Economics Bulletin

Volume 33, Issue 4

Timing Differences between SEO Methods

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Abstract

This paper investigates characteristics of Norwegian seasoned equity issuing companies. Literature about the timing issue has mainly been focusing on U.S. firm commitments, but we include rights issues and divide firm commitments into three subgroups, accelerated bookbuilt offerings, bought deals and fully marketed offerings. The main difference between the subgroups of firm commitments is that firms using accelerated bookbuilt offerings and bought deals have lower debt to assets ratio than firms using fully marketed offerings when issuing seasoned equity. Rights offer is usually not as well timed as firm commitments. The average book to market and debt to assets ratios are lower for companies that issue seasoned equity with firm commitments than for rights issuing firms.

I would like to thank Peter Molnár, Randi Næs, Marius Sikveland, Bernt Arne Ødegaard and participants in various seminars and conferences for helpful comments. I am solely responsible for all remaining errors and omissions.
Citation: Svein olav Krakstad, (2013) "Timing Differences between SEO Methods", *Economics Bulletin*, Vol. 33 No. 4 pp. 3070-3079.
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Submitted: October 31, 2013.   **Published:** December 23, 2013.

1 Introduction

If companies are able to time their seasoned equity offerings, more equity can be raised. In good market conditions, equity offerings are easier to float. Raising equity under bad market conditions could lead the companies to sell stocks cheaper and the probability of issue withdrawal is higher.

Baker and Wurgler (2002) find that companies with low debt level are companies that issue equity when the company's market to book ratio is high, and high leverage firms issue equity when the market value is low. Two-thirds of CFOs think the stock's over- or undervaluation is quite important for the decision to raise equity (Graham and Harvey 2001). However, DeAngelo et al. (2010) find that around 90% of CRSP/Compustat firms from 1973 to 2001 only issued three or fewer SEOs. The need for cash is the most important driver for a seasoned equity issue and that selling shares at a high price and life-cycle stage are secondary considerations.

Due to the fact that European companies use more rights issues than U.S. companies, researchers are interested in why European companies choose rights issues. Cronqvist and Nilsson (2005) investigate the choice between rights offerings and private placements for Swedish companies from 1986 to 1999. Firms with high or extreme asymmetric information are more likely to choose private placement because it reduces adverse selection costs. Chen et al. (2010) find evidence that the choice between private placement and rights issue is dependent on the history of the stock and the market. In a hot period it is more likely that the company will choose rights issue. Burch et al. (2004) use a database that consists of U.S. companies in the 1930s and 1940s in order to have U.S. sample, where firms were using both rights issues and firm commitments. They find that firms are more likely to use firm commitments when the stock price is relatively high.

The timing literature has mainly been focusing on U.S. firm commitments, but the firm specific properties of companies using different SEO types have not been well documented. Firm commitment can be divided into three subgroups: accelerated bookbuilt offering, bought deal and fully marketed offering.[1] By using subgroups of firm commitments we get more understanding of the choices that SEO companies make. It is easier for companies to pick the best time for an equity issue if they use faster offerings such as accelerated bookbuilt offerings and

[1] In accelerated bookbuilt offerings, the investment bank quickly performs a bookbuilding process to some selected institutional investors without road shows. A bought deal occurs when an investment bank purchases a number of stocks with an agreed price from an issuer before a prospectus is filed. Fully marketed offering is quite similar to the bookbuilt IPO process where the offering is marketed. Typically, the investment bank performs a road show and builds an order book, in which the issuer's management and the investment bank meet with institutional investors, analysts and securities sales personnel.

bought deals.

In this paper we look at the characteristics (descriptives) of firms using accelerated bookbuilt offerings, bought deals, cash placements, fully marketed and rights offerings. The book to market and debt to assets ratios for Norwegian companies are much lower for firm commitments and cash placements than for rights issues. Around 50% of the firm commitments and cash placements have book to market ratios below 0.5, while only 35% of rights issuing firms have book to market ratios below 0.5. Firms that exclude the use of rights, receive higher value for the stocks sold. Around half of the companies that use the accelerated bookbuilt offerings, have debt to assets ratios below 0.2 and book to market ratios below 0.4.

