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Delaware Reincorporation and the Double-Exit Puzzle: Evidence from Post-Initial Public Offering Acquisitions

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Abstract: Initial public offerings and mergers and acquisitions represent important opportunities for investors to exit and harvest their entrepreneurial success. Some firms are acquired shortly after their initial public offerings. This exit strategy is known as a double exit. In addition, issuing firms may choose to reincorporate in Delaware during their IPOs. In this study, we use hand-collected data from 1993 to 2020 to investigate whether and to what extent Delaware reincorporation may affect the M&As in the post-IPO stage. We use a Cox proportional hazard model to test the relation between Delaware reincorporation and the likelihood of being acquired for our sample IPOs. Recognizing that Delaware reincorporation is not a random decision, we adopt a Heckman switching regression method to estimate the relation between Delaware reincorporation and takeover premiums and announcement returns. We report that IPO firms choosing to reincorporate in Delaware experience a higher likelihood of being acquired compared to those IPO firms choosing to remain incorporated in their home states. We further document that IPO firms choosing to reincorporate in Delaware receive lower premiums in acquisitions, and experience lower abnormal returns on announcements.

Keywords: reincorporation; IPO; mergers and acquisitions; double exit



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1. Introduction

Mergers and acquisitions (M&As) represent an important exit strategy for many entrepreneurial firms so that investors can recoup their investments along with the returns, if any. Equally important are initial public offerings (IPOs), which allow the entrepreneurs and their investors to cash out and liquidate at least a portion of their equity stake in the issuing firms. Funds exiting from entrepreneurial firms may pursue other investment opportunities in the private sector. In this sense, exit strategies are important for both investors and entrepreneurs. Nonetheless, it has been a puzzle that around 30% of IPO firms are acquired shortly after they become public. In other words, investors and entrepreneurs first exit the entrepreneurial firms through IPO and subsequently exit through M&As, which is also known as a double-exit strategy (Dai et al. 2005). Given that both IPOs and M&As involve substantial flotation costs and transaction costs, it is crucial to gain deep insights on entrepreneurial firms' decisions to exit, especially through the double-exit strategy.

However, empirical evidence is still scant about the double-exit strategy, including its antecedents, motives, and consequences. In this study, we ask the research question as to whether and to what extent the reincorporation decisions of IPO firms may affect their subsequent exit through acquisitions. A US firm can incorporate in a state to become a legal person in that state even if it does not have any business in that state. As a result, the corporate law in the incorporated state applies to that firm. Moreover, firms in the U.S. are free to reincorporate in any other state (Heron and Lewellen 1998) to change their

legal domiciles. Although US firms can choose to incorporate in any of the states, they typically make a binary choice of incorporating either in their home states or Delaware (Daines 2002). Delaware provides a takeover-friendly law environment with fully defined codes and better experience in settling corporate cases (Daines 2001). Therefore, issuing firms may strategically reincorporate to Delaware, and such reincorporation decisions at the IPO stage may convey information on firms' intention to choose the double-exit route (Song et al. 2021). Our study intends to fill this void in the literature and shed further light on whether and to what extent Delaware reincorporation may affect the likelihood of being acquired for issuing firms choosing to reincorporate to Delaware. Furthermore, issuing firms' decisions to reincorporate to Delaware present an opportunity for academics and practitioners to understand the costs and benefits associated with the strategic decision.

In this study, we download IPO prospectuses from SEC EDGAR and manually collect information on firm incorporation and reincorporation decisions. We construct a sample of 1153 IPOs from 1993 to 2015, out of which 426 issuing firms reincorporated to Delaware right before or after their IPOs. We document that the likelihood of being acquired increases by 55% for firms reincorporated to Delaware compared to stay-at-home-state issuing firms. We posit that, although Delaware reincorporation facilitates the exit of issuing firms through acquisitions in the post-IPO period, issuing firms experience lower valuation and return in the acquisition. Our estimation reveals that reincorporated issuing firms would have received a higher takeover premium by 48.4% and experienced a higher cumulative abnormal return (CAR) on the announcement by 20.2% had they chosen to stay in their home states.

The remainder of this paper is organized as follows. Section 2 reviews the relevant literature and develops the research questions. Section 3 details our data, sampling procedure, and empirical method. Section 4 reports our empirical results. Section 5 summarizes and concludes.

2. Related Research and Hypotheses Development

2.1. Institutional Background of Incorporation and Reincorporation Decisions

In the U.S., firms are free to choose their states of incorporation. Moreover, firms tend to make a binary choice in terms of where to incorporate. In other words, most U.S. firms either incorporate in Delaware or their home states, with Delaware being able to attract more than 50% of publicly traded firms (Bebchuk and Cohen 2003). Earlier research proposes two competing hypotheses to explain the incorporation decisions of U.S. firms, whereas the empirical evidence remains mixed. The "Race to the top" hypothesis argues that the competition between states would benefit shareholders due to improved corporate laws that maximize the firm's value (Romano 1985). The "Race to the Bottom" hypothesis, similar to entrenchment theory, predicts that states providing pro-management corporate laws, such as antitakeover statutes, would harm shareholders' value (Cary 1973; Bebchuk 1992). More recently, Daines (2002) argues that some firms prefer in-state incorporation so that they are able to obtain favorable tax or operational treatments by displaying "loyal citizenship". Bebchuk and Cohen (2003) propose the extra-cost pull hypothesis, emphasizing the extra cost associated with incorporation in other states. Although the filing fees and franchise tax are not substantial for most publicly traded firms, they are nonnegligible for entrepreneurial firms.

