

Adverse selection and financing choices

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Company types

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Companies raising equity funds

- ▶ Existing company owners retain their fraction of the company, whose value they know, in addition to the value generated by the new investment
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- ▶ The company raising equity will be of low value, while the company raising **no equity** will be of **high value**

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Distinguishing company types

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- ▶ If adverse selection is **medium** **high-value companies** will choose **loans**

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- ▶ This information would then be reflected in the **value of the equity** as seen by **outside investors**

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