The remainder of this paper is organized as follows: data description is given in Section 2. The characteristics of Norwegian seasoned equity offering firms are presented in Section 3, and Section 4 concludes. An explanation of the Norwegian Equity market can be sent upon request.

2 Data

Our data consists of Norwegian firms issuing seasoned equity in the period between 1992 and 2011. The database comes from Dealogic. The data gives us insight in the SEO types used because the database distinguishes between rights issues, bought deals, accelerated bookbuilt offerings, fully marketed offerings, cash placements and more. The Norwegian market does not distinguish itself from the rest of Europe when it comes to the way companies raise seasoned equity. The main methods in Europe are accelerated bookbuilt offering, fully marketed offering and rights issue (Krakstad 2013). European and Norwegian companies do not use the fully marketed method as much as in the 1990s. Today, accelerated bookbuilt offering is the most common way to raise equity. Bortolotti et al. (2008) document that more and more companies worldwide do SEOs by accelerated bookbuilt method, and they conclude that this represents a shift towards an auction model for SEOs as predicted. According to them, more companies choose accelerated bookbuilt offerings because these deals have lower gross spread fee and underpricing. Table 1 indicates which SEO types Norwegian companies usually use.

In addition, an electronic database of Norwegian SEOs collected from Oslo Stock Exchange's web pages is utilized in order to compare the results from both databases. The database from the Stock Exchange has more observations, but it does not distinguish between private placements and firm commitments (we only know whether the deal is rights issue or not), and hence this database is only used as a robustness test of the results generated by the database from Dealogic. It is likely that there is a sample selection problem by using the sample from Dealogic, and hence it is important to compare the results by also using the larger Oslo

Table 1: Overview of common SEO types in Norway 1990-2011

The table shows the classification of the registered SEOs in the Dealogic database. Other is combination of the SEO types in the table.

Year	Rights issues	Cash placements	Accelerated bookbuilt offerings	Bought deals	Fully marketed offerings	Other	All
1992	0	0	0	1	1	0	2
1993	0	0	0	0	1	0	1
1994	4	5	0	0	3	0	12
1995	1	6	0	0	2	0	9
1996	0	0	0	1	3	0	4
1997	0	0	0	1	2	0	3
1998	2	1	3	0	2	0	8
1999	0	5	0	1	2	0	8
2000	2	2	2	2	1	0	9
2001	0	0	8	1	3	1	12
2002	10	3	6	0	2	1	21
2003	4	6	15	1	0	3	26
2004	4	10	12	2	2	4	30
2005	6	11	41	0	0	2	58
2006	5	8	40	0	4	2	57
2007	6	5	42	6	11	0	70
2008	6	7	21	3	2	0	39
2009	22	13	41	0	1	7	77
2010	12	18	37	0	5	12	72
2011	3	11	11	0	1	8	26
Sum	87	111	279	19	48	40	544
Sum/All obs	16.0 %	20.4 %	51.3 %	3.5 %	8.8 %	7.4 %	

Stock Exchange database. However, the results are mainly the same when using both databases, and the reader can get the robustness tests upon request.

3 Characteristics of SEO firms

We focus on debt to assets ratio because understanding of debt capacity is important for the decision to raise equity (Lemmon and Zender 2010). If companies are not constrained, they are more flexible and able to choose between different methods of raising capital. As Baker and Wurgler (2002) find, when firms with low debt level issue equity, the book to market ratio is often low, and the opposite is the case when firms have a high debt level. Hence, focus is given on the book to market ratios for firms issuing seasoned equity.

As Table 2 shows, there are some changes in book to market and debt to assets ratios for companies issuing seasoned equity. Firms that issue seasoned equity, have an insignificant negative book to market ratio change after the issue when using different SEO types (except when using bought deals). Lower book to market ratios means that companies' market value increase relative to book value of equity. On average, all SEO companies experience lower debt to assets ratios after the issue (except when using bought deals).

Table 3 divides seasoned equity issuing firms into seven book to market groups. This table indicates that there are differences between firms using different SEO types. Rights issuing companies have on average higher book to market ratios than the four other SEO types. The companies in the group with the lowest book to market ratios, have on average higher book to market ratios after the issue, indicating that the firms with lowest book to market ratios before the seasoned equity issue, time the SEO.

