AN EMPIRICAL EXAMINATION OF THE PRICING OF SEASONED EQUITY OFFERINGS: A TEST OF THE SIGNALING HYPOTHESIS

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This paper tests the predictions made by Signaling Theory against the competing Price Irrelevance Hypothesis (Eckbo and Masulis 1992). Signaling Theory suggests that the issue price of a security provides a signal of the quality of the issuing firm. In contrast, the Price Irrelevance Hypothesis suggests that equity pricing does not possess information content. This paper investigates the pricing of seasoned equity offerings by examining the role of firm quality and relative firm valuation on issue price discounts. Additionally, this paper investigates the relationship between the issue price discount and the market reaction at the issuance of seasoned equity offerings.

The results indicate that firm quality does not have a significant impact on the degree of price discounting by issuing firm. Relative firm market valuation does appear to be a determinant of the magnitude of discounting in setting the issue price. This study also provides evidence that seasoned equity offerings firms that provide a lower issue-price discount experience a lower stock-price decline following the issuance as compared to firms offering a higher price discount.

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