2002	73	70
2003	80	70
2004	70	65
2005	64	74
2006	95	70
2007	121	72
2008	62	84
2009	151	78
2010	123	78
2011	131	87
2012	119	86
2013	84	80

Source: The data are from the Financial Post InfoMart New Issues database.

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