CHAPTER 16:
MARKET EFFICIENCY LESSONS FOR CORPORATE FINANCE

16-1
If the firm does not have an immediate need for the cash, I would suggest waiting until January to take advantage of the January effect (small firms earn a substantial premium over large firms). I would be less inclined to suggest this if the firm has to make the issue in June, since the waiting period will be much longer.

16-2
Assuming that the delay will cost the firm in terms of lost projects, I would not advise the delay. Though there is evidence of a normal range for interest rates, it is far too weak for firms to reject projects for its sake.

16-3
I would not. There is no evidence that forecasting services are effective at forecasting interest rates or stock prices.

16-4
I would not expect a negative reaction if the market already knows that this plant is unprofitable. In fact, if the closing of the plant would save the firm from losing more in the future, it may lead to a stock price increase.

16-5
I would advise that the firm reveal the information immediately and preempt the analysts. By doing so, it may be able to put its best spin on the story, and minimize the negative market reaction.

16-6
Given the historical evidence, they would be right. The evidence suggests that markets overreact especially to extreme news announcements (positive as well as negative).

16-7
The fact that the stock price declines on the announcement of the rights offering suggests that markets are reacting to the fact that the firm is making an equity issue. This is consistent with the evidence. I would try to package this announcement with news about what the funds from the equity issue will be used for - new projects or investments. Note that the actual rights issue will cause the stock price to drop, but for a different reason. The rights issue will generally be at a much lower price than the current stock price.

16-8
I would expect the stock price to drop in the immediate aftermath of the sell recommendation, even though it is based on faulty information. I would expect the price to recover, however, soon after.

16-9
It may be pulling off a coup in the short term, especially relative to the ratings agencies and some analysts. Markets are unlikely to be fooled very long. In fact, I would expect markets to treat these securities as debt and assess risk accordingly.

16-10
The positive stock price reaction is not surprising. Financial markets had for long known that the Fokker division was losing substantial amounts of money for Daimler Benz. The write-off was viewed by markets as closure on a bad investment. The stock price reaction would have been negative if the markets had not realized the extent of the problems and had been surprised by the write-off.

16-11
I would expect the stock price to go up. Both stock splits and dividend increases have generally been viewed as positive signals by financial markets, leading to stock price increases.

16-12
While the underpricing is always a transfer of wealth from me to the new stockholders, I would be more inclined to support it if only 10% of the stock is being offered at the initial offering - the loss is smaller and the price increase following the offering may serve as a promotional for future offerings.

16-13
I would not follow her advice. The empirical evidence suggests that price momentum in financial markets is very weak especially in the short term.

16-14
Yes. The market reaction might be less negative if the information is revealed early rather than if it is a total surprise.

16-15
The fact that revenues/earnings occur in the summer months does not mean that stock prices will also peak in those months. In fact, what happens to stock prices during those months will depend in large part on whether the sales in those months exceed expectations or not.