FIN 411: Secondary Distributions

Mikkelson & Partch (JFE, 1985): study price effects of secondary distributions

sale of a large block of stock by one shareholder to many smaller buyers

- registered with the SEC, or
- unregistered (smaller)

Mikkelson & Partch (JFE, 1985)
Secondary Distributions

Primary distribution when the firm sells new shares and receives cash

Secondary distribution has no cash flow implications for the firm

- in fact, the firm probably doesn't even know it is happening

better experiment than primary because you don't have to worry about the what the firm uses the proceeds for [i.e., is NPV>0?]

Alternative Hypotheses About Price Effects of Secondary Distributions

1. Price pressure: demand curves generally slope downward
   - people are willing to pay less per unit for incremental units

2. Perfect competition: elastic demand curve (availability of many perfect substitutes)
   - e.g., other common stocks with the same risk and return characteristics

3. Information effects: identity of the seller conveys information about value of the stock (Lemons problem)
   - downward shift in the horizontal demand curve

Summary Statistics (Table 3)
underwritten secondaries, 1972-81

146 registered (321 unregistered)

- registration required if seller has control relationship (insider)

registered larger 828,000 shares (vs. 152,000)

- $31.6 million (vs. $3.5 mil)
- 8.1% (2.7%) of shares outstanding

Who is Selling? (Table 4)

53 insiders use registered (37% of cases)

- How do 6 insiders sell unregistered?

155 investment cos, banks, insurance cos sell unregistered

- 71% of cases where info is available
What Happens When the Sale Is Announced? (Table 5)

Day -1: -1.31% (R) & -.40% (U)
Day 0: -1.56% (R) & -.40% (U)
Day 1: .09% (R) & -1.56% (U)

- unregistered secondaries (U) typically are disclosed and distributed after the close of trading on day 0
- no price rebound later
- reflecting temporary price pressure

What Happens When Shares Are Distributed? (Table 6)

Registered secondaries are distributed well after the registration
- No stock price effect when trades occur
  - just when the intention to sell is announced
- No price rebound later
  - reflecting temporary price pressure
- Typically don't know identity of seller in unregistered secondaries until after the shares are distributed

Does It Matter Who Is Selling? (Table 10 -- registered)

Largest price effect for insiders (-3.4%; t=-8.5)
- -2.6% for other sellers, still significant

Largest price effect for largest sales: 19% of stock (-3.9%; t=-7)
- -2% (t=-4.5) for smallest sales

It is not good news that a large holder has decided to sell a block of stock
- and hasn't found a large buyer to replace him

Underwriting Spreads on Secondaries (Tables 11 & 12)

Spread is difference between price charged by underwriter and price received by seller
- avg spread = 4.9%

Spread is larger if size is larger:
- relative to shares outstanding, or
- relative to normal trading volume

Spread is smaller if the dollar size of the offering is larger

M&P (JFE, 1985) Secondary Distributions: Summary

(1) Costs of selling in secondary are high (2.5% announcement price effect, 6.5% underwriter fees)

(2) Adverse information effects are large (identity of seller, size of trade, etc.)

(3) No price pressure (temporary price reduction to absorb the large block of stock)


(1) Why would someone with a large block of stock choose to sell via a secondary distribution?

(2) If you were an uninformed investor with a large block of stock in one company, how could you credibly signal to the market that you were not selling due to adverse information?

(3) Why would anyone sell stock using an underwritten secondary distribution if the transactions costs are so large?