Firms in the U.S. are also free to change their state of domicile at any time without altering their current operation (Waisman et al. 2009). Nonetheless, reincorporated firms are subject to the corporate law of new states of incorporation even though they may not have any business in those states. Therefore, the conventional view regarding the incorporation choice is a "pure" question for the legal regime. It is natural for firms to choose their home state for incorporation because of lower legal costs and stronger local influence. As firms grow, they weigh more on corporate laws offered by the states of incorporation. Given that firms are making a binary choice, they have to balance the benefits and costs associated with their reincorporation decisions.

Reincorporation is not uncommon for U.S. firms. Using industrial manuals, Moody's OTC manuals, and the disclosure database, [Heron and Lewellen \(1998\)](#) find 1004 firms reincorporated between 1980 and 1992. According to the financial market and regulations, firms may choose to change their state of incorporation at the time of IPO (IPO reincorporation) or after IPO (midstream reincorporation). The existing literature largely focuses on midstream reincorporation and investigates the agency costs between entrenched managers and shareholders ([Peterson 1988](#); [Heron and Lewellen 1998](#)). Note that new issuing firms have more degrees of freedom to reincorporate because such decisions do not require votes ([Ferris et al. 2006](#)). Nonetheless, evidence is scant on how and why IPO firms make reincorporation decisions. To fill the void in the literature, we focus on IPO reincorporation to shed further light on this important corporate decision.

2.2. Initial Public Offerings and the Double-Exit Puzzle

[Celikyurt et al. \(2010\)](#) study an unexplored motive for IPOs: firms go public to make acquisitions. Equally importantly, [Dai et al. \(2005\)](#) find that VC-backed firms that went public between May 1996 and December 2000 are more likely to be acquired shortly after going public. Initial public offerings represent an important exit strategy, and so do mergers and acquisitions. M&As tend to have profound implications for both the target and acquirers ([Kellner 2024](#)). Issuing firms being acquired shortly after their IPOs is referred to as a double-exit puzzle because this exit strategy involves higher transaction costs and more uncertainties. In this study, our intention is not to explore the motives for firms choosing a double-exit strategy. Rather, we build on the literature on Delaware incorporation and the literature on M&As, and we investigate whether and to what extent Delaware incorporation may affect the issuing firms' exit through acquisitions in the post-IPO period.

We posit that Delaware reincorporation facilitates the exit of issuing firms through acquisitions in the post-IPO period. [Daines \(2001\)](#) reports that Delaware firms are more likely to attract takeover bids than firms incorporated in other states because of the mild Delaware antitakeover law environment. In other words, issuing firms choosing to reincorporate in Delaware are more likely to receive bidding offers. Moreover, Delaware is the only state with a specialized chancery court to resolve corporate law disputes ([Waisman et al. 2009](#); [Ni 2020](#)), and merger deals in Delaware are known to be quick, efficient, and business-friendly ([Fuerst and Geiger 2003](#)). Therefore, we propose the following hypothesis:

H1. *Compared with stay-at-home state issuing firms, IPO firms choosing Delaware reincorporation have a higher likelihood of being acquired in the post-IPO stage.*

On the other hand, we argue that a tradeoff exists between the quickness and easiness of exit through acquisition and the valuation of the transactions. The existing literature has explored the tradeoff between firms' valuation and their takeover likelihood. The "bargaining power hypothesis" claims that a target with strong takeover defenses will extract more analyst coverage in a negotiated acquisition ([Subramanian 2003](#); [Bainbridge 2002](#); [Gordon 2002](#)). The "bonding hypothesis" ([Johnson et al. 2015](#)) argues that issuing firms adopt a strong takeover defense during IPO to reduce the takeover likelihood so that they can protect their long-term business relationships. Therefore, building on the existing literature, we propose the following hypotheses:

H2. *Compared with stay-at-home-state issuing firms, IPO firms choosing Delaware reincorporation experience lower takeover premiums in their post-IPO acquisitions.*

H3. *Compared with stay-at-home-state issuing firms, IPO firms choosing Delaware reincorporation experience lower announcement returns in their post-IPO acquisitions.*

3. Data

3.1. Sample Selection

We obtain information for IPOs in the U.S. from Refinitiv's Securities Data Company (SDC) Platinum New Issues database. Following the convention, we require our sample IPO firms to be U.S. issuers with an offer price of no less than USD 5. We exclude offer types of unit issues, real estate investment trusts (REITs), closed-end funds, American Depositary Receipts (ADRs), and other non-common share types. We further exclude financial firms and utility firms because they operate in highly regulated industries.

We manually collect reincorporation information for our sample IPOs from the IPO prospectus in the SEC EDGAR database. Our study focuses on the issuing firms reincorporated to Delaware. In particular, we identify an IPO firm which was originally incorporated in a non-Delaware state and decided to change its state of incorporation to Delaware in a time window from six months preceding its IPO to six months after its IPO. For example, eBay incorporated in California in May 1996 and reincorporated into Delaware in April 1998. Less than six months later, eBay went public on 24 September 1998, and was traded on the Nasdaq exchange. For another instance, Ignyta went public on 13 March 2014, and reincorporated from Nevada to Delaware on 12 June 2014.

Our sampling procedure yields a sample of 446 issuing firms that reincorporated to Delaware in the period between 1993 and 2015. We define stay-at-home-state firms as firms that remain incorporated in non-Delaware states. We exclude those issuing firms that are incorporated in Delaware from their onset. We also eliminated the cases of reincorporation events not related to the going public process as we define it. During the same time frame, we are able to identify 727 IPOs as our matching sample and control group.

