

**Alternative Methods of Issuing Equity in Australia: Effects of Rights Issues and
Private Placements on Shareholder Wealth and Ownership Structure**

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1. Introduction

Two of the most commonly used methods of issuing equity by public firms are rights issues and private placements. Choosing an issuance mechanism allows firms to signal their quality (value) and affect ownership concentration, (Slovin et al., 2000). Rights issues have progressively become rarer in the US and UK and firms there have utilized private placements more frequently, (Eckbo and Masulis, 1992; Slovin et al., 2000). By contrast, a recent study by Cronqvist and Nilsson (2004) indicates that firms in Sweden have used these procedures roughly in equal proportion.

In Australia, Brown and Chan (2004) report that firms have used rights offers and placements in excess of 2000 times over a 5 year period ending in 2001, and that firms prefer private placements over rights issues – 1856 (85%) and 326 (15%) respectively. They also document that most Australian firms tailor their issues such that amount sought falls just below the ceiling stipulated by law. When the issuance ceiling was raised to 15% (from 10%) in 1998, firms quickly adjusted the amount sought upwards. There has been considerable debate regarding the 15% ceiling, with the ASX recognizing that it is restrictive, but attempts to change the regulation were recently unsuccessful, (ASX, 2003).

The consequences of choosing amongst equity issuance methods have been subject to extensive empirical analyses. Cronqvist and Nilsson (2004) provide evidence that family controlled firms in Sweden choose issuance method that maintains their control and does not subject (the family) to increased monitoring and market reactions to such offerings are insignificant. Announcement effects are negative both in US (Eckbo and Masulis, 1992) and UK (Slovin et al., 2000) for rights offerings. Kothare (1997) documents significant changes in ownership structures (resulting from various issuance methods) and suggests that these may influence market reactions to the announcements. Last, Khorana, et al (2002) document a negative announcement effect from rights offerings of closed-end funds in the US which is positively correlated with the offer discount to NAV.

Announcement wealth effects for private placements are consistently positive across a range of studies including Wruck (1989), Krishnamurthy et al. (2005), Barclay et al. (2005), and Cronqvist and Nilsson (2004). Positive re-valuations are seen a result of increased monitoring by active investors (Wruck, 1989) or a result of certification (whereby large investors “certify” the firm’s value by buying a large stake in it, Hertz and Smith 1993). Additionally Wu (2004) documents that firms use private placement to signal undervaluation to the market. However, Barclay et al. (2005) provide evidence that only firms placing equity with active investors experience long-term positive wealth effects, and suggest that the choice of equity issuance method is motivated by managerial entrenchment rather than by monitoring or certification.

2. Study Aims

The preceding literature review indicates the relevance of such decisions on market values of firms, on returns to investors (both current and new), and on firms’ ownership structures. We are not aware of any published evidence on consequences of such decisions made by Australian firms. A primary motivation is therefore to assess whether such decisions have any discernible impact on Australian firms (even in the presence of current restrictions). We will examine direct consequences of such decisions by asking the following questions –

- What are the discounts offered on rights offerings versus private placements? Are private placements systematically offered at higher discounts than rights offerings?
- How do these discounts relate to the announcement effects of such equity issuance? Are there any discernible long-term effects of such choice on firm return performance and value (Tobin’s q)?
- What is the level of participation of (existing) small and large shareholders in these issues? And does level of participation influence announcement period and post-issue returns for these firms?

Our empirical evidence on returns will provide a clear indication of the wealth effects of these decisions; it will compare the alternative hypotheses (monitoring, certification, and entrenchment); and finally, our analysis will address the interaction between ownership

structures, investor identity, and shareholder wealth. The results of the paper will have several implications regarding the current use and regulation of seasoned equity issues in Australia. By highlighting the causes and consequences of the two methods, it will allow issuing companies (and their shareholders) to make more informed, and perhaps optimal, choice. It will also inform the policy debate on the regulation of, and limits placed on, issuing seasoned equity in Australia.

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