In Table 4 we divide seasoned equity firms into six debt to assets ratio groups. Companies that issue seasoned equity with the bought deal or the accelerated bookbuilt offering are more likely to be in the lowest debt to assets ratio group. Around 50% of all companies using these two methods, have debt to assets ratios between 0 and 0.2. Rights issuing firms have marginally lower percentage on the two lowest debt to assets groups than fully marketed offerings and cash placements. Independently on the SEO type, all firms have lower debt to assets ratio on average after the SEO as expected.

Table 5 sorts firms using rights issues, bought deals, fully marketed offerings, accelerated bookbuilt offerings and cash placements on different debt to assets ratios and calculates average book to market, in order to see if companies with low debt level (here: low debt to assets), have lower book to market ratio. Since results in Table 5 confirm this, there is evidence that solid Norwegian companies (in terms of debt to assets ratios) prefer to issue seasoned equity when their market value

Table 2: Accounting ratios before and after the SEO

The table shows the means, standard deviations (Std.) and number of observations (Obs.) of the book to market (BM) and debt to assets (DtA) ratios for companies before and after a SEO. BM and DtA are reported at year end. t-tests are performed to see whether the means are significantly different. The database from Dealogic is used.

	Before		After		Both	
Book to Market	Mean	Std.	Mean	Std.	Obs.	t-test
Rights issue	1.15	0.64	0.98	0.60	65	1.58
Bought deal	0.37	0.08	0.56	0.13	15	-4.78
Fully marketed offering	0.68	0.23	0.67	0.19	21	0.13
Accelerated bookbuilt offering	0.76	0.91	0.69	0.66	196	0.93
Cash placement	0.86	0.60	0.74	0.34	43	1.18
	Before		After		Both	
Debt to Assets	Mean	Std.	Mean	Std.	Obs.	t-test
Rights issue	0.46	0.21	0.39	0.18	60	2.03
Bought deal	0.21	0.05	0.24	0.06	14	-1.66
Fully marketed offering	0.44	0.13	0.32	0.09	22	3.60
Accelerated bookbuilt offering	0.27	0.23	0.23	0.19	192	1.93
Cash placement	0.46	0.19	0.38	0.16	47	2.22

Table 3: Book to market ratios before and after SEO

Observations are sorted into seven book to market ratio groups. The table shows the percentage of observations in different book to market ratio groups for each SEO type. The book to market ratio is an accounting measure and is reported at the year end. The database from Dealogic is used.

SEO Type	Descr.	(0,0.25)	[0.25,0.5)	[0.5,0.75)	[0.75,1)	[1,1.5)	[1.5,2.5)	>2.5	N
Rights	Before	0.09	0.20	0.28	0.11	0.06	0.12	0.14	65
issue	After	0.08	0.20	0.22	0.22	0.17	0.08	0.05	65
Bought	Before	0.13	0.73	0.13	0.00	0.00	0.00	0.00	15
deals	After	0.20	0.27	0.40	0.00	0.13	0.00	0.00	15
Fully	Before	0.29	0.14	0.29	0.19	0.00	0.05	0.05	21
marketed o.	After	0.14	0.33	0.14	0.19	0.10	0.10	0.00	21
Accelerated	Before	0.28	0.24	0.26	0.06	0.04	0.08	0.05	196
bookbuilt o.	After	0.17	0.31	0.23	0.16	0.07	0.02	0.04	196
Cash	Before	0.26	0.37	0.16	0.07	0.02	0.02	0.09	43
Placement	After	0.12	0.30	0.33	0.07	0.12	0.00	0.07	43

Table 4: Debt to assets ratios before and after SEO

Observations are sorted into six debt to assets groups. The table shows the percentage of observations in six different debt to assets ratio groups for each SEO type. The debt to assets ratio is an accounting measure and is reported at the year end. The database from Dealogic is used.

