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Private Placements of Equity and Firm Value: Value Enhancing or Value Destroying?

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Abstract

This paper reassesses two conflicting hypotheses on the valuation impacts of private placements of equity (PPEs), the monitoring/certification hypothesis and the managerial entrenchment hypothesis, by focusing on the shareholder approval, active buyer, and premium pricing features of PPEs. We find that PPEs with these features have significant positive announcement returns and insignificant mean long-run returns, while the corresponding announcement and long-run returns for PPEs without such features are significantly negative. Firms with value-enhancing PPE features are better governed and use proceeds more efficiently. Thus, the heterogeneous nature of PPEs helps reconcile the puzzling return patterns and conflicting hypotheses regarding PPEs.

I. Introduction

The literature on private placements of equity (PPEs) provides mixed evidence on their valuation effects. For example, Wruck (1989) and Hertzel and Smith (1993) argue that firms engage in PPEs to signal the emergence of new blockholders who will monitor incumbent managers and certify the undervaluation of firm assets (the monitoring/certification hypothesis) and find positive PPE announcement returns. By contrast, others, including Krishnamurthy, Spindt, Subramaniam, and Woidtke (2005) and Barclay, Holderness, and Sheehan (2007), show that firms engage in PPEs to help managers entrench (the managerial entrenchment hypothesis), which adversely affects firm value in the long-run.[1] Although these studies improve our understanding of why firms undertake PPEs, it remains unclear why the valuation

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[1] In particular, Barclay et al. (2007) show that PPEs are frequently made to passive investors, helping managers strengthen their control of the firm. The managerial entrenchment hypothesis is further

effects of PPEs differ across studies and whether PPE characteristics can explain such a difference.

In this study, we reassess the valuation effects of PPEs by considering three important characteristics of PPEs that help enable existing shareholders or new buyers to perform value-increasing monitoring/certification services for placement firms. The first characteristic that we consider is whether the PPE requires shareholder approval for issuance. Because of the dilutive nature of PPEs, stock exchanges in the United States require PPEs with certain contractual terms to receive shareholder approval. Since managers can influence the choice of PPE contractual terms and thus make their proposed PPEs subject to shareholder approval, PPEs that require (avoid) shareholder approval are likely to signal managers' willingness to obtain monitoring/certification by existing shareholders, thereby signaling firms to be a good (bad) type.[2] Following the shareholder approval regulations adopted by the U.S. stock exchanges, we consider the following three types of PPEs to have a shareholder approval feature: i) discount PPEs in which firms sell more than 20% of the existing shares outstanding (*Discount Issues with Fraction More Than 20%*); ii) PPEs in which buyers purchase more than 20% of shares outstanding and become the largest shareholders (*Change-of-Control Issues*); and iii) PPEs in which managers purchase either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of a firm's shares outstanding (*Manager Participating Issues*).

The second characteristic that we consider is whether PPEs are sold to active buyers. Wruck (1989), Wruck and Wu (2009), and Hertzel and Smith (1993) argue that new investors of PPEs add value to firms by providing monitoring and certification services. By contrast, Barclay et al. (2007) and Krishnamurthy et al. (2005) show that PPEs are often made to passive, unaffiliated investors, which leads to significant long-run negative returns. These results suggest that buyer identity in PPEs is important for the PPE valuation effects. Following prior studies, we consider PPEs to have an active buyer feature if a new buyer demands board representation in an issuer (*Board Representing Buyer*), has a strategic relationship with the issuer (*Strategic Buyer*), or purchases a block ownership of at least 5% in the issuer as a single investor (*One Block Buyer*).

The last characteristic that we consider is PPEs' premium pricing feature. Although previous studies have examined how placement discounts work as compensation for buyers' monitoring efforts or certification roles (e.g., Wruck (1989), Hertzel and Smith (1993), and Wruck and Wu (2009)), they have paid little attention to the valuation effect of premium issues, which account for a large portion of PPEs. Investors' purchase of premium issues can signal the undervaluation of firm assets because they would participate in premium issues only when they perceive shares'

supported by negative long-run post-issuance excess returns for firms undertaking PPEs (e.g., Hertzel et al. (2002), Krishnamurthy et al. (2005)).

[2]For example, shareholder approval allows existing shareholders to monitor managers by rejecting placement proposals that are not in their best interests. To the extent that managers attempt to avoid shareholder approval for PPEs that destroy firm value, PPEs that receive shareholder approval can certify the value of the firm. Consistent with these arguments, Holderness (2018) shows that equity issuance around the world that requires (avoids) shareholder approval is associated with positive (negative) announcement returns.

long-run true value to be higher than the premium price that they pay. Moreover, these investors are more likely to actively monitor managers because they pay the premium price for the shares that they purchase. Firms that place shares at a premium do not experience dilution in share value because equity is sold at a premium (Hertzel and Smith (1993)). Thus, the premium pricing feature is likely to be an important value-enhancing PPE characteristic.

By using a sample of 4,725 PPEs from 1995 to 2016 and classifying them into various subgroups according to whether they have a value-enhancing feature (i.e., a shareholder approval feature, active buyer feature, or premium pricing feature), we find several important results that are consistent with the monitoring/certification (managerial entrenchment) hypothesis for the firms whose PPEs have (do not have) a value-enhancing feature. First, we find a significant mean cumulative abnormal return (CAR) from 1 day before the PPE announcement date to 1 day after the PPE announcement date (CAR $(-1, 1)$) of -1.81% for the firms whose PPEs do not have any value-enhancing feature. By contrast, the mean CAR $(-1, 1)$ for the firms whose PPEs have at least one value-enhancing feature is a significant 6.37%. By controlling for various firm and placement characteristics in the regressions, we further find that the mean CAR $(-1, 1)$ is significantly higher by 3.64% for the firms whose PPEs have at least one value-enhancing feature than for the firms whose PPEs do not have such a feature. These results suggest that the market views the firms that conduct PPEs with and without a value-enhancing feature as generally "good" and "bad" types of firms, respectively. The results are robust to excluding the PPEs with overlapping value-enhancing features from the regressions.

Second, we find that the firms that issue shares without any value-enhancing feature experience a significant mean buy-and-hold abnormal return (BHAR) of -15.3% during the 3 years following the announcement, while the firms that issue shares with a value-enhancing feature experience an insignificant mean BHAR of -0.55% during the same period. Calendar-time portfolio analyses show similar results. Thus, the puzzling results of positive announcement returns and subsequent negative long-run post-placement returns for the PPEs documented in the prior literature are unlikely to be driven by investor overreaction (Hertzel, Lemmon, Linck, and Rees (2002)); rather, they are likely to be driven by the differences in the placement characteristics that allow shareholders and new buyers to perform value-enhancing roles and thus help reduce managerial agency problems.

Finally, we find that the firms whose PPEs have at least one value-enhancing feature are more financially distressed and leveraged, perform worse, and have better governance prior to the PPE,[3] which suggests that they issue equity to timely meet their financing needs. By contrast, the firms whose PPEs do not have a value-enhancing feature are more likely to increase their cash holdings and debt and to engage in value-decreasing mergers and acquisitions (M&As) in the post-PPE period, which suggests that their PPEs are mainly driven by managerial agency problems, not by value-enhancing motivations, such as timely meeting their financing needs and

[3]Specifically, compared to other firms, the firms whose PPEs have at least a shareholder approval feature have higher managerial ownership, a higher proportion of outside directors on the board, and shorter chief executive officer (CEO) tenure, and the firms whose PPEs have at least an active buyer (premium) feature have younger CEOs (lower CEO-chair duality).

lowering their financial distress. These results further support our hypothesis that the PPEs with (without) a value-enhancing feature are motivated by the efficient use of proceeds and monitoring/certification benefits (managerial entrenchment).

Our study contributes to the literature on PPEs by showing that considering the heterogeneous nature of the private placements in the analysis helps reconcile the conflicting evidence regarding the valuation effects of PPEs. Although prior studies have examined the monitoring/certification role played by active buyers and the dilution effect of discount placements on the share value,[4] our study focuses on the shareholder approval feature as a new value-enhancing feature of PPEs. Although Holderness (2018) lays out the importance of the mandatory shareholder approval of equity issuances around the world including the 20% rule for discount private placements (i.e., a shareholder approval rule that applies to *Discount Issues with Fraction More Than 20%*) in the United States, we extend his analysis by performing a more thorough study of U.S. private placements with a larger database and by considering in the analysis all different types of shareholder approval rules, including the 20% rule for discount private placements, the approval requirement for *Change-of-Control Issues*, and the approval requirement for *Manager Participating Issues.* We also consider the premium pricing feature, which has received little attention in the literature, as an important PPE value-enhancing feature and provide new insights into the role of premium pricing in PPE valuation effects.

The remainder of the paper is organized as follows: In Section II, we discuss the value-enhancing features of PPEs. In Section III, we describe the data and summary statistics. Sections IV–VII present our empirical results. Section VIII summarizes and concludes the paper.

II. Value-Enhancing Features of PPEs

PPEs can have several unique features, including shareholder approval, active buyer, and premium pricing features, that enable existing and new shareholders to perform a valuable monitoring/certification role for the firms that place equity privately.

A. Shareholder Approval

Nasdaq, New York Stock Exchange (NYSE), and NYSE American have adopted three different types of rules that require firms to obtain shareholder approval prior to their PPEs. The first rule is applied to discount PPEs in which firms sell more than 20% of the existing shares outstanding.[5] The second rule is applied when equity offerings including PPEs and public equity offerings result in the change in the largest shareholders, which generally occurs if, as a result of equity issuance, an investor owns or has the right to acquire 20% or more of the shares outstanding.[6] The third rule is applied when managers participate in PPEs or public

[4]See, for example, Wruck (1989), Krishnamurthy et al. (2005), Barclay et al. (2007), and Wruck and Wu (2009) for the role of active buyers in PPEs and Wruck (1989), Hertzel and Smith (1993), and Chaplinsky and Haushalter (2010) for the dilution effects of PPEs.

[5]See Nasdaq Listing Rule 5635 (d), NYSE Rule 312.03 (e), and NYSE American Section 713 (a).

[6]See Nasdaq Rule 5635 (b), NYSE 312.03 (d), and NYSE American Section 713 (b).

equity offerings in which i) premium equity issuance to managers is part of an establishment or material amendment to the firm's equity compensation plan,[7] ii) shares are sold to managers at a discount, and iii) placement firms are listed on the NYSE and their managers acquire more than 1% of the shares outstanding. We consider PPEs to have a shareholder approval feature if the firms must obtain shareholder approval prior to the issuance of equity due to one of these three rules. We discuss the details of the rules, their exceptions, and the application of such rules in classifying our sample PPEs into those with and without a shareholder approval feature in Appendix A.

The shareholder approval rules for PPEs enable existing shareholders to perform a valuable monitoring/certification role through their voting on PPE proposals,[8] thereby helping improve firm value. Although managers' choices of PPEs that require shareholder approval depend on various firm-, industry-, and market-specific conditions, they can have a significant influence on such a decision. Thus, the managers' decision to choose a certain type of PPE that requires shareholder approval can signal their underlying motivation and conflicts, which allows us to identify the firms that reveal themselves to be a good (bad) type by seeking (avoiding) shareholder approval.

B. Active Buyer

The second value-enhancing feature that we consider is whether shares are sold privately to active buyers. Prior studies show that large shareholders enhance firm value by increasing monitoring and reducing free-rider problems (Shleifer and Vishny (1986)) and that outside directors play an important oversight role in monitoring top management (Weisbach (1988)). Allen and Phillips (2000) further show that investors who have a strategic relationship with the firms perform a valuable certification role. The literature on PPEs has extensively investigated the monitoring/certification roles performed by active buyers as large shareholders, outside directors, and strategic investors (e.g., Wruck (1989), Krishnamurthy et al. (2005), Barclay et al. (2007), and Wruck and Wu (2009)). Following these studies, we consider PPEs to have an active buyer feature if the private placement buyer is a *Board Representing Buyer*, a *Strategic Buyer*, or a *One Block Buyer*. To the extent that active buyers provide issuing firms with value-enhancing monitoring/certification services, we expect the active buyer feature to be an important PPE characteristic that helps enhance firm value.

C. Premium Pricing

Although PPEs are typically issued at an average discount of approximately 15% and public equity offerings are offered close to the market price, a large portion of PPEs are still issued at a premium. Unlike discount issues, premium issues are expected to enhance shareholder wealth because equity is sold at a price equal or higher than the market price, which thus does not dilute shareholder value

[7] See Nasdaq Rule 5635 (c), NYSE Rule 312.03 (a), and NYSE American Section 711.

