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How Companies Use Bad News to Torpedo IPOs from Competitors

FOR IMMEDIATE RELEASE

Lakewood Ranch, Fla. _ A new study published by the American Accounting Association finds publicly traded companies will strategically release bad news when a competitor is launching an initial public offering (IPO), in order to drive down the value of the IPO or torpedo the IPO completely.

"Because there is little company-specific information available to investors when a company attempts a public listing for the first time, investors trying to place a value on the offering depend largely on the information from publicly traded companies that are already operating in that industry," says Mark Ma, co-author of a paper on the work and an associate professor of business administration at the University of Pittsburgh.

"We wanted to see whether companies would make themselves appear less profitable in order to get a competitor to withdraw its IPO or limit the amount of money the competitor can raise."

For this study, researchers collected data on 3,878 firms that went public in the U.S. between 1991 and 2017, as well as 866 withdrawn IPOs. The researchers also evaluated quarterly financial statements issued by large, publicly traded companies during the same time period.

The researchers then used statistical tools to identify patterns among publicly traded companies when an industry competitor was preparing to issue an IPO.

To help identify the potential impact of a competitor's IPO offering, the researchers compared financial statements of companies who issued their statements shortly before a competitor's IPO was filed with companies in the same sector who issued statements after the IPO was filed.

"When a company files its IPO, publicly traded competitors in the same sector were more likely to report lower earnings, issue pessimistic revenue forecasts, and take a negative tone in their financial statements," Ma says.

"This strategy works," Ma says. "In cases where competitors issued negative financial statements, companies who had listed an IPO were more likely to revise their offering price downward or withdraw the IPO altogether. Even if these firms go public, they suffer poor operating performance – probably because they couldn't raise sufficient capital at the IPO stage. Meanwhile, their competitors experience higher profitability and market share growth.

“One takeaway message is that investors should be skeptical of competitors’ financial statements when evaluating IPO offerings.”

“Academic studies have shown that raising external capital can be costly for firms due to information asymmetry in capital market,” says Xiaoyun Yu, co-author of the study and a Chair Professor of Finance at Shanghai Jiao Tong University. “Our paper suggests the cost of financing may be higher than previously estimated when considering the strategic negative disclosure of already publicly traded industry peers.”

“In addition, by deploying strategic disclosure to hinder competitors’ ability to raise capital and to go public, large incumbents can shape the competitive landscape and alter the industry structure,” Yu says. “Consequently, industry policies may become tilted in favor of large incumbents, as they gain influence over the industry's development.”

The paper, “Torpedo Your Competition: Strategic Reporting and Peer Firm IPO,” is published in *The Accounting Review*. The paper was co-authored by Matthew Billett, Chase Chair Professor of Banking and Finance at Indiana University Bloomington.

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