We chose our sample period from 1993 to 2015 because we need to track the mergers and acquisitions of our sample IPOs within the 5-year window after their going public. We obtain information on M&As from Refinitiv's Securities Data Company (SDC) Platinum Mergers and Acquisitions database. We use Compustat Capital IQ database to collect financial information for our sample IPOs. Since the focus is on firms' M&A activities in the post-IPO stage, we follow [Celikyurt et al. \(2010\)](#) to use a five-year window after the IPO issue date. We only study the control contest takeover, for which the bidder seeks to own at least 50% of the target firms. While the target firms are U.S. public firms, the bidders can have different public statuses or countries of incorporation. We can use the following example to illustrate the timeline. After filing an IPO on 12 October 2006, FCStone reincorporated from Iowa to Delaware on 6 December 2006, and went public on 16 March 2007. The acquirer, International Assets Holding Corporation, announced that they were seeking to purchase 100% shares of FCStone on 2 July 2009, and the deal was completed on 30 September 2009.

Our final sample contains 1153 IPO firms, among which 426 chose to reincorporate to Delaware and 727 of which stayed in their original states of incorporation. Within five years after their IPOs, 149 reincorporated firms received 163 takeover bids, whereas 249 stay-at-home-state IPO firms received 273 takeover bids. In total, 315 of the 436 bids were completed.

3.2. Measures in the Analysis

3.2.1. Measures of M&A Activities

To test whether and to what extent Delaware reincorporation may affect post-IPO M&A activities of issuing firms as targets, we construct four dependent variables: the likelihood of being acquired, takeover premium, cumulative abnormal announcement returns, and deal completeness.

We construct a dummy variable which is equal to one if a firm receives a control contest bid within a five-year window after its IPO, and zero otherwise. This dummy variable considers bids with all types of completion statuses, including deals marked as "completed", "withdrawn", "pending", or "intended". Additionally, we have a dummy variable to test the likelihood of the firm being acquired within the next fiscal year. The

deal completeness is defined as a binary variable equal to one if the deal is completed and equal to zero otherwise.

We have two other measures to capture the performance of the targets in acquisitions. Following Officer (2003), we compute the premium using the “component” data, which is the aggregate amount of each form of payment to the target firm, and then scale the aggregate number by the market value of the target. Furthermore, we use the standard event study method to gauge the five-day cumulative abnormal returns (i.e., CAR [−2, 2]) for the targets on the announcement. In the unreported version, we use several other event windows to calculate the robustness of our findings.

3.2.2. Control Variables

Note that we focus on those post-IPO M&As in which our sample IPOs are the targets of the takeover. In our regression analysis, we include three sets of variables capturing various aspects of our sample firms’ new issuances, financial information, and M&A deal characteristics. We normalized all the nominal variables in 2015 constant dollars (USD). Specifically, for the first set of variables capturing IPO characteristics, we use *Underpricing* to gauge the information asymmetry at the IPO stage, and measure *Underpricing* as the percentage change in stock closing price on the first trading day relative to the IPO offer price. *Overhang* is the ratio of the number of shares retained to the total number sold at the IPO, which captures the dilution of the equity stake by the original shareholders of the issuing firms (Dolvin and Jordan 2008). Many Internet companies which went public in the late 1990s are reported to be associated with aggressive acquisition strategies (Schultz and Zaman 2001). We further add a dummy variable *Tech firm* to capture the technique attributes of our sample IPOs using the 33 tech industries based on 4-digit SIC codes defined by Loughran and Ritter (2004). We use indicators of Internet companies and Tech-IPOs to capture the industrial attributes of our sample IPOs (Junkunc and Eckhardt 2009; Ofek and Richardson 2003). We intend to see whether the timing of the IPO may affect the exit strategy, and, as such, follow Ritter and Welch (2002) by including a *Bubble* dummy as one for IPOs in 1999 and 2000, and zero otherwise. We gauge *Age at the IPO* as the year difference between a firm’s IPO year and its founding year, which is obtained from Professor Jay R. Ritter’s website. In addition, following Cremers et al. (2008), we include an indicator for “relationship-intensive industries” that tend to have longer-term relationships between the corporation and stakeholders, such as employees, customers, suppliers, and the local community. Issuing firms which intend to maintain such relationship-specific investment may choose to adopt antitakeover provisions at the IPO stage (Johnson et al. 2015).

The second set of variables measures the financial aspect of our sample IPOs. Following Eckbo (2010), 42 days were chosen to avoid run-up issues for the target firm’s valuation. We control for the *Market value of equity*, *Free cash flow (FCF)*, and *Leverage* 42 days ahead of the acquisition announcement. We also control for the *Market value of equity (target)*, since the study by Officer (2003) found that deal premium, deal completeness, and CAR for both the target and bidder are all negatively affected by the market value of equity (target). Jensen’s free cash flow hypothesis (1986) predicts that firms could be potential takeover targets when they have a large FCF but choose not to pay out to shareholders. His theory also relates high leverage to possible takeover for the reason that once the firm reaches a threshold of debt level, it cannot continue to exist in its old form to generate benefits. The reincorporated and stay-at-home-state firms in our sample have different leverage profiles. Therefore, we control target firms’ FCF and leverage for all regressions and expect leverage to affect the takeover likelihood positively.

The third set of variables is related to M&A transactions. To be specific, we include six indicators to capture whether a particular transaction is a tender offer, a cash offer, a stock offer, a friendly takeover, a private bid, or a horizontal acquisition (2-digit SIC), respectively (Masulis et al. 2007; Walters et al. 2007).