[8] The Institutional Shareholder Service (ISS) explicitly states in its U.S. Proxy Voting Summary Guidelines that private placements should be voted on a case-by-case basis by considering dilution, financial issues, management efforts to seek alternative financing, control issues, conflicts of interest, and stock market reaction.

(Hertzel and Smith (1993)). Moreover, investors who participate in premium placements have weaker incentives to liquidate their shares immediately after the placements and are more likely to actively monitor managers, as they pay the premium price for the shares that they purchase. In addition to these direct value-enhancing effects, premium issues can also signal the undervaluation of firm assets because investors would buy premium issues only when they believe that the long-run true share value of the firms is at least the premium price that they pay. Thus, the premium PPE would create a certification effect for the issuing firms that their shares are undervalued (Hertzel and Smith (1993)). Because of these valuable characteristics of premium PPEs, their investors would generally have strong incentives to maintain a long-term relationship with the issuing firms and to actively monitor issuing firms' managers,[9] which makes premium placements an important value-enhancing feature of PPEs.

III. Data and Summary Statistics

A. Sample

Our sample consists of the PPEs by U.S. firms listed on the NYSE, NYSE American, or Nasdaq that are reported in Sagient Research's PlacementTracker database between 1995 and 2016 inclusive. We require that financial and stock price data for issuers be available at the Compustat and Center for Research in Security Prices (CRSP) databases, respectively. We calculate the fraction of equity issued by using the number of shares outstanding reported in the CRSP monthly and Compustat quarterly databases. Our final sample consists of 4,725 PPEs by 2,231 unique firms. For a subset of our sample firms, we collect information on M&As and their announcement dates from the Securities Data Company (SDC) Platinum M&A database. We also obtain information on institutional and managerial ownership from Thomson Reuters Institutional Holdings (13F) and Electronic Data Gathering, Analysis, and Retrieval (EDGAR), respectively. We collect board- and CEO-specific characteristics, including the proportion of outside directors on the board, CEO-chair duality, CEO age, and CEO tenure, from ExecuComp, BoardEx, and EDGAR.

Graph A of Figure 1 shows the distribution of private placements by the premium/discount and the fraction placed.[10] We find that the majority of observations are concentrated in the discount issues, particularly those in which firms issue less than 20% of the existing shares outstanding, although premium issues are not uncommon (27.6% of the sample). The graph also shows that a large number of discount shares are clustered just below and in the proximity of the 20% threshold,

[9]In untabulated tests, we find that the frequencies of *Board Representing Buyer*, *Strategic Buyer*, and *One Block Buyer* are significantly higher in premium PPEs than in discount PPEs.

[10]We require the fraction of equity issued in the placement to be less than 100% of the existing shares and the placement premium to be less than 100% of the market price. The mean discount rate and the mean fraction of shares issued for our full sample of PPEs are 7% and 15%, respectively. We also find that the mean discount rate for our subsample of discount PPEs is 14.33%, which is similar to that reported in Chaplinsky and Haushalter (2010). The mean faction of equity issued in prior studies (e.g., Wruck (1989), Hertzel and Smith (1993), Hertzel et al. (2002), Barclay et al. (2007), and Wruck and Wu (2009)) ranges from 11% to 21%.

which creates an irregularity in the placement sample distribution. Graph B of Figure 1 further shows that the number of placements surges just below the 20% threshold and drops dramatically above the 20% threshold; this creates a discontinuity in the distribution. In Figure 2, we find that this distribution irregularity is evident only for discount issues, not for premium issues. For example, 5.5% (16%) of the sample firms place the shares at a discount with the fraction between 19%–20% (15%–20%). Thus, in a large number of PPEs, managers actively avoid the requirement of shareholder approval when they place equity privately at a discount.

FIGURE 1

Distribution of Premium/Discount Ratios for Private Placements of Equity and Their Frequency Histograms by the Fractions of Shares Placed

Figure 1 presents the distribution of premium/discount ratios for private placements of equity (PPEs) by the fractions of shares placed as a percentage of the total number of shares outstanding (Graph A) and the frequency histogram for PPEs by the fractions of shares placed (Graph B). The premium/discount ratio is the ratio of the difference between the issue price and the price 1 day before the private placement closing date to the price 1 day before the private placement. The sample consists of 4,725 PPEs reported in the Sagient Research PlacementTracker database from 1995 to 2016. Graph A shows the scatter plot of the premiums/discounts for PPEs with a vertical grid line drawn at the fractions of shares placed at 20% and a horizontal grid line drawn at the zero premium/discount issues. Graph B shows the frequency histogram for PPEs with a vertical grid line drawn at the fractions of shares placed at 20%.

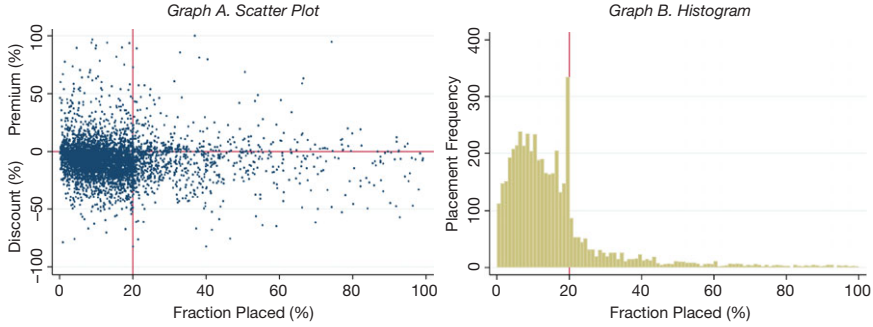

FIGURE 2

Distribution of Private Placements of Equity by the Fractions of Shares Placed: Subsamples of Premium and Discount Issues

Figure 2 plots the distribution of private placements of equity (PPEs) by the fractions of shares placed as a percentage of the total number of shares outstanding for a subsample of premium (discount) issues. The sample consists of 4,725 PPEs reported in the Sagient Research PlacementTracker database from 1995 to 2016. Graph A shows the frequency histogram for premium issues with a vertical grid line drawn at the fractions of shares placed at 20%. Graph B shows the frequency histogram for discount issues with a vertical grid line drawn at the fractions of shares placed at 20%.

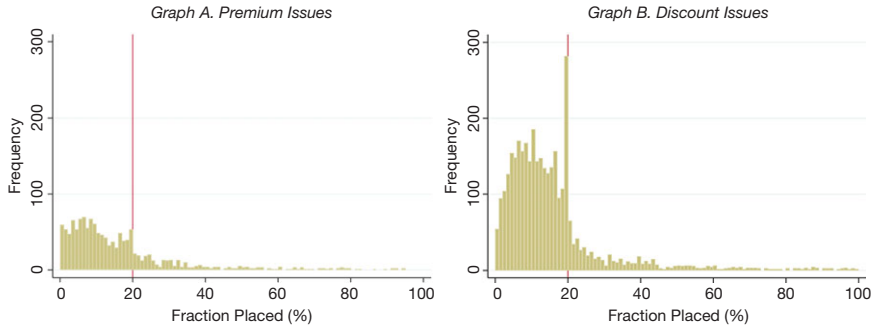

TABLE 1

Distribution of Private Placements of Equity According to the Existence of Value-Enhancing Features

Table 1 presents the frequency of private placements of equity (PPEs) according to the existence of value-enhancing features. The sample consists of 4,725 PPEs reported in the Sagient Research PlacementTracker database from 1995 to 2016. Value-enhancing features of PPEs (shareholder approval, active buyer, and premium pricing features) are PPE characteristics that allow existing shareholders or new buyers to provide issuing firms with value-increasing monitoring/certification services. PPEs with a shareholder approval feature are i) discount placements whose fractions placed are more than 20% of the shares outstanding (i.e., *Discount Issues with Fraction More Than 20%*), ii) placements in which the buyer purchases more than 20% of shares outstanding including existing and new shares and becomes the largest shareholder (i.e., *Change-of-Control Issues*), and iii) placements in which the manager purchases either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of shares outstanding in her NYSE listed firm (i.e., *Manager Participating Issues*). PPEs with an active buyer feature are those in which the buyer demands board representation in an issuing firm (*Board Representing Buyer*), has a strategic relationship with the issuing firm (*Strategic Buyer*), or purchases block ownership in the issuing firm as a single block owner (*One Block Buyer*). PPEs with a premium pricing feature are those in which the buyer pays the premium when purchasing equity. PPEs with only one nonoverlapping value-enhancing feature are those that have only one unique value-enhancing feature. PPEs with two different nonoverlapping value-enhancing features are those that have two distinct value-enhancing features.

Subsample	Frequency (%)
PPEs with no value-enhancing feature	2,317 (49.0)
PPEs with at least one value-enhancing feature	2,408 (51.0)
with at least shareholder approval feature	834 (17.7)
with at least active buyer feature	846 (17.9)
with at least premium pricing feature	1,305 (27.6)
PPEs with only one nonoverlapping value-enhancing feature	1,871 (39.6)
with only shareholder approval feature	625 (13.2)
with only active buyer feature	344 (7.28)
with only premium pricing feature	902 (19.1)
PPEs with two different nonoverlapping value-enhancing features	497 (10.5)
with only shareholder approval and active buyer features	134 (2.8)
with only shareholder approval and premium pricing features	35 (0.7)
with only active buyer and premium pricing features	328 (6.9)
PPEs with all three different value-enhancing features	40 (0.8)

B. Summary Statistics

Table 1 reports the distribution of our sample PPEs by the existence of value-enhancing features. Of the full sample of 4,725 PPEs, 2,408 (51%) have at least one value-enhancing feature: 834 PPEs (17.7%) with at least a shareholder approval feature, 846 PPEs (17.9%) with at least an active buyer feature, and 1,305 PPEs (27.6%) with at least a premium pricing feature. Of these 2,408 PPEs, 1,871 (39.6% of the full sample) have only one nonoverlapping value-enhancing feature, 497 (10.5%) have two different value-enhancing features, and 40 (0.8%) have all three different value-enhancing features. Of the 1,871 PPEs with only one nonoverlapping value-enhancing feature, 625 (344, 902) have only a shareholder approval (an active buyer or a premium pricing) feature. Our findings that the number of PPEs with at least one value-enhancing feature is larger than the number of PPEs with only one nonoverlapping value-enhancing feature suggest that some firms issue shares privately with multiple value-enhancing features.[11]

Table 2 presents the summary statistics for the subsamples of PPEs classified according to whether the placement has at least one value-enhancing feature. We find that the firms whose PPEs have at least one value-enhancing feature are smaller

[11]In particular, we find that a large fraction of the PPEs with an active buyer feature also have a premium pricing feature (38.77% (=328/846)). Thus, the positive valuation effects of active buyers documented in the previous literature may be at least partially attributable to PPEs' premium pricing feature.

