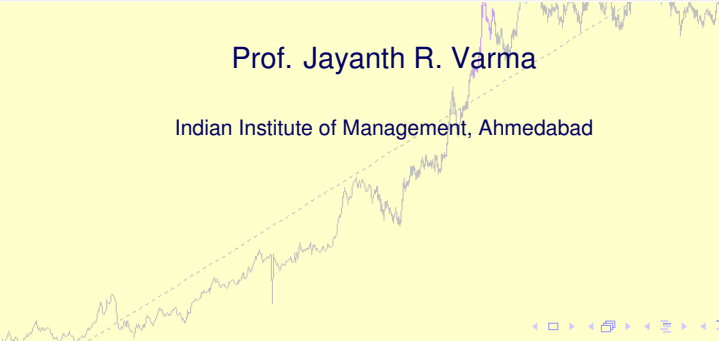


More Efficient Event Studies Comment on Shah 2014

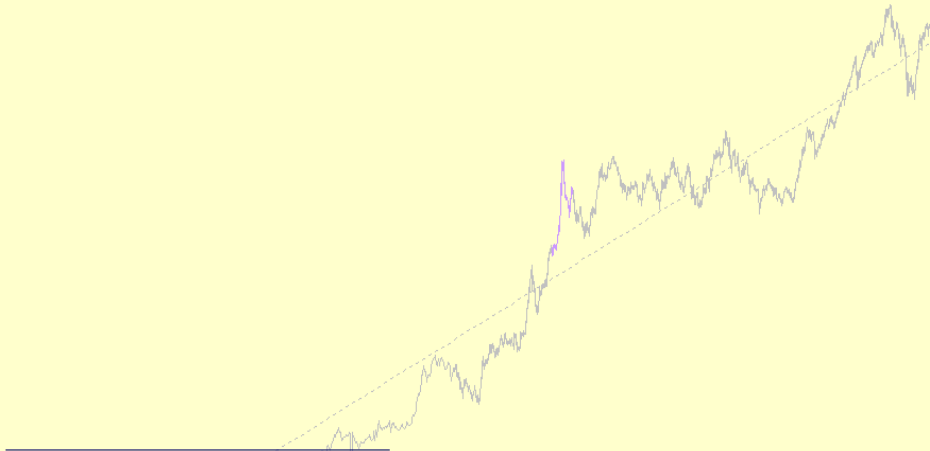
*5th Emerging Markets Finance Conference
18-20 December, 2014. Mumbai*

Prof. Jayanth R. Varma

Indian Institute of Management, Ahmedabad



We need more efficient event studies



I am biased. How can I not like a paper that uses my data library? (Though actually, the data library is only one-third mine.)



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- The paper mentions the importance of event studies in financial research, but there is also a lot of money riding on them. US courts routinely use event studies to quantify damages in class action law suits.

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- Yet the event study methodology is a sort of fossilized technology. Modern event studies are not radically different from the methodology of B&B or FFJR half a century ago.

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- Yet the event study methodology is a sort of fossilized technology. Modern event studies are not radically different from the methodology of B&B or FFJR half a century ago.
- If anything, there is some regress: $\beta = 1$ is a popular approximation.

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Priced Factors versus Risk Factors



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- Similarly, industry factors are valid in an event study (if the event is not industry wide).

Factors versus Characteristics



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 - Small firms cannot have higher returns than large firms because a conglomerate could buy a hundred small firms cheap, become big and then have the lower cost of capital of a big firm.
 - Firms that have a large beta on the size factor can have higher return because then the conglomerate would continue to have the same size beta as its hundred divisions by linearity of the beta.

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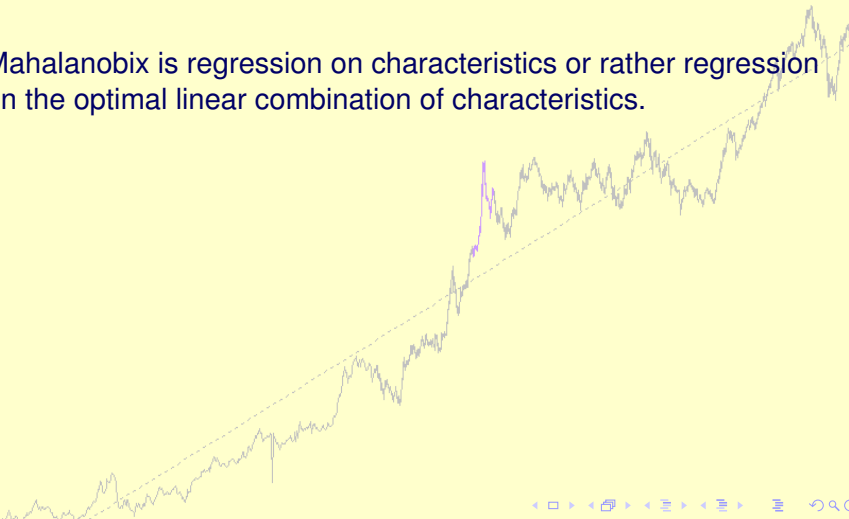
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- But event studies can use characteristics. We are predicting, and not computing a equilibrium.

Mahalanobix is regression on characteristics



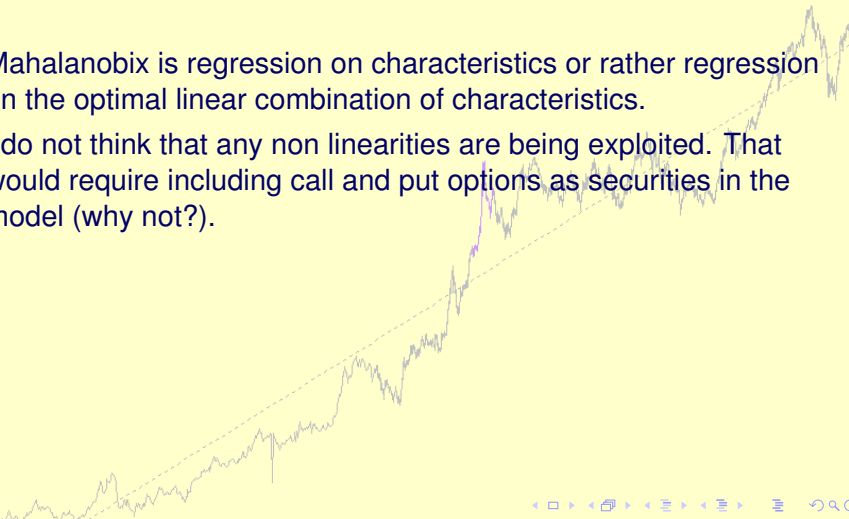
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- I do not think that any non linearities are being exploited. That would require including call and put options as securities in the model (why not?).
- Minor point (typo?): the optimal Counter Factual does not require $\beta_{i,CF} \rightarrow 1$. It requires $R_{i,CF}^2 \rightarrow 1$.

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- In this case, the Counter Factual includes 20 (weakly) event affected firms as well.