3.2.3. Instrument Variables

Firms do not make a random choice to reincorporate to Delaware during IPO. To address this self-selection, we adopt the endogenous switching regression in our study. Our first step is to predict firms' reincorporation likelihood by a probit model, using three variables that may affect firms' reincorporation decisions. The first two indicators measure if the firm is advised by a national law firm and whether this law firm has previous reincorporation advising experience. The third instrument variable is the antitakeover status for the firm's home state.

Firms choose their lawyers long before they go public, which implies that the law firm identity and characteristics are good instrument candidates for this endogeneity problem (Johnson et al. 2015). Daines (2002) finds that the national law firm has a significant influence on the firm's decision of the incorporating state. Local law firms without national identity are more inclined to advise firms to stay incorporated in their home state due to their familiarity with the local state corporate laws. On the other side, national law firms have better knowledge of Delaware corporate laws and are more capable of advising the reincorporation process to Delaware. We define the indicator of the *National law firm* as a law firm if it has led IPOs in more than four different states, which is the 90% percentile in our sample. The second measure of law firm identity is the law firm's previous experience with reincorporation. Similarly, we construct a *Law firm experience* dummy, which equals one if the IPO firm is advised by a law firm that has advised any reincorporation in the past two years before the IPO and zero otherwise. Our last instrument variable is a state *Antitakeover status* index which is based on the legal environment of the firm's original home state before reincorporation. Subramanian (2002) and Bebchuk and Cohen (2003) find that state-level antitakeover statutes positively relate to incorporation likelihood. We use a 0–6 scale index to control for the law environment, with a higher index representing a more pro-manager law environment.

3.3. Descriptive Statistics and Univariate Tests

Table 1 reports the descriptive statistics for our sample IPOs from 1993–2015 and our sample post-IPO M&A transactions from 1993–2020. Panel A reports firm characteristics during IPO, and panel B reports IPO deal characteristics. Here, 37% of the 1153 firms in our sample chose to reincorporate into Delaware during IPO. Close to half of the firms were VC-backed technology firms, and the average firm's age at IPO was 15.1 years. Furthermore, 50% of issuing firms were associated with national law firms, while 32% of all firms were advised by law firms with previous reincorporation experience. The average of the antitakeover index is 2.34, and the value of this index for Delaware is 1.

Panel C provides the firm characteristics before M&A, and panel D details the M&A deal characteristics. The average time to the first bid after IPO is 30.84 months, and the average time to complete a control contest (closing speed) is 99.9 calendar days, which is close to the 64.6 trading days to complete the deal reported in the literature survey work by Betton et al. (2008). The mean (median) of the takeover premium in our samples is 49% (34%). The average 5-day cumulative abnormal announcement return for the target (the bidder) is 26% (–2%).

Table 2 reports the results of univariate tests for variables across the subsamples of Delaware-incorporated IPOs and stay-at-home-state IPOs. As evidenced by panel A, 398 of the 1153 firms in our sample engaged 436 M&A deals within five years after their IPOs. Reincorporated firms are less likely to hire local law firms and have a home-state pro-management law environment before reincorporation. In panel B of Table 2, we see that the overall reincorporated firms have higher offer prices, underpricing, IPO proceeds, retain more shares (*Overhang*), and are more likely to go public during bubble years. Panels C and D compare M&A deal characteristics and firm financial conditions before M&A. We find that reincorporated firms have a lower leverage ratio, receive a higher takeover premium, are more likely to receive a cash offer, take less time to receive the first control contest bid, and complete the deal faster.

Table 1. Descriptive statistics.

	N	Mean	Std.Dev.	Min	P25	Median	P75	Max
Panel A: IPO firms' characteristics								
Reincorporated to DE (indicator)	1153	0.37	0.48	0	0	0	1	1
VC-backed (indicator)	1153	0.46	0.50	0	0	0	1	1
Tech firm (indicator)	1153	0.47	0.50	0	0	0	1	1
Age at IPO (years)	1112	15.1	18.7	0	5	9	16	144
National law firm (indicator)	1029	0.50	0.50	0	0	1	1	1
Law firm experience (indicator)	1029	0.32	0.47	0	0	0	1	1
Antitakeover status (home state)	1030	2.34	2.07	0	0	3	4	6
Relation intensive industries	1153	0.36	0.48	0	0	0	1	1
Panel B: IPO deal characteristics								
IPO proceeds (USD mil)	1153	77	299	3	25	46	78	9608
Offer price	1153	12.35	4.66	5.00	9.00	12.00	15.00	38.00
Underpricing	1105	0.30	0.55	−0.47	0.02	0.13	0.33	6.98
Overhang	1152	3.12	4.67	−1.00	0.79	2.17	3.62	19.34
Insider shares reduction	844	19.57	12.25	−23.30	10.60	17.60	27.25	93.80
IPO during bubble (indicator)	1153	0.23	0.42	0	0	0	0	1
Panel C: Firms' characteristics before M&A								
Market value of equity(USD mil)	257	334	458	11	49	131	377	1722
Leverage	257	0.11	0.17	0.00	0.00	0.02	0.13	0.93
Free cash flow	212	−0.13	0.30	−1.44	−0.17	−0.02	0.04	0.33
Profitability	202	−0.03	0.26	−0.76	−0.11	0.06	0.13	0.22
Engaged in RD (indicator)	436	0.62	0.49	0.00	0.00	1.00	1.00	1.00
Panel D: M&A deal characteristics								
Time to first bid after IPO (months)	436	30.84	14.83	1.0	19.0	30.0	43.5	59.0
Closing speed (days)	351	99.92	61.84	0	60	85	126	434
Premium	344	0.49	0.34	0.01	0.23	0.42	0.67	1.28
Deal completeness (indicator)	414	0.85	0.36	0	1	1	1	1
CAR for target	375	0.26	0.38	−0.89	0.06	0.20	0.37	2.91
CAR for bidder	224	−0.02	0.14	−0.56	−0.07	−0.01	0.05	0.58
Transaction value (USD mil)	399	756	2185	0	66	191	547	29,396
Tender offer (indicator)	436	0.20	0.40	0	0	0	0	1
Attitude (indicator)	436	0.92	0.27	0	1	1	1	1
Private bid (indicator)	436	0.18	0.39	0	0	0	0	1
Cash offer (indicator)	436	0.39	0.49	0	0	0	1	1
Stock offer (indicator)	436	0.30	0.46	0	0	0	1	1
Horizontal acquisition (indicator)	436	0.52	0.50	0	0	1	1	1