TABLE 2

Summary Statistics

Table 2 presents the mean and median summary characteristics for the full sample and the subsamples of firms that conduct private placements of equity (PPEs) classified according to whether the placement has at least one value-enhancing feature. The sample consists of 4,725 PPEs reported in the Sagient Research PlacementTracker database from 1995 to 2016. Value-enhancing features of PPEs (shareholder approval, active buyer, and premium pricing features) are PPE characteristics that allow existing shareholders or new buyers to provide issuing firms with value-increasing monitoring/certification services. PPEs with a shareholder approval feature are i) discount placements whose fractions placed are more than 20% of the shares outstanding (i.e., *Discount Issues with Fraction More Than 20%*), ii) placements in which the buyer purchases more than 20% of shares outstanding including existing and new shares and becomes the largest shareholder (i.e., *Change-of-Control Issues*), and iii) placements in which the manager purchases either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of shares outstanding in her NYSE listed firm (i.e., *Manager Participating Issues*). PPEs with an active buyer feature are those in which the buyer demands board representation in an issuing firm (*Board Representing Buyer*), has a strategic relationship with the issuing firm (*Strategic Buyer*), or purchases block ownership in the issuing firm as a single block owner (*One Block Buyer*). PPEs with a premium pricing feature are those in which the buyer pays the premium when purchasing equity. Appendix B provides detailed descriptions of the variables. The figures (in parentheses) in the first 3 columns are the mean (median) summary statistics. The figures (in parentheses) in the last column are the *t*-statistics for the test of equality of means (Wilcoxon signed rank *z*-statistics for the test of equality of medians). *, **, and *** stand for statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

	Full Sample	Sample With at Least One Value-Enhancing Feature	Sample With No Value-Enhancing Feature	Test of Difference
	(N = 4,725)	(N = 2,408)	(N = 2,317)	*t*-Statistic (Wilcoxon *z*-Statistic)
Variable	1	2	3	2 – 3
Firm and Ownership Characteristics				
SIZE (market value of equity: $100m)	4.02	3.67	4.39	−1.40
	(0.98)	(0.80)	(1.21)	(−11.31***)
MB	3.40	3.22	3.60	−6.29***
	(3.19)	(2.86)	(3.54)	(−7.27***)
LEVERAGE	0.26	0.30	0.22	9.79***
	(0.17)	(0.21)	(0.13)	(11.50***)
PROFITABILITY	−0.04	−0.05	−0.03	−7.69***
	(−0.03)	(−0.03)	(−0.02)	(−8.78***)
CASH	0.11	0.13	0.09	8.06***
	(0.07)	(0.08)	(0.06)	(7.53***)
HIGH_DISTRESS	0.10	0.13	0.07	7.05***
	(0.00)	(0.00)	(0.00)	(7.69***)
MANAGERIAL_OWNERSHIP (%)	7.73	7.71	7.76	−0.13
	(2.07)	(1.91)	(2.17)	(−1.36)
INSTITUTIONAL_OWNERSHIP (%)	24.05	23.70	24.42	−0.99
	(17.31)	(16.74)	(17.82)	(−1.47)
Placement Characteristics				
REGISTERED_DIRECT	0.26	0.21	0.30	−6.00***
	(0.00)	(0.00)	(0.00)	(−6.71***)
WARRANTS_INCLUDED	0.42	0.47	0.37	6.77***
	(0.00)	(0.00)	(0.00)	(7.59***)
HEDGE_FUND/BUYOUT/ PRIVATE_EQUITY	0.31	0.26	0.35	−6.11***
	(0.00)	(0.00)	(0.00)	(−6.56***)
Governance Characteristics				
CEO-CHAIR_DUALITY	0.35	0.32	0.38	−2.74***
	(0.00)	(0.00)	(0.00)	(−2.97***)
CEO_TENURE (years)	7.22	6.93	7.49	−1.53
	(5.00)	(5.00)	(5.00)	(−2.99***)
CEO_AGE (years)	53.24	53.71	53.95	−0.56
	(52.00)	(53.00)	(54.00)	(−0.42)
PROPORTION_OF_OUTSIDE_ DIRECTORS (%)	44.92	43.55	46.25	−1.36
	(62.50)	(60.00)	(66.67)	(−1.72*)

and more distressed than the firms whose PPEs have no value-enhancing feature.[12] They also have a lower MB (market-to-book ratio), higher leverage, lower profitability, and more CASH (the ratio of the sum of cash and short-term marketable

[12]We measure a firm's distress by following Campbell, Hilscher, and Szilagyi (2008). Our results are similar when we use a traditional measure of firm distress (i.e., Ohlson's (1980) *O*-score).

securities to the market value of the firms (market value of equity + book value of debt)), which suggests that these firms issue equity privately mainly to overcome their financial difficulties. Managerial ownership and institutional ownership are not different between the two groups. Regarding the placement characteristics, we find that compared to the PPEs with no value-enhancing feature, the PPEs with at least one value-enhancing feature have a lower registration status and a higher ratio of warrants included, which suggests that their investors purchase equity with the intention of holding it for a longer period of time. They also have a lower proportion of investors that are hedge funds, buyout funds, or private equity funds, who are typically viewed as passive investors in the PPE literature (e.g., Lim, Schwert, and Weisbach (2020)). Finally, we find that the firms whose PPEs have at least one value-enhancing feature have a lower proportion of CEO-chair duality and a shorter CEO tenure, which suggest that they generally have better governance.[13] The detailed definitions of the variables used in Table 2 are provided in Appendix B.

IV. Market Reaction to PPE Announcements

In this section, to investigate the market's ex ante valuation of the monitoring/certification gains and managerial entrenchment costs signaled by firms' choice of value-enhancing features, we examine whether stock market reactions to the announcements of PPEs are related to the shareholder approval, active buyer, and premium pricing features attached to PPEs.

A. Univariate Analysis

For each private placement event, we use the date disclosed in the PlacementTracker database as the announcement date. Although the closing dates of placements are available for the full sample period, the PlacementTracker database began to extensively cover the announcement dates of placements only after 2003. We supplement these missing announcement dates by searching LexisNexis and Factiva around the closing dates of the placements. We use a market model to assess the valuation effect of the announcements. Specifically, daily abnormal returns are calculated by using a market model with a 200-trading-day estimation period beginning 245 days before and ending 46 days before the announcement date. The CRSP value-weighted return is used as a proxy for the market return. The daily abnormal returns are cumulated to obtain the CAR.

Table 3 reports the CARs (−1, 1) around the announcement dates of the PPEs. In Panel A, we report the differences in the CARs (−1, 1) between the PPEs with no value-enhancing feature and the PPEs with at least one value-enhancing feature. We find that the PPEs with no value-enhancing feature have a significant negative mean (median) CAR (−1, 1) of −1.81% (−1.86%), while the PPEs with at least one value-enhancing feature have a significant positive mean (median) CAR (−1, 1) of 6.37% (0.83%). The difference in mean (median) CARs (−1, 1) between the two groups is significant at the 1% level.[14] When we further divide

[13]The information on these governance variables is available for only 2,043 firms.

[14]In untabulated tests, we find a positive and significant mean CAR (−1, 1) of 0.68% and a negative and significant median CAR (−1, 1) of -0.55% for the full sample of PPEs, which suggests that the

TABLE 3

Three-Day Mean and Median Cumulative Abnormal Returns Around Private Placement Announcement Dates Classified According to the Existence of Value-Enhancing Features

Table 3 presents the cumulative abnormal returns (CARs) for private placement firms from 1 day before the placement announcement date to 1 day after the placement announcement date (CARs (−1, 1)). The sample consists of 4,725 private placements of equity (PPEs) reported in the Sagient Research PlacementTracker database from 1995 to 2016. Panel A (Panel B) presents the differences in CARs (−1, 1) between the subsample of PPEs with no value-enhancing feature and the subsamples of PPEs with at least one (only one nonoverlapping) value-enhancing feature. Value-enhancing features of PPEs (shareholder approval, active buyer, and premium pricing features) are PPE characteristics that allow existing shareholders or new buyers to provide issuing firms with value-increasing monitoring/certification services. PPEs with a shareholder approval feature are i) discount placements whose fractions placed are more than 20% of the shares outstanding (i.e., *Discount Issues with Fraction More Than 20%*), ii) placements in which the buyer purchases more than 20% of shares outstanding including existing and new shares and becomes the largest shareholder (i.e., *Change-of-Control Issues*), and iii) placements in which the manager purchases either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of shares outstanding in her NYSE listed firm (i.e., *Manager Participating Issues*). PPEs with an active buyer feature are those in which the buyer demands board representation in an issuing firm (*Board Representing Buyer*), has a strategic relationship with the issuing firm (*Strategic Buyer*), or purchases block ownership in the issuing firm as a single block owner (*One Block Buyer*). PPEs with a premium pricing feature are those in which the buyer pays the premium when purchasing equity. PPEs with only one nonoverlapping value-enhancing feature are those that have only one unique value-enhancing feature. PPEs with multiple nonoverlapping value-enhancing features are those that have at least two different types of value-enhancing features. Daily abnormal returns are calculated by using a market model with a 200 trading-day estimation period beginning 245 days before and ending 46 days before the PPE announcement date. The CRSP value-weighted return is used as a proxy for the market return. The daily abnormal returns are cumulated to obtain the CAR. In Panel A (Panel B), the figures in the last 4 (3) rows are the *t*-statistics for the test of equality of means and the Wilcoxon signed rank *z*-statistics for the test of equality of medians. *, **, and *** stand for statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

Subsample	No. of Obs.	Mean	Median
Panel A. Differences in CARs between the Subsample of PPEs with No Value-Enhancing Feature and the Subsamples of PPEs with at Least One Value-Enhancing Feature			
PPEs with no value-enhancing feature: a	2,317	−1.81***	−1.86***
PPEs with at least one value-enhancing feature: b	2,408	6.37***	0.83***
PPEs with only one nonoverlapping value-enhancing feature: c	1,871	0.63*	0.04
PPEs with multiple nonoverlapping value-enhancing features: d	537	11.42***	5.19***
Test of difference:		*t*-Statistic	Wilcoxon *z*-Statistic
(b – a)		8.91***	11.10***
(c – a)		5.71***	7.05***
(d – a)		13.81***	14.31***
(d – c)		9.59***	9.79***
Panel B. Differences in CARs between the Subsample of PPEs with No Value-Enhancing Feature and the Subsamples of PPEs with Only One Nonoverlapping Value-Enhancing Feature			
PPEs with no value-enhancing feature: a	2,317	−1.81***	−1.86***
PPEs with only shareholder approval feature: b	625	−0.12	−0.32
PPEs with only active buyer feature: c	344	3.39***	1.62***
PPEs with only premium pricing feature: d	902	0.10	−0.38
Test of difference:		*t*-Statistic	Wilcoxon *z*-Statistic
(b – a)		3.05***	4.29***
(c – a)		7.24***	7.91***
(d – a)		3.59***	3.73***

the PPEs with at least one value-enhancing feature into the PPEs with only one nonoverlapping value-enhancing feature and the PPEs with multiple nonoverlapping value-enhancing features (i.e., the PPEs with at least two different types of value-enhancing features), we find that the mean and median CARs (−1, 1) for both subsamples are significantly higher than for the subsample of PPEs with no value-enhancing feature. We also find that the mean and median CARs (−1, 1) are significantly higher for the PPEs with multiple nonoverlapping value-enhancing features than for the PPEs with only one nonoverlapping value-enhancing feature, which suggests that when the number of value-enhancing features is larger, the PPE valuation effects are greater.

distribution of CARs (−1, 1) is highly skewed. In comparison, Wruck (1989) and Hertzel and Smith (1993) find a mean CAR (−1, 0) of 1.89% and a mean CAR (-3, 0) of 1.72% for their full sample of PPEs.

In Panel B of Table 3, we limit our attention to the subsample of PPEs with only one nonoverlapping value-enhancing feature and examine whether the valuation effects of the PPEs with only a shareholder approval (an active buyer, a premium pricing) feature are different from the valuation effects of the PPEs without any value-enhancing feature. We find that the mean and median CARs (−1, 1) for all of these different types of PPEs with only one nonoverlapping value-enhancing feature are significantly higher than the mean and median CARs (−1, 1) for the PPEs without any value-enhancing feature, although the mean and median CARs (−1, 1) are positive and significant for the subsample of PPEs with only an active buyer feature and insignificant for the subsamples of PPEs with only shareholder approval and premium pricing features. Because the mean and median CARs (−1, 1) for the PPEs without any value-enhancing feature are negative and significant at the 1% level, the results suggest that each value-enhancing feature of PPEs has its own incremental positive valuation impact that helps offset the negative valuation impact inherent in the PPEs without such a feature.

In Panel A of Table 4, we further divide the PPEs with at least a shareholder approval (an active buyer) feature into PPEs with three different shareholder approval (active buyer) subfeatures and examine whether their valuation effects are different from PPEs without these subfeatures.[15] We find that each subsample of PPEs with at least one shareholder approval (active buyer) subfeature and the PPEs with at least a premium pricing feature have positive and significant mean and median CARs (−1, 1), except for the insignificant median CAR (−1, 1) of *Discount Issues with Fraction More Than 20%.* We also find that the mean and median CARs (−1, 1) for each subsample of PPEs with at least one value-enhancing subfeature are significantly higher than the mean and median CARs (−1, 1) for the subsample of PPEs without any corresponding value-enhancing subfeature, except for the mean CAR (−1, 1) of *Discount Issues with Fraction More Than 20%.* The insignificant difference in mean CARs between *Discount Issues with Fraction More Than 20%* and other PPEs is largely because other PPEs includes premium PPEs that are associated with the positive mean CAR (−1, 1).

