CMU CENTRAL MICHIGAN UNIVERSITY | College of Business Administration

Do Demand Curves For Stocks Slope Down?: Evidence From a Regulation Induced Supply Shock

Discussant: Pawan Jain

Summary

- SEBI mandated that all listed companies in India should have at least 25% public shareholding at all times
  - Using this as a natural experiment this study tests if the affected stocks experience a negative price reaction.
  - If so, when?
  - Significant negative excess return in the 11 days surrounding the sale of securities.
  - A majority of the negative excess returns occurs on the issue date and during the following week.
  - Negative excess return is not information driven

Comments

- Demand?
  - Two aspects: price and quantity demanded
  - How do you capture quantity demanded?
  - number of trades vs. quotes (?); trade direction (?)
- Kaul et al (2000): “since the revision was done on a single day for all stocks, it raises the possibility of some other actual or anticipated event influencing prices.”
  - This setting might be better as you capture true reaction, instead of learning
  - If the promoters can choose any day to sell their stake within 3 years, won’t they pick the most overvalued day?

Comments

- Excess supply or price impact?
  - “If the price reaction documented is a result of price pressure, then the negative returns should reverse as soon as abnormal volume subsides.”
  - Non necessarily: If the promoters chose a day when the stock was significantly overvalued, their trades may result in permanent price impact.
- Demand curve shifts?
  - Firms that try to meet the regulation which improves the stock’s market quality might result in a shift in demand curve

Comments

- “PSUs are highly-constrained and regulated firms and are likely to have a steeper demand curve”
  - Not necessarily true. PSUs are much more transparent as compared to non-PSUs
- “companies that issue bonus or rights shares to existing non-promoter shareholders in order to comply with the regulation do not experience any negative price reaction.”
  - Flatter demand curve?
  - Small sample: 10 firms

Comments

- SEBI Announcement day effect
  - Day 0:depends on timing of the announcement
  - Positive announcement effect and maybe traders were penalizing firms for not meeting the requirements during the first few days (?)
- Company’s Announcement day effect
  - Authors do not find any effect. However, there is negative excess return of 2.71% during the first 2 days following the anouncement.

Comments

- More robust analysis for “overpricing” explanation:
  - Comparing compliant vs. non-compliant firms might not be enough
  - Analyze the timing of the “new supply”
- Price movement around the deadline to comply
- Factor models for calculating AR:
  - HML, SMB, Momentum, Illiquidity

Comments

- Interesting paper
- Solid data and analysis
- Has a potential for deeper investigation