Table 2. Comparison between reincorporated firms and stay-at-home-state firms.

	Number of Stay-at-Home-State Firms	Number of Reincorporated Firms	Mean of Stay-at-Home-State Firms	Mean of Reincorporated Firms	Mean of Difference	p Value
Panel A: IPO firms' characteristics						
VC-backed (indicator)	727	426	0.35	0.65	−0.30	0.00
Tech firm (indicator)	727	426	0.39	0.62	−0.23	0.00
Age at IPO (years)	692	420	15.99	10.30	5.69	0.00
National law firm (indicator)	654	375	0.37	0.73	−0.35	0.00
Law firm experience (indicator)	654	375	0.14	0.63	−0.49	0.00
Antitakeover status (home state)	654	376	3.08	1.05	2.03	0.00
Relation intensive industries	727	426	0.35	0.36	−0.01	0.75
Panel B: IPO deal characteristics						
IPO proceeds (USD mil)	727	426	43.82	49.25	−5.43	0.03
Offer price	727	426	11.90	12.68	−0.78	0.00
Underpricing	682	423	0.17	0.41	−0.25	0.00
Overhang	726	426	2.08	5.86	−3.78	0.00
Insider shares reduction	561	283	20.64	16.56	4.08	0.00
IPO during bubble (indicator)	727	426	0.14	0.38	−0.25	0.00

Table 2. Cont.

	Number of Stay-at-Home-State Firms	Number of Reincorporated Firms	Mean of Stay-at-Home-State Firms	Mean of Reincorporated Firms	Mean of Difference	p Value
Panel C: Firms' characteristics before M&A						
Market value of equity(USD mil)	167	90	304.31	390.97	−86.66	0.20
Leverage	167	90	0.12	0.06	0.06	0.00
Free cash flow	143	69	−0.10	−0.16	0.06	0.14
Profitability	133	69	0.03	−0.14	0.17	0.00
Engaged in RD (indicator)	273	163	0.68	0.52	0.16	0.00
PPEnt by Asset	167	89	0.37	0.21	0.16	0.00
Panel D: M&A deal characteristics						
Time to receive first bid after IPO (months)	273	163	32.85	27.56	5.29	0.00
Closing speed (days)	223	128	102.35	87.52	14.82	0.00
Premium	213	131	0.53	0.43	0.10	0.01
Deal completeness (indicator)	257	157	0.87	0.82	0.05	0.16
CAR for target	232	143	0.25	0.24	0.00	0.93
CAR for bidder	133	91	−0.02	−0.01	−0.01	0.32
Transaction value (USD mil)	248	151	491.55	609.20	−117.66	0.20
Tender offer (indicator)	273	163	0.19	0.23	−0.04	0.32
Attitude (indicator)	273	163	0.93	0.91	0.02	0.41
Private bid (indicator)	273	163	0.19	0.17	0.02	0.62
Cash offer (indicator)	273	163	0.34	0.46	−0.12	0.02
Stock offer (indicator)	273	163	0.31	0.28	0.03	0.57
Horizontal acquisition (indicator)	273	163	0.50	0.55	−0.04	0.37

4. Multivariate Analysis of Post-IPO M&A Activity

This section reports the empirical result in investigating whether and to what extent Delaware reincorporation may affect issuing firms' post-IPO M&A activities.

4.1. The Likelihood of Post-IPO M&A Engagement

In this section, we adopt a Cox proportional hazard model to investigate the relation between Delaware reincorporation and the likelihood of our sample IPOs being acquired after their IPOs. With the proceeds raised in the IPO, firms may expand their business by launching cash-consuming investment projects or restructuring their debt and equity ratio, which causes considerable variations in their financial conditions on a yearly basis. Although we assume a constant hazard rate, we recognize that the hazard rate (likelihood) of engaging in M&A is likely to vary over time. Therefore, we control the reincorporation effect for each fiscal year and test our hypothesis for the firm's likelihood of being acquired in the next fiscal year.

