

FIN 411: Secondary Distributions

Mikkelson & Partch (JFE, 1985): study price effects of secondary distributions

sale of a large block of stock by one shareholder to many smaller buyers

- registered with the SEC, or
- unregistered (smaller)

Mikkelson & Partch (JFE, 1985) Secondary Distributions

Primary distribution when the firm sells new shares and receives cash

Secondary distribution has no cash flow implications for the firm

- in fact, the firm probably doesn't even know it is happening

better experiment than primary because you don't have to worry about the what the firm uses the proceeds for [i.e., is $NPV > 0$?]

Alternative Hypotheses About Price Effects of Secondary Distributions

(1) Price pressure: demand curves generally slope downward

- people are willing to pay less per unit for incremental units

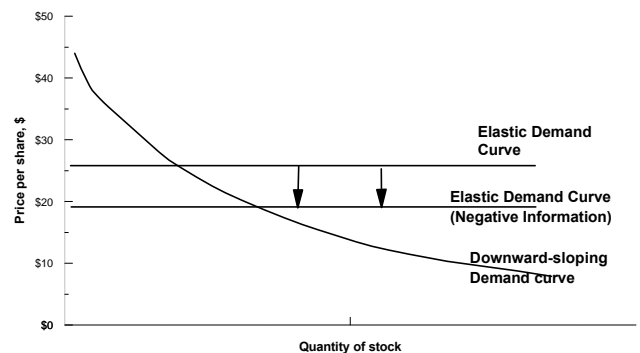
(2) Perfect competition: elastic demand curve (availability of many perfect substitutes)

- e.g., other common stocks with the same risk and return characteristics

(3) Information effects: identity of the seller conveys information about value of the stock (Lemons problem)

- downward shift in the horizontal demand curve

Alternative Hypotheses About Price Effects of Secondary Distributions



Summary Statistics (Table 3)

underwritten secondaries, 1972-81

146 registered (321 unregistered)

- registration required if seller has control relationship (insider)

registered larger 828,000 shares (vs. 152,000)

- \$31.6 million (vs. \$3.5 mil)
- 8.1% (2.7%) of shares outstanding

Who is Selling? (Table 4)

53 insiders use registered (37% of cases)

- How do 6 insiders sell unregistered?

155 investment cos, banks, insurance cos sell unregistered

- 71% of cases where info is available

What Happens When the Sale Is Announced? (Table 5)

Day -1: -1.31% (R) & -.40% (U)

Day 0: -1.56% (R) & -.40% (U)

Day 1: .09% (R) & -1.56% (U)

- unregistered secondaries (U) typically are disclosed and distributed after the close of trading on day 0

no price rebound later

- reflecting temporary price pressure

What Happens When Shares Are Distributed? (Table 6)

Registered secondaries are distributed well after the registration

No stock price effect when trades occur

- just when the intention to sell is announced

No price rebound later

- reflecting temporary price pressure

Typically don't know identity of seller in unregistered secondaries until after the shares are distributed

Does It Matter Who Is Selling? (Table 10 -- registered)

Largest price effect for insiders (-3.4%; t=-8.5)

- -2.6% for other sellers, still significant

Largest price effect for largest sales: 19% of stock (-3.9%; t=-7)

- -2% (t=-4.5) for smallest sales

It is not good news that a large holder has decided to sell a block of stock

- and hasn't found a large buyer to replace him

Underwriting Spreads on Secondaries (Tables 11 & 12)

Spread is difference between price charged by underwriter and price received by seller

- avg spread = 4.9%

Spread is larger if size is larger:

- relative to shares outstanding, or
- relative to normal trading volume

Spread is smaller if the dollar size of the offering is larger

M&P (JFE, 1985) Secondary Distributions: Summary

- (1) Costs of selling in secondary are high (2.5% announcement price effect, 6.5% underwriter fees)
- (2) Adverse information effects are large (identity of seller, size of trade, etc.)
- (3) No price pressure (temporary price reduction to absorb the large block of stock)

M&P (JFE, 1985) Secondary Distributions: Questions

- (1) Why would someone with a large block of stock choose to sell via a secondary distribution?
- (2) If you were an uninformed investor with a large block of stock in one company, how could you credibly signal to the market that you were not selling due to adverse information?
- (3) Why would anyone sell stock using an underwritten secondary distribution if the transactions costs are so large?