SEO type	Description	(0,0.2)	[0.2,0.4)	[0.4,0.6)	[0.6,1)	[1,1.5)	>1.5	Obs
Rights	Before	0.22	0.25	0.15	0.23	0.13	0.02	60
issue	After	0.23	0.28	0.28	0.17	0.03	0.00	60
Bought	Before	0.50	0.43	0.07	0.00	0.00	0.00	14
deals	After	0.50	0.29	0.14	0.07	0.00	0.00	14
Fully	Before	0.27	0.23	0.18	0.18	0.00	0.14	22
marketed o.	After	0.36	0.32	0.23	0.09	0.00	0.00	22
Accelerated	Before	0.53	0.20	0.14	0.09	0.02	0.03	192
bookbuilt o.	After	0.53	0.31	0.10	0.05	0.02	0.00	192
Cash	Before	0.21	0.32	0.11	0.21	0.09	0.06	47
placement	After	0.30	0.28	0.17	0.21	0.04	0.00	47

compared to the book value is high. Firms using bought deals, fully marketed offerings, accelerated bookbuilt offerings and cash placements have lower book to market ratios than rights issuing firms in all groups except the two highest debt to assets ratio group for accelerated bookbuilt offerings and the highest group for cash placements. This finding is, however, not unreasonable. Given that companies are in financial distress and they need cash fast in order to not get bankrupt, and hence the fastest way of raising equity would be preferable. Rights issues are not an option in situations like this because it would at least take five weeks in order to fulfill the Oslo Stock Exchange requirements.

Given that companies issue seasoned equity, companies using bought deals, fully marketed offerings, accelerated bookbuilt offerings and cash placements often time their equity issue better than for rights issuing firms in terms of having lower book to market ratios. In our sample, all SEO companies seem to avoid issuing equity if their company has high debt ratio and high book to market ratio since few companies raise equity when their book to market and debt to assets ratios are high.

Table 5: Timing of SEOs

The table divides all firms using rights issues, bought deals, fully marketed offerings, accelerated bookbuilt offerings, and cash placements into five debt to assets (DtA) groups, and in each group the book to market (BM) ratio mean, BM standard deviation, and observations are reported. The BM and DtA ratios are accounting measures and are reported at the year end. The database from Dealogic is used.

Rights issues				Bought deals			
Groups	Mean	Std	Obs	Groups	Mean	Std	Obs
$(0.0, 0.2)$	0.491	0.118	13	$(0.0, 0.2)$	0.325	0.050	7
$[0.2, 0.4)$	0.659	0.196	15	$[0.2, 0.4)$	0.388	0.052	6
$[0.4, 0.6)$	1.397	0.304	9	$[0.4, 0.6)$	0.256	0.014	1
$[0.6, 0.8)$	1.429	0.319	14	$[0.6, 0.8)$			0
$[0.8, 1.0)$	2.175	0.405	8	$[0.8, 1.0)$			0

Fully marketed offerings				Accelerated bookbuilt offerings			
Groups	Mean	Std	Obs	Groups	Mean	Std	Obs
$(0.0, 0.2)$	0.352	0.053	6	$(0.0, 0.2)$	0.392	0.223	98
$[0.2, 0.4)$	0.341	0.045	5	$[0.2, 0.4)$	0.421	0.171	37
$[0.4, 0.6)$	1.196	0.187	4	$[0.4, 0.6)$	1.247	0.415	26
$[0.6, 0.8)$	1.049	0.117	4	$[0.6, 0.8)$	1.709	0.485	17
$[0.8, 1.0)$			0	$[0.8, 1.0)$	5.403	0.674	4

Cash placements			
Groups	Mean	Std	Obs
$(0.0, 0.2)$	0.330	0.072	10
$[0.2, 0.4)$	0.492	0.156	13
$[0.4, 0.6)$	0.510	0.068	5
$[0.6, 0.8)$	0.759	0.150	10
$[0.8, 1.0)$	4.188	0.562	4

4 Conclusion

This paper investigates characteristics of Norwegian firms issuing seasoned equity. Independently of SEO type, firms seem to try to issue seasoned equity when their book to market and debt to asset ratios are low. Firm commitments is used more when firms have good financials (lower ratios). Rights issuing firms have on average higher book to market and debt to assets ratios than firms using firm commitments. Obviously, using the fastest SEO types would make it easier for companies to time the seasoned equity issue. Rights issues are often done over a two-months period, and it would therefore be harder to time rights issues. Hence, firms are more likely to use firm commitments or cash placements when they want to time their equity issue. Firm commitments are in the paper split into three subgroups: accelerated bookbuilt offerings, bought deals and fully marketed offerings. The characteristics of firms using these subgroups are similar, but firms using accelerated bookbuilt and bought deals have lower debt to assets ratios than firms using fully marketed offerings.

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