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

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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 announcement.
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