Table 3 presents the results of Cox proportional hazard regression to test Hypothesis 1. The Cox model can be expressed by the hazard function denoted by $h(t)$. We use the model in Equation 1 to simultaneously evaluate the effects of various factors on survival. In other words, we are able to investigate how specified factors influence the rate of a particular event happening (e.g., engaging in M&As in the post-IPO stage) at a particular point in time, which is commonly referred to as the hazard rate.

$$h(t) = h_0(t) \times \exp(\beta_1 \text{reincorporation}_1 + \beta_2 \text{M\&A characteristics} + \beta_3 \text{IPO characteristics} + \beta_4 \text{Financial characteristics}) \quad (1)$$

In model 1, we add one set of control variables related to M&A deal characteristics. We further control *Underpricing* and other IPO deal characteristics variables in model 2. In model 3, we include a set of variables to capture various aspects of firm financial conditions. Across different model specifications, we document that the decision to reincorporate to Delaware during IPO is associated with a significantly higher probability of being acquired within the first five years of IPO. Therefore, Hypothesis 1 is supported by the findings. In addition, we gauge the economic significance of our findings by using the coefficient of

reincorporation (i.e., 0.44) in model 3. We report a hazard ratio of 1.55 ($e^{0.44}$), which reveals that Delaware reincorporation is associated with a 55% increase in the likelihood of being acquired.

Regarding other control variables, our findings are generally in line with existing literature. For example, *Tender offer* and *Attitude* are positively related to the likelihood of issuing firms to receive acquisition bids (Betton et al. 2008). Consistent with the free cash flow hypothesis (Jensen 1986), *Leverage* has a significant positive effect on the likelihood of being taken over.

Table 3. Delaware reincorporation and likelihood of being acquired in the post-IPO stage.

Independent Variable	Dependent Variable: Likelihood of Being Acquired		
	Model 1	Model 2	Model 3
Reincorporation	0.25 ** (0.11)	0.39 *** (0.14)	0.44 ** (0.18)
Tender offer	0.15 (0.13)	0.14 (0.14)	0.17 (0.16)
Attitude	0.23 (0.23)	0.3 (0.24)	0.38 (0.27)
Private bidder	−0.07 (0.17)	−0.11 (0.17)	−0.33 (0.21)
Cash offer	−0.25 * (0.14)	−0.09 (0.15)	−0.03 (0.18)
Stock offer	0.05 (0.14)	0.24 (0.15)	0.26 (0.18)
Premium	−0.03 (0.11)	0.06 (0.11)	0.16 (0.11)
Horizontal acquisition	−0.04 (0.11)	0.03 (0.11)	−0.06 (0.13)
National law firm		−0.11 (0.12)	−0.14 (0.14)
Law firm experience		0.02 (0.15)	0.01 (0.18)
Antitakeover status		0.03 (0.03)	0.02 (0.04)
Underpricing		−0.08 (0.12)	0.06 (0.14)
VC-backed		0.03 (0.12)	0.11 (0.14)
Tech firms		−0.26 ** (0.12)	−0.15 (0.15)
Age at IPO		0.01 (0)	0.01 * (0)
Bubble		0.37 ** (0.15)	0.24 (0.18)
Relation intensive industries		−0.17 (0.11)	−0.26 ** (0.13)
Market value of equity(log)			−0.02 (0.05)
Free cash flow			−0.23 (0.23)
Leverage			1.7 *** (0.43)
Log likelihood	−2808.96	−2662.56	−1977.34
N	1107	1065	856

This table presents the estimation result of the Cox proportional hazard regression. The dependent variable is a binary variable equaling 1 if firms are acquired in the next fiscal year for models 1 to 4. Standard errors are in parentheses. The symbols ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

4.2. Takeover Premium and Short-Term Cumulative Abnormal Return

To test Hypotheses 2 and 3, we examine the effects of Delaware reincorporation on the takeover premiums and announcement returns in this section and report our results in Table 4. In particular, we adopt a switching regression method to address the possible self-selection bias on reincorporation decisions.

Table 4. Reincorporation effects on takeover premium and target cumulative abnormal return (CAR).

Independent Variables	Premium			CAR		
	OLS	Reincorporat-ed Firms (2S)	Stay-at-Home-State Firms (2S)	OLS	Reincorporat-ed Firms (2S)	Stay-at-Home-State Firms (2S)
Reincorporation	−0.29 *** (0.1)			−0.16 ** (0.06)		
Tender offer	−0.03 (0.09)	−0.26 ** (0.11)	−0.07 (0.11)	0.08 (0.06)	−0.22 ** (0.09)	0.01 (0.06)
Attitude	0.03 (0.11)	0.1 (0.12)	−0.01 (0.16)	0.12 * (0.07)	0.06 (0.1)	0.16 * (0.08)
Private bidder	0.23 ** (0.09)	−0.08 (0.1)	0.3 ** (0.12)	−0.01 (0.06)	0.14 * (0.07)	−0.11 * (0.06)
Cash offer	0.23 * (0.13)	0.23 * (0.13)	0.48 ** (0.19)	0.02 (0.09)	0.06 (0.09)	0.15 (0.11)
Stock offer	0.01 (0.09)	−0.1 (0.09)	0.12 (0.12)	−0.06 (0.06)	−0.1 (0.07)	0.03 (0.06)
Horizontal acquisition	−0.05 (0.15)	−0.1 (0.15)	−0.16 (0.27)	0.2 ** (0.09)	0.11 (0.12)	0.25 ** (0.11)
Underpricing	0.1 (0.13)	−0.01 (0.14)	0.19 (0.17)	−0.02 (0.08)	−0.17 * (0.1)	0.08 (0.08)
VC-backed	−0.08 (0.11)	0.17 (0.14)	−0.19 (0.15)	0.11 (0.07)	0.16 * (0.09)	0.03 (0.08)
Tech firms	−0.11 (0.12)	−0.09 (0.16)	−0.05 (0.15)	0.01 (0.07)	−0.22 ** (0.1)	0.05 (0.08)
Age at IPO	0 (0)	0 (0)	−0.02 (0.02)	0 (0)	0 (0)	−0.01 (0.01)
Bubble	−0.13 (0.11)	−0.12 (0.09)	−0.17 (0.21)	0 (0.07)	0.01 (0.07)	−0.03 (0.11)
Overhang	−0.02 (0.09)	0.06 (0.09)	−0.03 (0.12)	0.06 (0.06)	0.02 (0.07)	0.06 (0.06)
Market value of equity(log)	0.11 (0.3)	−0.41 (0.51)	0.22 (0.36)	−0.04 (0.18)	−0.25 (0.27)	−0.13 (0.18)
Free cash flow	−0.35 ** (0.16)	−0.07 (0.16)	−0.51 ** (0.21)	0.05 (0.09)	0.06 (0.11)	0.19 * (0.1)
Leverage	−0.03 (0.03)	0.04 (0.03)	−0.04 (0.04)	−0.02 (0.02)	0.06 ** (0.03)	0 (0.02)
Inverse Mills ratio		−0.11 (0.09)	0.17 (0.17)		−0.03 (0.07)	0.09 (0.09)
Adjusted R2	0.09	−0.02	0.17	0.19	0.23	0.58
N	177	52	119	203	64	131

