The Choice and Effect of SEO Underwriting Mechanisms:

A Microstructure Approach

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Abstract

The purpose of this study is to examine if the degree of heterogeneity among investors would affect a firm’s choice on underwriting methods (book building vs. fixed pricing) for a Secondary Offer (SEO). We use the Taiwan Stock Market’s intraday order flow data to measure the degree of investors’ heterogeneity. Our results show that firms with significant heterogeneity among investors tended to adopt the book building approach in which a contracted underwriting firm would underwrite the whole issue from the issuing firm, announce an allocation schedule, and search for buying interest (and prices) privately from a group of selected investors. On the other hand, firms whose value most investors agreed on usually employed the fixed pricing methods in which the offer price is preset and offered to the public, and in the case of over-subscription, the issue is allocated to subscribing investors randomly.

Our results also show that the book building method could reduce the degree of heterogeneity among investors much more significantly than the fixed pricing method. The above findings suggest that the book building method, even though more costly to implement, is a more effective method to resolve information asymmetry than the fixed pricing method. However, firms that do not have serious information asymmetry problem may still choose the fixed pricing methods to save their issuing cost.