In Panel B of Table 4, we examine whether the announcement returns for PPEs differ as the number of value-enhancing subfeatures increases. The results show a monotonic increase in mean and median CARs (−1, 1) as the number of value-enhancing subfeatures increases. For example, the mean and median CARs (−1, 1) for the PPEs with only one value-enhancing subfeature are 0.23% and −0.16%, respectively, both of which are insignificant. However, the corresponding returns for the PPEs with four or more value-enhancing subfeatures are 18.67% and 12.54%, both of which are significant. These mean and median CARs (−1, 1) are both significantly higher for the PPEs with four or more value-enhancing subfeatures than for the PPEs without any value-enhancing feature. In untabulated tests, we find that the differences in median CARs (−1, 1) between the PPEs

[15] Table 4 shows that *Discount Issues with Fraction More Than 20%* (615 issues), *Change-of-Control Issues* (119 issues), and *Manager Participating Issues* (197 issues) account for 13%, 3%, and 4% of the full sample, respectively. It also shows that issues with a *Board Representing Buyer* (269 issues), issues with a *Strategic Buyer* (276 issues), and issues with *One Block Buyers* (597 issues) account for 6%, 6%, and 13% of the full sample, respectively.

TABLE 4

Three-Day Mean and Median Cumulative Abnormal Returns Around Private Placement Announcement Dates Classified According to the Existence of Value-Enhancing Subfeatures

Table 4 presents the cumulative abnormal returns (CARs) for private placement firms from 1 day before the placement announcement date to 1 day after the placement announcement date (CARs (−1, 1)). The sample consists of 4,725 private placements of equity (PPEs) reported in the Sagient Research PlacementTracker database from 1995 to 2016. Panel A presents the differences in CARs (−1, 1) between the subsamples of PPEs with at least one value-enhancing feature and the subsamples of PPEs without such a feature. Panel B presents CARs (−1, 1) for the subsamples of PPEs by the number of value-enhancing features. Value-enhancing features of PPEs (shareholder approval, active buyer, and premium pricing features) are PPE characteristics that allow existing shareholders or new buyers to provide issuing firms with value-increasing monitoring/certification services. PPEs with a shareholder approval feature are i) discount placements whose fractions placed are more than 20% of the shares outstanding (i.e., *Discount Issues with Fraction More Than 20%*), ii) placements in which the buyer purchases more than 20% of shares outstanding including existing and new shares and becomes the largest shareholder (i.e., *Change-of-Control Issues*), and iii) placements in which the manager purchases either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of shares outstanding in her NYSE listed firm (i.e., *Manager Participating Issues*). PPEs with an active buyer feature are those in which the buyer demands board representation in an issuing firm (*Board Representing Buyer*), has a strategic relationship with the issuing firm (*Strategic Buyer*), or purchases block ownership in the issuing firm as a single block owner (*One Block Buyer*). PPEs with a premium pricing feature are those in which the buyer pays the premium when purchasing equity. Daily abnormal returns are calculated by using a market model with a 200 trading-day estimation period beginning 245 days before and ending 46 days before the PPE announcement date. The CRSP value-weighted return is used as a proxy for the market return. The daily abnormal returns are cumulated to obtain the CAR. The figures in parentheses and brackets are the median CAR (−1, 1) and the number of observations, respectively. In Panel A (Panel B), the figures in the last 2 columns (last row) are the *t*-statistics for the test of equality of means and the Wilcoxon signed rank *z*-statistics for the test of equality of medians, respectively. *, **, and *** stand for statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

	Value-Enhancing Feature		Test of Difference 2 − 1	
Subsample	No 1	Yes 2	*t*-Statistic	Wilcoxon *z*-Statistic
Panel A. Differences in CARs Between tde Subsamples of PPEs Witd at Least One Value-Enhancing Feature and tde Subsamples of PPEs Witdout Such a Feature				
PPEs with at least shareholder approval feature	0.09 (−0.75***) [3,891]	3.33*** (0.64***) [834]	4.52***	4.68***
Discount issue with fraction more than 20%	0.55* (−0.62***) [4,110]	1.39** (0.08) [615]	1.03	1.98**
Change-of-control issue	0.35 (−0.62***) [4,606]	12.83*** (7.09***) [119]	7.17***	6.25***
Manager participating issue	0.40 (−0.61***) [4,528]	6.66* (0.48**) [197]	4.57***	3.06***
PPEs with at least active buyer feature	−1.01*** (−1.14***) [3,879]	8.34*** (3.45***) [846]	13.32***	13.69***
Board representing buyer	−0.15 (−0.79***) [4,456]	14.09*** (5.86***) [269]	12.22***	10.58***
Strategic buyer	0.06 (−0.73***) [4,449]	10.39*** (6.67***) [276]	8.91***	9.70***
One block buyer	−0.32 (−0.94***) [4,128]	7.44*** (3.30***) [597]	9.49***	11.26***
PPEs with at least premium pricing feature	−0.30 (−0.99***) [3,420]	3.19*** (0.86***) [1,305]	5.72***	6.75***

Panel B. CARs for the Subsamples of PPEs by the Number of Value-Enhancing Features

Number of Value-Enhancing Features	No. of Obs.	Mean	Median
No value-enhancing feature: a	2,317	−1.81***	−1.86***
One value-enhancing feature	1,741	0.23	−0.16
Two value-enhancing features	437	8.11***	3.29***
Three value-enhancing features	168	13.22***	7.64***
Four or more value-enhancing features: b	62	18.67***	12.54***
Test of difference:		*t*-Statistic	Wilcoxon *z*-Statistic
(b − a)		12.62***	7.59***

with two value-enhancing subfeatures and the PPEs with one value-enhancing feature, between the PPEs with three value-enhancing subfeatures and the PPEs with two value-enhancing features, and between the PPEs with four or more value-enhancing subfeatures and the PPEs with three value-enhancing features

are all significant. Thus, shareholders benefit more when PPEs have more value-enhancing subfeatures.

Overall, these results suggest that the announcement returns for PPEs are closely related to the existence of value-enhancing features in PPEs. Supporting the managerial entrenchment hypothesis, firms that undertake PPEs with no value-enhancing feature experience significantly negative announcement returns. By contrast, consistent with the monitoring/certification hypothesis, PPEs with at least one value-enhancing feature are associated with positive announcement returns, and their announcement returns increase as the number of value-enhancing (sub) features increases. Thus, combining PPEs' shareholder approval and premium pricing features with their active buyer feature, which has received significant attention in the literature in analyzing the valuation effect of PPEs, is important and crucial in understanding such an effect.

B. Multivariate Regression Analysis

To better understand the cross-sectional variation in issuer CARs, we present estimates from the multivariate regressions by using CAR (−1, 1) as the dependent variable and the indicators for value-enhancing features as the key independent variables. We control for firm- and placement-specific characteristics in Table 2. We control for REGISTERED_DIRECT (indicator), WARRANTS_INCLUDED (indicator), and HEDGE_FUND/BUYOUT/PRIVATE_EQUITY (indicator) in the regressions because Lim et al. (2020) show that these variables are important for explaining PPE announcement returns.[16] We include log(SIZE) to control for firm resources and information asymmetry, MB to control for firms' future growth opportunities, and INSTITUTIONAL_OWNERSHIP and MANAGERIAL_OWNERSHIP to control for the quality of corporate governance and managerial agency problems, respectively. Finally, we include PROFITABILITY, CASH, LEVERAGE, and HIGH_DISTRESS (indicator) to control for firms' past performance and their immediate need for equity financing.

The results are reported in Table 5. In column 1, we use VALUE-ENHANCING_PRIVATE_PLACEMENT (an indicator that takes the value of 1 if the PPE has at least one value-enhancing feature and 0 otherwise) as the key independent variable of interest. Consistent with the univariate analysis, we find that the coefficient on VALUE-ENHANCING_PRIVATE_PLACEMENT is a significant 3.64%. With a mean market value of approximately $402 million for our sample issuing firms, this difference translates into an average value increase of $14.6 million per issuance.

In columns 2–4 of Table 5, we replace VALUE-ENHANCING_PRIVATE_PLACEMENT with SHAREHOLDER_APPROVAL_FEATURE, ACTIVE_BUYER_FEATURE, and PREMIUM_PRICING_FEATURE, respectively. SHAREHOLDER_APPROVAL_FEATURE is an indicator that takes the value of 1

[16]Lim et al. (2020) view hedge funds and private equity funds as passive investors that provide liquidity to financially constrained firms at a discount price and that exit as soon as possible when the placement is registered for trading. Consistent with this view, we find that the correlations of the indicator for HEDGE_FUND/BUYOUT/ PRIVATE_EQUITY with the indicators for *Board Representing Buyer*, *Strategic Buyer*, and *One Block Buyer* are very low at -0.01, -0.13, and 0.01, respectively.

TABLE 5

OLS Regressions of the Three-Day Cumulative Abnormal Returns Around Private Placement Announcement Dates

Table 5 presents estimates of OLS regressions of the cumulative abnormal returns (CARs) for private placement firms from 1 day before the placement announcement date to 1 day after the placement announcement date. The sample consists of 4,725 private placements of equity (PPEs) reported in the Sagient Research PlacementTracker database from 1995 to 2016. In column 6, the PPEs with overlapping value-enhancing features (i.e., the PPEs with at least two different types of value-enhancing features) are excluded from the analysis. Value-enhancing features of PPEs (shareholder approval, active buyer, and premium pricing features) are PPE characteristics that allow existing shareholders or new buyers to provide issuing firms with value-increasing monitoring/certification services. PPEs with a shareholder approval feature are i) discount placements whose fractions placed are more than 20% of the shares outstanding (i.e., *Discount Issues with Fraction More Than 20%*), ii) placements in which the buyer purchases more than 20% of shares outstanding including existing and new shares and becomes the largest shareholder (i.e., *Change-of-Control Issues*), and iii) placements in which the manager purchases either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of shares outstanding in her NYSE listed firm (i.e., *Manager Participating Issues*). PPEs with an active buyer feature are those in which the buyer demands board representation in an issuing firm (*Board Representing Buyer*), has a strategic relationship with the issuing firm (*Strategic Buyer*), or purchases block ownership in the issuing firm as a single block owner (*One Block Buyer*). PPEs with a premium pricing feature are those in which the buyer pays the premium when purchasing equity. Daily abnormal returns are calculated by using a market model with a 200 trading-day estimation period beginning 245 days before and ending 46 days before the PPE announcement date. The CRSP value-weighted return is used as a proxy for the market return. The daily abnormal returns are cumulated to obtain the CAR. All control variables are measured at the quarter immediately prior to the placement announcement dates, and their detailed descriptions are provided in Appendix B. The *t*-statistics are in parentheses and are estimated by using White standard errors that adjust for heteroscedasticity and firm clustering. *, **, and *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

	Sample Including PPEs with Overlapping Value-Enhancing Features					Sample Excluding PPEs with Overlapping Value-Enhancing Features
Independent Variable	1	2	3	4	5	6
VALUE- ENHANCING_PRIVATE _PLACEMENT	3.64*** (7.63)					
SHAREHOLDER_APPROVAL _FEATURE		1.85* (1.83)			2.55*** (2.71)	1.10* (1.77)
ACTIVE_BUYER_FEATURE			6.75*** (6.45)		6.25*** (5.91)	3.59*** (4.58)
PREMIUM_PRICING_FEATURE				3.04*** (4.60)	2.85*** (4.46)	2.70*** (4.41)
REGISTERED_DIRECT	−7.68*** (−10.92)	−8.23*** (−12.14)	−7.16*** (−11.22)	−8.22*** (−11.06)	−6.71*** (−11.00)	−6.25*** (−10.71)
WARRANTS_INCLUDED	−4.70*** (−7.56)	−4.34*** (−6.92)	−3.78*** (−6.48)	−4.57*** (−7.57)	−4.20*** (−7.07)	−3.97*** (−7.33)
HEDGE_FUND/BUYOUT/ PRIVATE_EQUITY	−1.55*** (−2.63)	−2.00*** (−3.36)	−1.85*** (−3.16)	−1.73*** (−2.81)	−1.50** (−2.55)	−0.99* (−1.90)
log(SIZE)	−0.41 (−1.62)	−0.47* (−1.80)	−0.64** (−2.57)	−0.48* (−1.90)	−0.49** (−1.96)	−0.32 (−1.53)
MB	−0.00 (−0.64)	−0.00 (−0.08)	−0.00 (−1.24)	−0.00 (−0.64)	−0.00 (−1.60)	0.00 (0.47)
CASH	8.83** (2.35)	10.82*** (2.84)	8.21** (2.17)	9.51*** (2.66)	6.35* (1.70)	5.87* (1.96)
LEVERAGE	1.35 (0.79)	2.45 (1.43)	1.35 (0.78)	1.99 (1.22)	0.50 (0.29)	3.58** (2.45)
PROFITABILITY	−4.67 (−0.36)	−5.34 (−0.42)	−4.37 (−0.35)	−5.80 (−0.45)	−3.96 (−0.32)	5.11 (0.71)
HIGH_DISTRESS	1.56 (1.12)	1.67 (1.18)	1.59 (1.15)	1.70 (1.23)	1.42 (1.02)	0.76 (0.68)
INSTITUTIONAL_OWNERSHIP	0.03*** (2.60)	0.04*** (2.70)	0.03** (2.27)	0.03** (2.57)	0.03** (2.25)	0.02** (2.10)
MANAGERIAL_OWNERSHIP	0.03 (0.77)	0.03 (0.73)	0.03 (0.68)	0.03 (0.74)	0.03 (0.72)	−0.00 (−0.09)
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
No. of obs.	4,725	4,725	4,725	4,725	4,725	4,181
Adj. R^2	0.07	0.07	0.08	0.07	0.09	0.09

if the PPE is a *Discount Issue with Fraction More Than 20%*, a *Change-of-Control Issue*, or a *Manager Participating Issue* and 0 otherwise; ACTIVE_BUYER_FEATURE is an indicator that takes the value of 1 if the private placement buyer is either a *Board Representing Buyer*, or a *Strategic Buyer*, or a *One Block Buyer* and 0 otherwise; and PREMIUM_PRICING_FEATURE is an indicator that takes the value of 1 if a firm issues equity privately at a premium and 0 otherwise. We find that the coefficients on these indicators are all positive and significant.[17]

