On the intrinsic preference of public equity markets for short term investment opportunities

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Content:
This paper shows that a preference for short term investment opportunities arises naturally in public equity markets when there is (i) periodic financial reporting, (ii) reinvestment of past earnings, and (iii) different generations of investors. The model includes two types of investors that differ in the periods that they can trade. Short-horizon investors only trade for one period while long-horizon investors can trade for one or two periods. In equilibrium, a short term investment opportunity attracts more equity capital than a long term investment opportunity. Furthermore, a short term investment opportunity attracts more demand from short-horizon investors than long-horizon investors. The explanation is that the short term investment opportunity enables inter-temporal risk sharing across the generations of short-horizon investors. The results (partly) reverse when considering public debt financing. In public debt markets, more capital will ow to the long term investment opportunity when the effective interest rate is sufficiently low. The paper further shows that a long term investment opportunity becomes more (less) attractive when financial reporting features impairment accounting (conditional accounting conservatism).

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All Interested are Welcome