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Buyout Groups' Reputational Concerns and Costs of Debt Financing: Evidence from Bond Offerings by IPO Firms*

by

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Abstract

A popular view is that buyout groups are focused on short-term improvements in operations and wealth redistribution at the expense of long-term value creation. Using bonds offered during 1983-2009 by firms after their initial public offerings (IPOs), we examine the effects of buyout groups (private equity firms) on bond yield spreads, credit ratings, and bond issuers' dividend and investment decisions. We find that yield spreads on bonds offered after the IPO by buyout-backed IPO firms are on average 67 basis points lower than those on bonds by other IPO firms, after controlling for other issuer and issue risk attributes, in spite of the fact that bond ratings by both Standard & Poor's and Moody's are unrelated to whether the issuer's IPO was buyout-backed. We also provide evidence that buyout-backed IPO firms are less likely to pay dividends and invest less than other IPO firms in the fiscal years of bond offerings. Our findings suggest that the reputational concerns of buyout groups can help their portfolio firms reduce the agency costs of debt.

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