In column 5 of Table 5, we include all three indicators for the value-enhancing features together in the regression and find that their coefficients are again all positive and significant at the 1% level. In column 6, to mitigate potential multicollinearity problems in the results, we exclude the PPEs with overlapping value-enhancing features from the sample and reestimate the regression in column 5. We find that all three indicators for the value-enhancing features are still positive and significant but with smaller magnitudes of the coefficients, which suggests that having multiple value-enhancing features in PPEs helps increase firm value more.[18]

In untabulated tests, we reestimate the regressions in columns 1–3, 5, and 6 of Table 5 by using only the subsample of discount issues. The results are similar to those for the full sample, with the exception that the coefficients on SHAREHOLDER_APPROVAL_FEATURE become larger in magnitude with higher statistical significance than those in columns 2, 5, and 6. These results suggest that the shareholder approval feature is particularly important when PPEs are issued at a discount.

Overall, these results suggest that the positive announcement effects for PPEs documented in the literature are evident only when PPEs have at least one value-enhancing feature, which helps enable existing and new shareholders to perform a value-enhancing monitoring/certification role. By contrast, PPEs without any value-enhancing feature are associated with significantly negative announcement returns due to dilution and lack of monitoring/certification benefits.

Finally, we examine whether the timeliness of the shareholder approval of PPEs affects their valuation effects by using the subsample of PPEs for which the information on approval meeting type is available. Specifically, we divide

[17]In untabulated tests, we replace PREMIUM_PRICING_FEATURE with an indicator for PPEs with a premium ratio between 0%–5% (47% of premium PPEs) and an indicator for other premium PPEs, and we reestimate the regression in column 4 of Table 5. We find that the coefficients on both indicators are positive and significant at the 1% level. The difference in coefficient estimates between the two indicators is not significant.

[18]The coefficient on HIGH_DISTRESS is insignificant across all regressions. In untabulated tests, we find that the mean CAR (−1, 1) for the subsample of 479 high-distress firms (i.e., firms with a value of HIGH_DISTRESS that equals 1 and negative PROFITABILITY) is a significant 2.49%, while the mean CAR (−1, 1) for the subsample of 950 low-distress firms (i.e., firms with a value of HIGH_DISTRESS that equals 0 and positive PROFITABILITY) is an insignificant −0.11%. For the remaining 3,296 firms, their mean CAR (−1, 1) is a significant 0.62%. The difference in mean CARs (−1, 1) between high-distress and low-distress firms is significant at the 1% level. We also find that of the six firms whose PPEs are subject to the financial viability exception rule, four belong to the subsample of high-distress firms. The mean CAR (−1, 1) is significantly higher for these four firms than for the 140 high-distress firms whose PPEs have other shareholder approval features. These results suggest that the PPEs conducted by high-distress firms are viewed more favorably by investors than the PPEs conducted by low-distress firms.

the PPEs that require approval into the following three groups: i) PPEs scheduled to vote at annual shareholder meetings (170 PPEs), ii) PPEs scheduled to vote at special shareholder meetings (136 PPEs), and iii) PPEs scheduled to apply for the financial viability exception rule (6 PPEs).[19] We then replace SHAREHOLDER_APPROVAL_FEATURE in column 2 of Table 5 with the indicators for these three groups of PPEs and reestimate the regressions. The results are reported in Table A.1 of the Supplementary Material. In column 3, we find that the coefficient on the indicator for the PPEs scheduled to vote at special shareholder meetings is significantly more positive than the coefficient on the indicator for the PPEs scheduled to vote at annual shareholder meetings. We also find that the coefficient on the indicator for the PPEs scheduled to apply for the financial viability exception is significantly more positive than the coefficient on the indicator for the PPEs scheduled to vote at annual shareholder meetings.[20] These results suggest that obtaining timely approval of PPEs, which helps firms raise funds in a quick, timely manner, is important for the value-enhancing effect of PPEs.

V. Long-Term Post-Issuance Returns

In this section, we examine whether PPEs' value-enhancing features that positively affect their announcement returns also positively affect their long-term post-issuance returns by comparing the long-term post-issuance returns between the PPEs with no value-enhancing feature and the PPEs with at least one (only one nonoverlapping) value-enhancing feature. Previous studies show that although the firms whose PPEs are purchased by active investors experience significant positive announcement returns, the firms whose PPEs are sold to passive investors realize significant negative mean long-run returns in the post-issuance period (Krishnamurthy et al. (2005), Barclay et al. (2007)).

Following the previous literature (Hertzel et al. (2002), Krishnamurthy et al. (2005)), we use BHAR and calendar-time portfolio abnormal return approaches to measure the long-term post-issuance returns of PPEs. BHARs are calculated by subtracting the return for a control firm matched by industry, size, and book-to-market ratio from a private placement firm's buy-and-hold return.[21] For the

[19]Despite the literature's view that PPE firms are generally distressed, we find that the number of PPEs scheduled to apply for the financial viability exception is relatively small. Such a small number suggests that firms avoid shareholder approval not because they want to conduct timely PPEs and thus obtain the immediate liquidity but because they are concerned about shareholders' disapproval of their proposed PPEs.

[20]Specifically, the coefficient on the indicator for the PPEs scheduled to vote at annual shareholder meetings is an insignificant -0.52, while the coefficient on the indicator for the PPEs scheduled to vote at special shareholder meetings (financial viability exception PPEs) is a significant 4.85% (31.57%).

[21]We choose a control firm by first sorting the firms into ten size decile bins within the 2-digit Standard Industrial Classification (SIC) codes and then finding the closest book-to-market firm within the same industry and size decile. Consistent with Barber and Lyon (1997), the market value of equity and the book-to-market ratio are measured at the end of the most recent June and at the end of year $t-1$, respectively. Following Billett, Flannery, and Garfinkel (2011), we mitigate the concern of double counting multiple placement firms' returns in overlapping periods by calculating each abnormal return up to the subsequent placement. We follow the same approach when estimating calendar-time portfolio returns.

calendar-time portfolio approach, we form equally weighted portfolios of firms that have just completed private placements for each following calendar month.[22] We keep these firms in the portfolio for a holding period of 36 months relative to the announcement month. We rebalance the portfolio every month by dropping all firms that have reached the end of their holding period and adding all firms that have just announced a placement. The time series of portfolio excess returns is then regressed on the 3 factors from Fama and French (1993). Issuer portfolio abnormal performance (α) is estimated as the intercept of the following time series regression:

$$Rp,t–Rf,t = \alpha + \beta m(Rm,t–Rf,t) + \beta_{SMB}\,\mathrm{SMB}t + \beta_{HML}\,\mathrm{HML}t + \varepsilon t,$$

where ($Rp,t – Rf,t$) is the excess return of the placement portfolio, ($Rm,t – Rf,t$) is the market excess return, SMBt is the size factor, and HMLt is the book-to-market factor.

The results are presented in Table 6. In Panel A, we divide the sample into PPEs with no value-enhancing feature and PPEs with at least one value-enhancing feature. We find that both the mean BHAR and the mean calendar-time monthly portfolio alpha for the PPEs with no value-enhancing feature are significantly negative, while the mean BHAR and the mean calendar-time monthly portfolio alpha for the PPEs with at least one value-enhancing feature are insignificant.[23] The differences in mean BHARs and mean calendar-time monthly portfolio alphas between the two groups are significant at the 1% level. Although the median BHAR and the median calendar-time monthly portfolio alpha are significantly negative for both groups, they are significantly less negative for the PPEs with at least one value-enhancing feature than for the PPEs with no value-enhancing feature. Further separating the PPEs with at least one value-enhancing feature into PPEs with only one value-enhancing feature and PPEs with multiple nonoverlapping value-enhancing features does not change the results for the significant difference in the long-term excess returns compared to the PPEs with no value-enhancing feature.

In Panel B of Table 6, we limit our attention to the subsample of PPEs with only one nonoverlapping value-enhancing feature and examine whether their long-term excess returns are different from the long-term excess returns for PPEs with no value-enhancing feature. We find that both the mean BHAR and the mean calendar-time monthly portfolio alpha are insignificant for the PPEs with only a shareholder approval feature, the PPEs with only an active buyer feature, and the PPEs with only a premium pricing feature, although the median BHAR and the median portfolio alpha for these PPEs are significantly negative, except for the median portfolio alpha for the PPEs with only a shareholder approval feature. The differences in mean BHARs and mean portfolio alphas between each of the three subsamples of PPEs with only one nonoverlapping value-enhancing feature and the subsample of PPEs with no value-enhancing feature are all significant. The median BHARs and the median portfolio alphas are also significantly different between the two groups except for the median BHAR for the PPEs with only a shareholder approval feature and the median portfolio alpha for the PPEs with only a premium pricing feature.

[22] We require at least two firms to be included in each calendar month to avoid spurious beta and alpha estimates.

[23] In untabulated tests, consistent with Hertzel et al. (2002), Krishnamurthy et al. (2005), and Barclay et al. (2007), we find that the mean (median) BHAR and the mean (median) calendar-time monthly portfolio alpha for the full sample are negative and significant at the 1% level.

TABLE 6

Mean and Median Long-Term Buy-and-Hold Abnormal Returns and Calendar-Time Portfolio Abnormal Returns After Private Placement Announcement Dates

Table 6 presents the long-term buy-and-hold abnormal returns (BHARs) and calendar-time portfolio abnormal returns for private placement firms for 3 years following the placement announcement date. The sample consists of 4,413 private placements of equity (PPEs) reported in the Sagient Research PlacementTracker database from 1995 to 2016. Panel A (Panel B) presents the differences in long-run stock returns between the subsample of PPEs with no value-enhancing feature and the subsamples of PPEs with at least one (only one nonoverlapping) value-enhancing feature. Value-enhancing features of PPEs (shareholder approval, active buyer, and premium pricing features) are PPE characteristics that allow existing shareholders or new buyers to provide issuing firms with value-increasing monitoring/certification services. PPEs with a shareholder approval feature are i) discount placements whose fractions placed are more than 20% of the shares outstanding (i.e., *Discount Issues with Fraction More Than 20%*), ii) placements in which the buyer purchases more than 20% of shares outstanding including existing and new shares and becomes the largest shareholder (i.e., *Change-of-Control Issues*), and iii) placements in which the manager purchases either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of shares outstanding in her NYSE listed firm (i.e., *Manager Participating Issues*). PPEs with an active buyer feature are those in which the buyer demands board representation in an issuing firm (*Board Representing Buyer*), has a strategic relationship with the issuing firm (*Strategic Buyer*), or purchases block ownership in the issuing firm as a single block owner (*One Block Buyer*). PPEs with a premium pricing feature are those in which the buyer pays the premium when purchasing equity. PPEs with only one nonoverlapping value-enhancing feature are those that have only one unique value-enhancing feature. PPEs with multiple nonoverlapping value-enhancing features are those that have at least two different types of value-enhancing features. BHARs are calculated by subtracting the buy-and-hold return for a control firm matched by industry, size, and book-to-market ratio from the buy-and-hold return for a private placement firm. We choose the control firms by first sorting the firms into size decile bins within the 2-digit Standard Industrial Classification (SIC) codes and then finding the closest book-to-market ratio firm within the same industry and size decile. To compute long-term calendar-time portfolio abnormal returns, we first form equally weighted portfolios of firms that have just completed private placements for each following calendar month. We keep these firms in the portfolio for a holding period of 36 months relative to the announcement month. We rebalance the portfolio every month by dropping all firms that have reached the end of their holding period and adding all firms that have just announced a placement. The time series of portfolio excess returns are then regressed on the 3 factors from Fama and French (1993). Issuer portfolio abnormal performance is estimated as the intercept (α) of the following time series regression: $Rp,t - Rf,t = \alpha + \beta m\,(\,Rm,t - Rf,t\,) + \beta SMB\,\mathrm{SMB}t + \beta HML\,\mathrm{HML}t + \varepsilon t$, where ($Rp,t - Rf,t$) is the excess return of the placement portfolio, ($Rm,t - Rf,t$) is the market excess return, SMBt is the size factor, and HMLt is the book-to-market factor. To test the differences in calendar-time portfolio returns between the portfolios constructed with PPEs with a value-enhancing feature and the portfolios constructed with PPEs without such a feature, we use the Fama–French 3-factor adjusted monthly excess returns of a zero-cost portfolio strategy that buys PPEs with a value-enhancing feature and sells PPEs without such a feature. In Panel A (Panel B), the figures in the last 4 (3) rows are the t-statistics for the test of equality of means and the Wilcoxon signed rank z-statistics for the test of equality of medians. *, **, and *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