This table presents estimation results for ordinary least square regression and switching regression, for which only the second-stage results are given. Standard errors are in parentheses. The symbols ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All regressions control for year and industry fixed effects.

We study this effect on reincorporation and stay-at-home-state firms separately in our switching regression method. Table 4 provides the coefficient of each independent variable in the OLS regression and switching regressions for the analysis of takeover premium. The OLS regression results indicate that the reincorporation is significantly negatively associated with the takeover premiums (Dospinescu and Dospinescu 2019). We then perform a Heckman (1979) analysis correcting for self-selection in the subsamples of reincorporated issuing firms and stay-at-home-state issuing firms. In the first stage, we model issuing firms' choice regarding reincorporation, and calculate the Mills ratios for both subsamples from the first-stage probit regression. In the second stage, we include the invers Mills ratios as an additional control, and we run regression analyses separately for both subsamples. We only report the second-stage regression results in Table 4. In addition, we measure the market reaction to the takeover deal announcement using the short-term

cumulative abnormal return (CAR) with a 5-day event window. The reincorporation effect on the CAR for the target firm, presented in columns 4–6 of Table 4, shows a similar pattern to the study of takeover premiums. Specifically, reincorporated issuing firms experience lower CARs on the announcement of acquisitions in the post-IPO stage. Therefore, the results reported in Table 4 lend strong support to Hypotheses 2 and 3.

In Table 5, we summarize the actual versus hypothetical outcomes for reincorporated firms and stay-at-home-state firms. We use the regression results reported in Table 4 to calculate the hypothetical outcomes had issuing firms chosen the other strategy regarding reincorporation at their IPOs. We find that issuing firms choosing to reincorporate to Delaware would have experienced higher takeover premiums had they chosen not to do so, as shown in Panel A. The premium difference, 48.4%, is economically and statistically significant. On the contrary, stay-at-home-state firms would have received a 6.4% lower premium if they had decided to reincorporate into Delaware during their IPOs. Similarly, the target's CAR would be larger if reincorporated firms had decided to stay in their home state during the IPO. When all control variables are applied, the reduction in CAR for reincorporated firms is 20.2%, and the value is significant at the 5% level. On the other hand, CAR for stay-at-home-state firms would be 16.4% lower if they had made the decision to reincorporate into Delaware during the IPO.

Table 5. Actual versus hypothetical premium and abnormal return.

	Actual	Hypothetical	Difference	Sample Size
Panel A: Comparisons for reincorporated firms				
Takeover premium	0.414	0.898	−0.484 ***	52
Cumulative abnormal return [−2, 2]	0.208	0.411	−0.202 **	64
Panel B: Comparisons for stay-at-home-state firms				
Takeover premium	0.594	0.531	0.064 *	119
Cumulative abnormal return [−2, 2]	0.294	0.130	0.164 ***	131

This table compares the means of the actual takeover premium, cumulative abnormal return, and the deal completeness with their hypothetical counterparts for the reincorporated firms (Panel A) and stay-at-home-state firms (Panel B). The hypothetical values reflect what the takeover deals would be had the firms made the alternative decision related to reincorporation during their IPOs. The difference in means between actual and hypothetical are reported. The symbols ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively.

Taken as a whole, the results reported in Tables 3–5 support Hypotheses 1–3, and indicate that there is a tradeoff between the easiness and quickness of exit through acquisitions and lower firm valuation in the transaction.

4.3. Robustness Checks

In this section, we conduct a series of tests to ensure the robustness of our findings. Researchers tend to use different windows to calculate the takeover premium. Following [Cremers and Sepe \(2015\)](#), we use one week before the announcement date as the pre-announcement day to measure the premium. However, [Boone and Mulherin \(2007\)](#) use four weeks before the announcement date to calculate the premium to avoid near-term information leakage. We also use the approach proposed by [Boone and Mulherin \(2007\)](#) and replicate it in our analysis. The adoption of this alternative measure does not change our findings in a material way. Likewise, we use different event windows, namely [−1, 1], [−3, 3], and [−4, 4], to calculate CARs and document consistent results.

In addition, we focus only on venture-backed IPOs because venture capitalists are likely to influence corporate decisions on reincorporation and are equally likely to consider the double-exit strategy through acquisitions after IPOs. Around 46% of the 1153 IPO firms in our sample are backed by venture capital. Out of the 436 takeover deals, 232 had the target firms backed by venture capital before IPO. Using subsamples of IPOs backed by venture capital, we find that the positive effect of Delaware reincorporation on the

likelihood of post-IPO acquisitions is even stronger. As evidenced in Table 6, we document a consistently negative relation between Delaware reincorporation and premium as well as CAR.

