Two stage exit vs. direct sellout: is it worth going public before being acquired?

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Structured Abstract

Purpose – Once a firm's shareholders decide to sell the company, they may consider the possibility of taking it public before being acquired. Since IPOs ease acquisitions in a number of ways, we hypothesize that firms choosing a two-stage exit strategy (IPO and subsequent M&A) benefit from a valuation premium with respect to firms opting for a direct sellout when still private. We identify three main hypothesis that motivate such a premium: (1) the increased visibility brought by the status of public firm, (2) the stronger bargaining power vis-à-vis the acquirer, and (3) the possibility to optimally exercise the exit option.

Design/methodology/approach – Using a sample of 314 firms that go public in Europe during 1995-2011 and are acquired within three years after the IPO ('two-stage exit' firms), we perform a propensity score matching methodology on a control sample of 4,633 European firms acquired in the same period but as still private. The aim is to assess the existence of a valuation premium recognized by acquirers to two-stage firms. We then investigate the determinants of the valuation premium by employing a cross-sectional OLS regression.

Originality/value – While most of the studies linking Initial Public Offerings and the market for corporate control consider IPOs as a way to facilitate subsequent M&A activity as acquirer, we take the opposite perspective and investigate whether going public can be a useful decision for firms who want to sell out to another company. We find that a firm opting for a two-stage exit is targeted at an average 57% higher valuation than a similar firm selling out as private. This valuation premium is driven by the characteristics of the firm at the IPO. Consistent with the increased visibility motivation, it is larger for smaller firms going public. It is also influenced by the reputation of the IPO underwriter, the level of underpricing and the fraction of the firm's intangible assets, as predicted by the bargaining power hypothesis.

Practical implications – This paper provides empirical evidence that a two-stage exit (i.e. going public before selling out) is a valuable strategy for firms looking for an acquirer. Hence, once a firm's shareholders decide to exit the company, they should consider the possibility of taking it public first, in order to maximize their wealth.

Keywords – Firm exit, IPOs, M&As, valuation premium.

Paper type – Empirical paper