	Buy-and-Hold Return			Monthly Portfolio Alpha		
Subsample	No. of Obs.	Mean	Median	No. of Obs.	Mean	Median
Panel A. Differences in Long-run Stock Returns between the Subsample of PPEs with No Value-Enhancing Feature and the Subsamples of PPEs with at Least One Value-Enhancing Feature						
PPEs with no value-enhancing feature: a	2,168	−15.30***	−28.31***	255	−1.09***	−1.41***
PPEs with at least one value-enhancing feature: b	2,245	−0.55	−22.30***	255	−0.12	−0.76**
PPEs with only one nonoverlapping value-enhancing feature: c	1,741	−3.14	−22.34***	255	−0.11	−0.51*
PPEs with multiple nonoverlapping value-enhancing features: d	504	8.40	−21.52***	251	−0.12	−0.75
Test of difference:		*t*-Statistic	Wilcoxon *z*-Statistic		*t*-Statistic	Wilcoxon *z*-Statistic
(b – a)		3.75***	2.99***		3.27***	3.09***
(c – a)		3.09***	2.57**		3.12***	2.83**
(d – a)		3.86***	2.35**		2.13**	1.50
(d – c)		1.51	0.71		−0.04	−0.43
Panel B. Differences in Long-run Stock Returns Between the Subsample of PPEs With No Value-Enhancing Feature and the Subsamples of PPEs With Only One Nonoverlapping Value-Enhancing Feature						
PPEs with no value-enhancing feature: a	2,168	−15.30***	−28.28***	255	−1.09***	−1.41***
PPEs with only shareholder approval feature: b	576	−5.46	−27.31***	254	−0.03	−1.02
PPEs with only active buyer feature: c	321	8.07	−12.50***	245	0.00	−1.14*
PPEs with only premium pricing feature: d	844	−5.82	−23.31***	255	−0.24	−1.04*
Test of difference:		*t*-Statistic	Wilcoxon *z*-Statistic		*t*-Statistic	Wilcoxon *z*-Statistic
(b – a)		1.72*	0.22		2.30**	1.71*
(c – a)		3.64***	3.71***		2.55**	2.46**
(d – a)		2.10**	1.95*		2.20**	1.57

Overall, the results for long-term post-issuance returns, together with the results for announcement returns in Section IV, help explain the contradictory findings in the literature for positive announcement returns and negative long-term post-issuance returns associated with PPEs. The results also suggest that the positive announcement returns associated with PPEs are unlikely to be due to overreaction, as argued by Hertzel et al. (2002). Instead, our results suggest that the market correctly interprets monitoring/certification benefits and managerial incentives conveyed by the announcements of PPEs with value-enhancing features and responds accordingly over short- and long-term periods. Thus, the contradictory conclusions in the literature regarding announcement and long-term post-issuance returns for PPEs seem to be largely due to a failure to account for the heterogeneous nature of PPE value-enhancing features.

VI. Likelihood of Conducting PPEs with at Least One Value-Enhancing Feature

In this section, we investigate whether the likelihood of conducting PPEs with at least one value-enhancing feature is related to the benefits and costs associated with PPEs discussed in the private placements literature. Specifically, we estimate logit regressions in which the dependent variable is VALUE-ENHANCING_PRIVATE_PLACEMENT (indicator), and the explanatory variables are PPE, firm, ownership, and the governance characteristics used in Table 2.

The results are reported in Table 7. In column 1, we include all explanatory variables except the governance characteristics. We find that the PPEs with at least one value-enhancing feature are less likely to have a registration status and hedge fund/buyout/private equity investors but are more likely to include warrants. These results suggest that the buyers of PPEs with at least one value-enhancing feature are more likely to be long-term investors and are less likely to be passive investors. We further find that the firms conducting PPEs with at least one value-enhancing feature are smaller, less profitable and more distressed, have higher future growth and higher leverage, and hold more cash. Thus, these firms appear to have a greater need to lower financial distress. We also find that the firms conducting PPEs with at least one value-enhancing feature have higher institutional ownership, which suggests that they are better governed. In column 2, we add CEO-CHAIR_DUALITY (indicator), PROPORTION_OF_OUTSIDE_DIRECTORS, log(CEO_TENURE), and CEO_AGE as additional governance variables. The sample size is reduced to 2,005 from 4,712 due to the unavailability of data on some of these variables. We find that none of the coefficients on these governance variables are significant.

In columns 3 and 4 of Table 7, we reestimate the regressions in columns 1 and 2 separately by using a dependent variable that takes the value of 1 for firms that conduct PPEs with at least a shareholder approval feature and 0 otherwise. We find similar results as those in columns 1 and 2. However, in column 4, although the coefficient on INSTITUTIONAL_OWNERSHIP loses its significance, the coefficients on MANAGERIAL_OWNERSHIP and PROPORTION_OF_OUTSIDE_DIRECTORS become significantly positive, and the coefficient on log(CEO_TENURE) becomes significantly negative. These results suggest that PPEs by better governed firms are more likely to include a shareholder approval feature.

TABLE 7

Likelihood of Conducting Private Placements with at Least One Value-Enhancing Feature

Table 7 presents estimates of logit regressions of the likelihood of conducting private placements with at least one value-enhancing feature. The sample consists of 4,712 private placements of equity (PPEs) reported in the Sagient Research PlacementTracker database from 1995 to 2016. Value-enhancing features of PPEs (shareholder approval, active buyer, and premium pricing features) are PPE characteristics that allow existing shareholders or new buyers to provide issuing firms with value-increasing monitoring/certification services. PPEs with a shareholder approval feature are i) discount placements whose fractions placed are more than 20% of the shares outstanding (i.e., *Discount Issues with Fraction More Than 20%*), ii) placements in which the buyer purchases more than 20% of shares outstanding including existing and new shares and becomes the largest shareholder (i.e., *Change-of-Control Issues*), and iii) placements in which the manager purchases either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of shares outstanding in her NYSE listed firm (i.e., *Manager Participating Issues*). PPEs with an active buyer feature are those in which the buyer demands board representation in an issuing firm (*Board Representing Buyer*), has a strategic relationship with the issuing firm (*Strategic Buyer*), or purchases block ownership in the issuing firm as a single block owner (*One Block Buyer*). PPEs with a premium pricing feature are those in which the buyer pays the premium when purchasing equity. In columns 1 and 2, the dependent variable is an indicator that takes the value of 1 for a PPE that has at least one value-enhancing feature and 0 otherwise. In columns 3 and 4, the dependent variable is an indicator that takes the value of 1 for a PPE with at least a shareholder approval feature and 0 otherwise. In columns 5 and 6, the dependent variable is an indicator that takes the value of 1 for a PPE with at least an active buyer feature and 0 otherwise. In columns 7 and 8, the dependent variable is an indicator that takes the value of 1 for a PPE with at least a premium pricing feature and 0 otherwise. All control variables are measured at the quarter immediately prior to the placement announcement dates, and their detailed descriptions are provided in Appendix B. The *t*-statistics are in parentheses and are estimated by using White standard errors that adjust for heteroscedasticity and firm clustering. *, **, and *** stand for statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

	At Least One Value-Enhancing Feature		At Least Shareholder Approval Feature		At Least Active Buyer Feature		At Least Premium Pricing Feature	
Independent Variable	1	2	3	4	5	6	7	8
REGISTERED_ DIRECT	−1.05***	−1.12***	−1.08***	−0.83***	−1.64***	−1.70***	−0.46***	−0.75***
	(−11.11)	(−8.19)	(−8.45)	(−4.69)	(−10.43)	(−7.77)	(−4.78)	(−5.22)
WARRANTS_INCLUDED	0.60***	0.68***	0.37***	0.57***	−0.49***	−0.46**	0.59***	0.64***
	(7.46)	(5.34)	(3.84)	(3.61)	(−4.61)	(−2.43)	(6.77)	(4.52)
HEDGE_FUND/BUYOUT/ PRIVATE_EQUITY	−0.85***	−0.90***	−0.30***	−0.24	−0.58***	−0.79***	−0.76***	−0.82***
	(−9.86)	(−6.57)	(−3.01)	(−1.53)	(−4.54)	(−3.64)	(−7.86)	(−5.39)
log(SIZE)	−0.19***	−0.16***	−0.27***	−0.03	0.07*	0.03	−0.14***	−0.21***
	(−5.13)	(−2.62)	(−5.82)	(−0.45)	(1.67)	(0.35)	(−3.64)	(−3.05)
MB	0.00**	0.00	−0.00	−0.00	0.00***	0.00	0.00***	0.00***
	(2.30)	(1.56)	(−0.58)	(−0.45)	(2.84)	(1.26)	(3.00)	(2.73)
CASH	2.04***	2.24***	0.90***	0.71	1.76***	2.23***	1.54***	2.01***
	(5.96)	(4.23)	(2.70)	(1.28)	(5.06)	(3.66)	(4.78)	(3.81)
LEVERAGE	1.56***	1.57***	0.81***	0.81**	1.22***	0.74*	0.93***	0.90**
	(7.80)	(4.62)	(3.75)	(2.09)	(4.94)	(1.79)	(4.78)	(2.45)
PROFITABILITY	−1.90***	−4.15***	−0.98	−4.68***	−1.24**	−3.09**	0.22	1.30
	(−2.79)	(−3.01)	(−1.60)	(−3.00)	(−2.19)	(−2.36)	(0.38)	(0.94)
HIGH_DISTRESS	0.28**	0.29	0.27*	0.16	0.17	−0.07	0.11	0.22
	(2.22)	(1.37)	(1.89)	(0.66)	(1.14)	(−0.26)	(0.89)	(1.07)
INSTITUTIONAL_OWNERSHIP	0.00*	0.01**	−0.00	−0.00	0.01***	0.02***	0.00**	0.01
	(1.71)	(2.10)	(−0.80)	(−0.35)	(3.69)	(4.62)	(2.35)	(1.45)
MANAGERIAL_OWNERSHIP	−0.00	0.01	−0.00	0.01**	0.00	0.00	−0.00	0.00
	(−1.16)	(1.46)	(−0.79)	(2.24)	(0.72)	(0.02)	(−0.42)	(0.37)
CEO-CHAIR_DUALITY		−0.08		0.10		0.01		−0.28**
		(−0.66)		(0.64)		(0.09)		(−2.11)
PROPORTION_OF_OUTSIDE _DIRECECTORS		−0.00		0.01**		−0.00		−0.00
		(−0.26)		(2.48)		(−0.19)		(−1.56)
log(CEO_TENURE)		−0.10		−0.24***		0.12		0.03
		(−1.60)		(−2.84)		(1.34)		(0.37)
CEO_AGE		−0.01		0.01		−0.02*		−0.01
		(−0.74)		(1.62)		(−1.95)		(−0.98)
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No. of obs.	4,712	2,005	4,638	1,957	4,652	1,961	4,707	1,949
Pseudo-R^2	0.13	0.16	0.10	0.11	0.13	0.18	0.10	0.14

In columns 5 and 6 of Table 7, we use as the dependent variable an indicator that takes the value of 1 for firms that conduct PPEs with at least an active buyer feature and 0 otherwise. The results echo those in columns 1 and 2 except that the coefficient

on CEO_AGE becomes significantly negative, which suggests that PPEs undertaken by younger CEOs are more likely to welcome new active buyers in the PPEs.