Table 6. Robustness checks for the subsample of venture-backed firms.

	Actual	Hypothetical	Difference	Sample Size
Panel A: Comparisons for reincorporated firms				
Takeover premium	0.398	1.480	−1.082 ***	41
Cumulative abnormal return [−2, 2]	0.195	0.891	−0.696 ***	49
Deal completeness	0.732	0.366	0.366 ***	41
Panel B: Comparisons for stay-at-home-state firms				
Takeover premium	0.674	0.309	0.365 ***	53
Cumulative abnormal return [−2, 2]	0.403	0.032	0.371 ***	56
Deal completeness	0.942	0.904	0.038	52

This table reports switching regression results conducted for venture-backed firms. The means of the actual takeover premium, cumulative abnormal return, and the deal completeness are compared to their hypothetical counterparts for the reincorporated firms (Panel A) and stay-at-home-state firms (Panel B). The difference in means between actual and hypothetical is reported with significance. The values are based on switching regression models, which contain all control variables. The symbols *** denotes significance at the 1% level.

5. Discussion

In this study, we posit that Delaware reincorporation is positively associated with the likelihood of our sample IPOs being acquired after their going public (H1). We further propose that there is a tradeoff between the easiness and quickness of M&A transactions and the investor returns in terms of takeover premiums (H2) and announcement returns (H3). In Table 3, our findings based a Cox proportional hazard model provide strong support to Hypothesis 1. We further test the relation between Delaware reincorporation and takeover premiums as well as announcement returns in Tables 4 and 5, respectively. In line with our expectation, issuing firms choosing to reincorporate in Delaware experience lower takeover premiums and lower announcement returns in the post-IPO M&A transactions. Therefore, Hypotheses 2 and 3 are supported.

6. Summary and Conclusions

This article builds on two streams of research on Delaware incorporation and exit strategies for entrepreneurial firms. Specifically, US firms can freely choose to incorporate in any states to become legal persons of that state, and they can reincorporate to other states as their legal domiciles (Daines 2001, 2002). In addition, US entrepreneurial firms make important decisions as to their strategies to exit. Some entrepreneurial firms choose to undergo the IPO process and then are acquired shortly after their IPOs. This exit strategy is known as a double-exit strategy. We extend these two lines of research by investigating the relation between Delaware reincorporation and the M&As of newly public firms in their post-IPO stage.

Our evidence reveals that Delaware reincorporation is associated with a higher likelihood of being taken over at the post-IPO stage. Nonetheless, firms choosing to reincorporate to Delaware during their IPOs experience lower takeover premiums, CARs on the announcement, and deal completeness. The findings in this paper indicate that issuing firms choosing to reincorporate to Delaware make a clear tradeoff between the easiness and quickness of acquisition and the lower returns for selling shareholders.

We believe that our study contributes to the literature in several important ways. Firstly, to the best of our knowledge, this is the first study focusing on reincorporation decisions at the IPO stage. Existing research mostly focuses on reincorporation decisions for firms that have already been traded in public market (Cumming and MacIntosh 2002; Heron and Lewellen 1998; Peterson 1988). In contrast, we document that the number of reincorporation events associated with the firm's going public decision is non-trivial. Such

decisions may represent important strategic considerations for the issuing firms' operation and financing activities in the post-IPO stage. Secondly, our research sheds further light on the double-exit puzzle. The majority of existing research treats IPOs and M&As as two alternative exit strategies (Amor and Kooli 2019; Bayar and Chemmanur 2006). Our study extends this line of research by focusing on the interplay between the IPO market and M&A market. Although our intention is not to investigate the underlying motives for firms to exit through acquisitions shortly after their IPOs, we report evidence that Delaware reincorporation facilitates the double-exit strategy. Thirdly, our study adds to the literature on mergers and acquisitions related to the events of new equity issuances (Boeh and Dunbar 2021). Firms constantly explore various ways to grow, either internally or externally. Our research highlights the valuation implication on selling equity stakes after raising capital through IPOs. Particularly, we use a switching regression method to correct the self-selection bias, and report that the faster exit through acquisitions after IPOs is associated with significant cost, and that issuing firms which exit through this strategy experience lower returns.

The findings reported in our paper also have important managerial implications for practitioners. Managers of issuing firms can make informed decisions regarding reincorporation decisions at the IPO stage. In the event that they consider exit through M&As after their IPOs, our study facilitates their decision-making process by stressing the lower valuation of exiting through M&As. This article is equally important for legal firms and consulting agencies to gain better insights on the consequences of reincorporation decisions and subsequent options to exit in the post-IPO stage.

Our research is not without limitations. For example, we limit our sample to those issuing firms originally incorporated in non-Delaware states so that we are able to investigate the treatment effect with a proper control group. We are, thus, unable to investigate the subsample of firms which choose to incorporate in Delaware at their onset. Furthermore, we lack data as to which party initiates the reincorporation decision in the IPO process. The incumbent managers, venture capitalists, law firms, and investment banks are all likely to propose the decision to change legal domiciles. Nonetheless, this study suggests a few directions for future research. For example, given that changing legal domiciles means changing the applicable corporate law, researchers can examine the wealth effects of litigation in corporate laws following the reincorporation of newly public firms (Badawi and Chen 2017). It is also plausible to investigate whether Delaware reincorporation is associated with better information disclosure and high analyst coverage (Stewart 2023).

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