

UNIVERSITY OF ROCHESTER

William E. Simon Graduate School of Business Administration

Finance 411
Investments

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Quiz # 2: April 16, 1997

1. (5 points)

“Cigarette manufacturers, such as Phillip Morris and RJR Nabisco, are in a dying industry. The proportion of the population that smokes continues to decline, the risk of litigation expenses from customers is rising, and many institutional investors (notably the Harvard University endowment) have decided not to invest in such socially irresponsible companies. With all of these negatives facing this industry, investments in these stocks are not recommended. Instead, we recommend investments in industries with high future growth rates, such as biotechnology or cellular telephone stocks.”

Evaluate this (fictitious) statement from an investment advisor.

2. (5 points)

Mikkelson and Partch find that secondary distributions are an expensive way for people to sell large blocks of stock. First, investment banking fees average about 6% of the value of the block of stock. Plus, the stock price drops by 2-3.5% when the sale is announced.

- (a) Does this substantial discount prove that demand curves for common stocks slope downward (i.e., that investors must accept a large discount if they want to sell a large block of stock)? **Why, or why not?** *[Hint: what would you expect would happen to the stock price after the block has been sold?]*
- (b) If you owned a large block of stock in a publicly traded company (if only you were so lucky to have this "problem"), under what circumstances would you use a secondary distribution to sell your stock?
- (c) If you were selling your stock through a secondary distribution, under what circumstances might you voluntarily choose to register your sale with the S.E.C.?