In columns 7 and 8 of Table 7, the dependent variable is an indicator that takes the value of 1 for firms that conduct PPEs with at least a premium pricing feature and 0 otherwise. Again, the results are similar to those in columns 1 and 2 except that the coefficients on PROFITABILITY and the indicator for HIGH_DISTRESS lose their significance. However, the coefficient on the indicator for CEO-CHAIR_DUALITY becomes significantly negative, which indicates that better-governed firms are more likely to include a premium pricing feature in their PPEs.

Overall, the results in Table 7 indicate that firms whose PPEs have at least one value-enhancing feature have a greater need to overcome their financial difficulties prior to equity issuance. They also have better internal governance, although the significance of each governance variable differs across firms whose PPEs have a different value-enhancing feature.

VII. Post-Placement Use of Funds and M&A Announcement Returns

To further evaluate the managerial motivation for undertaking PPEs with no value-enhancing feature, in this section, we examine firms' use of funds and their investment efficiency in the post-placement period. If managers decide not to include value-enhancing features in PPEs for their private benefits, we expect the firms whose PPEs have no value-enhancing feature to hold more cash, invest more, and use cash in more value-decreasing investments after PPEs (e.g., Jensen (1986)).

The results for the use of cash in the post-placement period (1 year (2 years) after PPEs) are presented in Table A.2 of the Supplementary Material. We focus on the changes in cash holdings, leverage, dividend payments, total investment, and acquisition frequency as the measures of how firms use their cash after PPEs. Our key independent variable of interest is an indicator for PRIVATE_PLACEMENT_WITH_NO_VALUE-ENHANCING_FEATURE, which takes the value of 1 if the private placement does not have any value-enhancing features and 0 otherwise. We include as control variables those used in Table 5 except for CASH and LEVERAGE. The dependent variables in columns 1–5 (columns 6–10) are the changes in the use of cash from quarters t to $t+4$ ($t+8$), where quarter t is the quarter immediately prior to the PPE closing date.

In columns 1 and 6 of Table A.2, we find that for the firms that undertake PPEs with no value-enhancing feature, the change in the ratio of cash holdings to the market value of the firm (the sum of the market value of equity and the book value of total liabilities) is significantly higher than for other firms. In columns 2 and 7, we find that the firms that undertake PPEs with no value-enhancing feature increase leverage more than other firms in the post-placement period. These results, together with the findings in Table 7, which show that the firms whose PPEs have no value-enhancing feature have fewer needs to overcome financial difficulties than other firms prior to PPEs, suggest that these firms engage in PPEs to increase their excess cash holdings, not to reduce their financial constraints. The coefficients on PRIVATE_PLACEMENT_WITH_NO_VALUE-ENHANCING_

FEATURE are insignificant in columns 3 and 8 (columns 4 and 9), in which we use the change in dividends (total investment) as the dependent variable. In columns 5 and 10, we use acquisition frequency as the dependent variable and find that the coefficient on PRIVATE_PLACEMENT_WITH_NO_VALUE-ENHANCING_FEATURE is positive and significant. Thus, the firms that issue shares with no value-enhancing feature engage in more empire building via external acquisitions than other firms whose PPEs have a value-enhancing feature.

To assess whether the valuation effects of M&As undertaken in the post-issuance period are different between the firms that conducted PPEs with no value-enhancing feature and the firms that conducted PPEs with at least one value-enhancing feature, we examine abnormal announcement returns for the firms that engage in M&As after their PPEs.

The results are reported in Table 8. The dependent variable is the CAR from 1 day before to 1 day after the M&A announcement date for the placement firms that acquire other firms in the post-placement period. In columns 1 and 2, we use 184 M&As that occur within 1 year after PPEs, and in columns 3 and 4, we use 399 M&As that occur during the tenure of the CEOs who engaged in PPEs. In addition to controlling for the variables used in Table 5, we include other M&A deal and firm characteristics used in Masulis, Wang, and Xie (2007) as additional controls in columns 2 and 4. In all four regressions, we find that the firms that issue shares with no value-enhancing feature experience lower CARs $(-1, 1)$ than the firms that issue shares with a value-enhancing feature. The coefficient of -4.08 for PRIVATE_PLACEMENT_WITH_NO_VALUE-ENHANCING_FEATURE in column 2 suggests that, all else being equal, the M&As by firms whose PPEs have no value-enhancing feature are associated with a 4.08 percentage-point lower CAR $(-1, +1)$ than the M&As by firms whose PPEs have at least one value-enhancing feature. This figure is economically large given that the mean CAR $(-1, +1)$ for the full sample is 1.30%. The result is consistent with Masulis et al. (2007), who find that firms with weaker governance have significantly lower M&A announcement returns than other firms.

Overall, the results in this section are consistent with our hypothesis that the managers of firms that issue shares with no value-enhancing feature are generally entrenched.

VIII. Summary and Conclusion

This paper reassesses two competing hypotheses on the valuation impacts of private placements documented in prior literature, specifically, the monitoring/certification hypothesis and the managerial entrenchment hypothesis, by focusing on the value-enhancing features of PPEs. We argue that the shareholder approval, active buyer, and premium pricing features in PPEs enable existing and new shareholders to perform value-increasing monitoring/certification roles for placement firms; thus, announcements of PPEs with and without such features reveal information about whether an issuing firm is a good or bad type.

Consistent with the managerial entrenchment hypothesis, we find that the PPEs with no value-enhancing feature are associated with negative and significant announcement and long-run post-issuance returns. By contrast, in support of the

TABLE 8

M&A Announcement Returns After Private Placements of Equity

Table 8 presents estimates of OLS regressions of the cumulative abnormal returns (CARs) for the placement firms that acquire other firms in the post-placement period from 1 day before the merger and acquisition (M&A) announcement date to 1 day after the M&A announcement date. In columns 1 and 2, the sample consists of 184 M&As from the SDC Platinum M&A database that occur within 1 year after private placements of equity (PPEs). In columns 3 and 4, the sample consists of 399 post-placement M&As that occur during the tenure of CEOs who engaged in PPEs. Daily abnormal returns are calculated by using a market model with a 200 trading-day estimation period beginning 211 days before and ending 11 days before the M&A announcement date. The CRSP value-weighted return is used as a proxy for the market return. Appendix B provides detailed descriptions of the control variables. The *t*-statistics are in parentheses and are estimated by using White standard errors that adjust for heteroscedasticity and firm clustering. *, **, and *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

	CARs (−1, 1) for M&As After PPEs			
	Within 1 Year After PPEs		Within CEO Tenure	
Independent Variable	1	2	3	4
PRIVATE_PLACEMENT_WITH_NO_VALUE-ENHANCING_FEATURE	−3.67**	−4.08**	−3.15***	−3.77***
	(−2.16)	(−2.20)	(−2.70)	(−3.16)
REGISTERED_DIRECT	2.19	1.95	2.01	1.91
	(0.91)	(0.80)	(1.47)	(1.22)
WARRANTS_INCLUDED	−2.57	−2.23	−1.06	−0.49
	(−1.05)	(−0.75)	(−0.72)	(−0.29)
HEDGE_FUND/BUYOUT/PRIVATE_EQUITY	3.11*	4.20**	1.77	2.08
	(1.72)	(2.42)	(1.27)	(1.47)
log(SIZE)	−0.62	−0.06	−0.00	0.28
	(−0.80)	(−0.06)	(−0.01)	(0.46)
MB	−0.05	−0.03	−0.07	−0.08
	(−0.76)	(−0.50)	(−1.32)	(−1.39)
CASH	6.42	1.86	1.01	−0.03
	(1.55)	(0.38)	(0.33)	(−0.01)
LEVERAGE	−10.32**	−13.16**	−4.78	−4.60
	(−2.62)	(−2.47)	(−1.54)	(−1.13)
PROFITABILITY	22.45	20.06	10.59	8.43
	(0.90)	(0.76)	(0.49)	(0.38)
HIGH_DISTRESS	6.85**	7.95*	8.65**	10.27*
	(2.26)	(1.86)	(2.19)	(1.97)
INSTITUTIONAL_OWNERSHIP	−0.00	−0.03	0.02	0.01
	(−0.12)	(−0.76)	(0.65)	(0.28)
MANAGERIAL_OWNERSHIP	−0.03	−0.05*	−0.03	−0.04
	(−1.27)	(−1.91)	(−1.20)	(−1.56)
TOBIN'S_Q		−0.87		0.10
		(−1.06)		(0.21)
FREE_CASH_FLOW		0.87		2.41
		(0.24)		(0.68)
STOCK_PRICE_RUN_UP		−2.17		−2.46***
		(−1.54)		(−2.64)
INDUSTRY_M&A		−36.89		48.65
		(−0.53)		(0.64)
RELATIVE_DEAL_SIZE		0.02***		0.00
		(2.68)		(0.47)
HIGH_TECH		−4.62		1.44
		(−1.30)		(0.42)
HIGH_TECH × RELATIVE_DEAL_SIZE		0.01		−0.03
		(0.22)		(−0.76)
DIVERSIFYING_ACQUISITION		−0.43		0.06
		(−0.22)		(0.06)
PUBLIC_TARGET × STOCK_DEAL		9.39***		1.37
		(2.81)		(0.52)
PUBLIC_TARGET × ALL-CASH_DEAL		8.80		0.80
		(1.07)		(0.36)
PRIVATE_TARGET × STOCK_DEAL		2.51		1.94
		(1.12)		(1.20)
PRIVATE_TARGET × ALL-CASH_DEAL		1.59		0.11
		(0.78)		(0.07)

(continued on next page)

TABLE 8 (continued)

M&A Announcement Returns After Private Placements of Equity

	CARs (−1, 1) for M&As After PPEs			
	Within 1 Year After PPEs		Within CEO Tenure	
Independent Variable	1	2	3	4
SUBSIDIARY_TARGET		2.59		−1.26
× ALL-CASH_DEAL		(1.20)		(−0.64)
Year fixed effects	Yes	Yes	Yes	Yes
Industry fixed effects	Yes	Yes	Yes	Yes
No. of obs.	184	179	399	388
Adj. R^2	−0.018	0.022	0.046	0.054

monitoring/certification hypothesis, for the issues with at least one value-enhancing feature, their announcement returns and mean long-run post-issuance returns are significantly positive and insignificant, respectively. Thus, the puzzling results of positive announcement returns and subsequent negative long-run post-issuance returns for PPEs are unlikely driven by investor overreaction (Hertzel et al. (2002)); instead, they are likely driven by the prior literature's failure to account for the heterogeneous nature of PPE characteristics.

We also find that firms with a greater need to overcome their financial difficulties and firms with better governance are more likely to place shares with at least one value-enhancing feature, which further supports the monitoring/certification hypothesis. By contrast, firms whose PPEs do not have any value-enhancing feature increase cash and debt and engage in more value-destroying acquisitions in the post-placement period, which is consistent with the managerial entrenchment hypothesis.

Overall, our study suggests that considering the heterogeneous differences in the value-enhancing features of PPEs is important for better understanding the valuation impact of PPEs and for reconciling the contradictory conclusions in the literature regarding announcement and long-term post-issuance returns for PPEs. In corporate finance, the studies that analyze the impact of corporate events on firm value and policies often treat the sample events to have homogeneous characteristics and categorize them under a common label although their characteristics are heterogeneous and fundamentally different. Our findings suggest that these studies can also benefit from a similar analysis to the one conducted in this study for private placements.

Appendix A. Shareholder Approval Rules for PPEs

Appendix A discusses the details about shareholder approval rules for PPEs, their exceptions, and how we apply such rules to our sample firms to identify the PPEs with a shareholder approval feature.

A.1. Discount Issues with Fraction More Than 20%

Because of the dilutive nature of discount issues, Nasdaq, NYSE, and NYSE American have adopted shareholder approval rules for discount PPEs in which firms

sell more than 20% of the existing shares outstanding. In particular, Nasdaq Rule 5635 (d) adopted in 1990 states that "Each company shall require shareholder approval prior to the issuance of securities… at a price less than the greater of book or market value, which… equals 20% or more of the common stock, or 20% or more of the voting power outstanding before the issuance."[24] This 20% rule is unique to private offerings. However, because private placements tend to be used by a large number of distressed firms, Nasdaq makes an exception to the 20% rule when a delay in equity financing is likely to "seriously jeopardize the financial viability" of the firm (financial viability exception rule, Nasdaq Rule 5635 (f)). The PPEs that are subject to this financial viability exception are approved by the audit committee or a comparable body of the board of directors that consists solely of independent, disinterested directors, not by shareholders.[25]

When shareholder approval is required, the minimum vote is the majority of the total votes cast on the proposal. These votes may be cast in person or by proxy at an annual or special meeting or by written consent of the majority of shareholders (see Nasdaq Rule 5635 (e)(4)). The typical timeline for the voting procedure is that a firm first announces the private placement closure, which is followed by a proxy statement filing and an annual or special shareholder meeting in which shareholders can vote on the PPE. Consistent with Listokin (2008), who finds that the majority of manager-sponsored proposals are eventually approved at shareholder meetings because the proposals can be removed strategically by the firm's management if they cannot obtain the majority of shareholders' support, votes for private placements are rarely rejected.[26]

A.2. Change-of-Control Issues

Stock exchanges in the U.S. require shareholder approval for both public and private equity offerings if these offerings result in a change of the largest shareholders. Nasdaq Rule 5635 (b) states that "shareholder approval is required prior to the issuance of securities when the issuance or potential issuance will result in a change of control of the company." Although the rule does not explicitly specify when the change of control occurs, Nasdaq Listing Center describes that a change of control generally occurs if as a result of the equity issuance, an investor owns or has the right to acquire 20% or more of the outstanding shares or of the voting power and such ownership share or voting power would be the largest position in the firm. In addition, according to the Listing Center, equity offerings that result in a new controlling position such as an increase in equity

[24]Nasdaq Listing Rule 5635 (previously Rule 4350) governs the regulations of listed firms regarding shareholder approval. Following the NYSE shareholder approval rules adopted in 1989, Nasdaq adopted Rule 5635 (including 5635 (a), 5635 (b), 5635 (c), 5635 (d), and 5635 (f)) in 1990, and this rule has remained largely unchanged since then (see Release No. 34-27489, File No. SR-NASD-89-42, and Release No. 34-27035, File No. SR-NYSE-88-19).

[25]Similar rules exist for both NYSE American and NYSE. For example, NYSE American Section 713 (a) and NYSE Rule 312.03 (c) describe the 20% shareholder approval rule for private placements, and NYSE American Section 710 (b) and NYSE Rule 312.05 describe the financial viability exception. PPEs that are subject to the financial viability exception rule, however, are rare. Of 615 sample PPEs, only 6 PPEs are subject to the financial viability exception.

[26]We find that only four of 615 PPEs were canceled after announcements of placements selling more than 20% of firms' shares at a discount. Even in these four cases, the cancelations were not due to shareholder rejection of private placements but to other reasons.

ownership by the largest shareholders from below 20% to above 20% are required to receive shareholder approval. Similarly, NYSE American Section 713 (b) and NYSE Rule 312.03 (d) require shareholder approval for change of control.

To identify the PPEs that result in a change of control, we first examine whether a firm's largest shareholder holds more than 20% of its shares outstanding after the PPE by using a post-placement proxy statement in EDGAR. Next, with a pre-placement proxy statement, we check whether the largest shareholder in the post-placement period is not the largest shareholder or has less than 20% of the firm's shares outstanding prior to the issuance. Finally, for the largest shareholder who meets these two conditions, we examine whether she is one of the investors stated in the PlacementTracker database or the placement announcement.

A.3. Manager Participating Issues

All three stock exchanges in the U.S. require equity issuance to managers that results in the establishment or material amendment to the managerial equity compensation plan (including but not limited to an increase in the number of shares available for managers) to receive shareholder approval (Nasdaq Rule 5635 (c), NYSE American Section 711, and NYSE Rule 312.03 (a)). Moreover, the Nasdaq Listing Center considers the issuance of common stock to officers, directors, employees, or consultants at a price less than the market value of the stock as a form of "equity compensation" that requires shareholder approval (Nasdaq IM-5635-3). In addition, unlike firms listed on other exchanges, those listed on the NYSE are required to seek approval when their managers acquire more than 1% of shares outstanding (NYSE Rule 312.03 (b)).[27] In our analyses, we consider the following three cases as *Manager Participating Issues* that require shareholder approval: i) when managers purchase discount issues, ii) when managers purchase premium issues that are part of an establishment or material amendment to the firm's compensation plans,[28] and iii) when managers purchase large issues that account for more than 1% of shares outstanding in their NYSE listed firms.

A.4. Other Issues

Shareholder approval is also required for an equity issuance related to the acquisition of the stock or assets of another firm if i) the firm acquires the other firm by issuing more than 20% of its outstanding shares (irrespective of whether the issuance is at a premium or at a discount) or ii) its director, officer, or substantial shareholder owns 5% or more in the target firm (Nasdaq Rule 5635 (a), NYSE American Section 712). Since our sample includes only the former cases and not the latter, PPEs that require shareholder approval due to Nasdaq Rule 5635 (a) and NYSE American Section 712 are completely subsumed by *Discount*

[27]Before 2003, Nasdaq had a rule (4350 (i)(1)(4)) similar to NYSE Rule 312.03 (b) but removed it in 2003. In our sample, although we find a few cases of discount issues to which this rule applies, we do not separately consider them as *Manager Participating Issues* since we already include all discount issues sold to managers as PPEs that require shareholder approval.

[28]When identifying *Manager Participating Issues* sold at a premium that require shareholder approval, we do not consider general shareholder approval of establishments or amendments to the equity compensation plan as *Manager Participating Issues* because such approval is often sought at annual shareholder meetings that have nothing to do with a specific PPE.

Issues with Fraction More Than 20% and issues with *Premium Pricing Feature.* Thus, we do not separately categorize these PPEs as those that require a new type of shareholder approval.

Appendix B. Variable Definitions

Appendix B shows detailed descriptions of the construction of all the variables used in the tables.

ACTIVE_BUYER_FEATURE: Indicator that takes the value of 1 if the private placement buyer demands board representation in an issuing firm (*Board Representing Buyer*), has a strategic relationship with the issuing firm (*Strategic Buyer*), or purchases a block ownership of at least 5% in the issuing firm as a single investor (*One Block Buyer*) and 0 otherwise.

All-CASH_DEAL: Indicator that takes the value of 1 for acquisitions financed fully with cash and 0 otherwise.

CASH: Cash and short-term investments / (market value of equity + total liabilities).

CEO_AGE: CEO age (in years).

CEO-CHAIR_DUALITY: Indicator that takes the value of 1 if the CEO is the chairman of the board and 0 otherwise.

DIVERSIFYING_ACQUISITION: Indicator that takes the value of 1 if the bidder and target do not share the same Fama–French 48-industry classification and 0 otherwise.

FREE_CASH_FLOW: (Operating income before depreciation − interest expenses − income taxes − capital expenditures) / book value of total assets.

HEDGE_FUND/BUYOUT/PRIVATE_EQUITY: Indicator that takes the value of 1 if hedge funds, buyout funds, or private equity funds are the majority buyers (i.e., more than 50%) in private placements of equity and 0 otherwise.

HIGH_DISTRESS: Indicator that takes the value of 1 if a firm is in the highest distress decile group and 0 otherwise, where distress is measured by using the coefficients of a predicted 12-month-ahead financial failure model (*CHS*) in Table 4 in Campbell et al. (2008). Specifically, their model coefficient estimations are as follows: $CHS = -20.26\ NIMTAAVG + 1.42\ TLMTA - 7.13\ EXRETAVG + 1.41\ SIGMA - 0.045\ RSIZE - 2.13\ CASHMTA + 0.075\ MB - 0.058\ PRICE - 9.16$, where *NIMTAAVG*, *TLMTA*, and *CASHMTA* are the geometrically decreasing average of quarterly net income, total liabilities, and cash plus short-term investments, respectively, all divided by the sum of the market value of equity and total liabilities; *EXRETAVG* is the difference between a firm's 1-year average monthly raw return and the S&P 500 monthly return; *SIGMA* is the annualized 3-month return standard deviation; *RSIZE* is the ratio of a firm's market value of equity to the total S&P 500 market value; *MB* is the ratio of the market value of equity to the book value of equity, where the book value of equity is constructed as in Cohen, Polk, and Vuolteenaho (2003); and *PRICE* is the stock price winsorized at $15. All variables are measured by using quarterly data.

HIGH_TECH: Indicator that takes the value of 1 if the bidder and target are both from high-tech industries and 0 otherwise (Loughran and Ritter (2004)).

INDUSTRY_M&A: Value of all corporate control transactions with the value being more than $1 million in the acquirers' Fama–French 48-industry classification in the previous year divided by the total book value of the assets of all Compustat firms in the same Fama–French 48-industry classification and year (Masulis et al. (2007)).

INSTITUTIONAL_OWNERSHIP: Sum of institution ownership divided by the total number of shares outstanding.

LEVERAGE: Book value of total debt / (market value of equity + book value of total debt).

log(CEO_TENURE): Natural logarithm of the number of years that the CEO has been at the firm.

log(SIZE): Natural logarithm of the market value of equity (in $100 millions).

MANAGERIAL_OWNERSHIP: Ownership held by the top 5 executives (CEO, CFO, COO, CTO, and CIO).

MB: Market-to-book equity ratio. Book value of equity is measured as stockholder's equity + deferred taxes + investment tax credit - postretirement benefit liabilities - book value of preferred stock (Cohen et al. (2003)).

PREMIUM_PRICING_FEATURE: Indicator that takes the value of 1 if a firm issues equity privately at a premium and 0 otherwise.

PRIVATE_PLACEMENT_WITH_NO VALUE-ENHANCING_FEATURE: Indicator that takes the value of 1 if the private placement does not have any value-enhancing features (i.e., SHAREHOLDER_APPROVAL_FEATURE, ACTIVE_BUYER_FEATURE, and PREMIUM_PRICING_FEATURE) and 0 otherwise.

PRIVATE_TARGET: Indicator that takes the value of 1 for private targets and 0 otherwise.

PROFITABILITY: Geometric decreasing average of the ratio of quarterly net income to the sum of the market value of equity and total liabilities (Campbell et al. (2008)).

PROPORTION_OF_OUTSIDE_DIRECTORS: Ratio of the number of outside directors to the total number of directors on the board.

PUBLIC_TARGET: Indicator that takes the value of 1 for public targets and 0 otherwise.

REGISTERED_DIRECT: Indicator that takes the value of 1 for private placements with registered direct status and 0 otherwise.

RELATIVE_DEAL_SIZE: M&A deal value over bidder market value of equity.

SHAREHOLDER_APPROVAL FEATURE: Indicator that takes the value of 1 for i) a discount private placement whose fraction is more than 20% of the shares outstanding (i.e., *Discount Issue with Fraction More Than 20%*), ii) a private placement in which the buyer purchases more than 20% of shares outstanding including existing and new shares and becomes the largest shareholder (i.e., *Change-of-Control Issue*), and iii) a private placement in which the manager purchases either discount issues, or premium issues that are part of an establishment or material amendment to the firm's equity compensation plan, or large issues that account for more than 1% of shares outstanding in her NYSE listed firm (i.e., *Manager Participating Issue*) and 0 for other private placements.

STOCK_DEAL: Indicator that takes the value of 1 for acquisitions financed either partially or fully with stock and 0 otherwise.

STOCK_PRICE_RUN_UP: Bidder's buy-and-hold abnormal return from day −210 to day −11, where day 0 is the M&A announcement date.

SUBSIDIARY_TARGET: Indicator that takes the value of 1 for subsidiary targets and 0 otherwise.

TOBIN'S_Q: Market value of assets (total assets - book value of common equity + market value of equity − deferred taxes) over the book value of assets.

WARRANTS_INCLUDED: Indicator that takes the value of 1 for private placements with warrants included in the contract and 0 otherwise.

VALUE-ENHANCING PRIVATE_PLACEMENT: Indicator that takes the value of 1 for a private placement that has either a SHAREHOLDER_APPROVAL_FEATURE, or an ACTIVE_BUYER_FEATURE, or a PREMIUM_PRICING_FEATURE and 0 otherwise.

Supplementary Material

To view supplementary material for this article, please visit http://dx.doi.org/10.1017/S0022109020000599.

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