Stock Repurchase by Tender Offer: An Analysis of the Causes of Common Stock Price Changes: Discussion
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result is similar to the effects on stockholders from a rights offering with no resale of rights, since the right to tender is nontransferable. Given that stockholders know the consequences of not tendering, why does it occur? Presumably, it occurs because under heterogeneous beliefs and/or opportunities such as differential personal tax treatment, it is rational for the stockholders with more optimistic beliefs or with higher costs or constraints, not to tender.

It could be argued that the development of this hypothesis ignores the fact that offers can be cancelled, and consequently the probability of having ones tendered shares repurchased is less than α, as is assumed in eq (2). However, the probability of an offer being cancelled is negligible given that only three of the 256 offers found were cancelled, as detailed in footnote 7. This point is further supported by the fact that of the final sample of 199 offers, only two were found to state that a minimum number of tendered shares was a prerequisite for the offer to be consummated.

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DISCUSSION

DAVID DOWNES*: The ideal discussant is one who is currently doing research on the same topic as the author of the paper to be discussed. I am not in that situation but I have benefitted from the working paper and comments of Theo Vermaelan at the University of British Columbia.

Professor Masulis' paper differs from the other two presented in this session in a very significant way. It is an empirical study of a corporate financial policy—the decision by a firm's management to tender for its own shares. We need more

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empirical research to improve our understanding of the value of various corporate financial policies and decisions and I commend Professor Masulis for his initiative. Unfortunately I am not satisfied that his work here really increases our understanding of stock repurchases.

My main concern with this paper is in the formulation of the hypotheses and predictions regarding the security price impacts of tender offers. Masulis restricts his study to four hypotheses "which have testable predictions."

H1: tender offers are substitutes for cash dividends with personal tax benefits.
H2: tender offers financed by debt increase corporate tax shelters
H3: tender offers transfer wealth across security classes
H4: tender offers transfer wealth from nontendering to tendering stockholders

If these are reasonable hypotheses to predict security price impacts, then they should be consistent with the motives of management in undertaking a tender offer. In other words, a management that was considering a tender offer should have had in mind one or more reasons for making the offer and predictions about the price impact on the firm's stock. Furthermore, these predictions should have been consistent with rational, value-maximization behavior on the part of management, or the idea of making a tender offer should have been discarded.

Turning to H1, I know of no widely accepted explanation about why firms pay cash dividends, nor do I know the direction to predict stock price reactions to an increase in dividends. While it is true that a firm paying a regular cash dividend, taxable at the ordinary income rate, should experience an increase in value if it could substitute an identical form of payment that was taxable at a lower rate. But this is unlikely to be the case with stock repurchases. Thus, I do not understand why this motive should lead to a positive price impact.

In the same vein, we have no clear picture of how to determine a firm's optimal capital structure; nor are we convinced that increasing the amount of debt will increase (or even affect) the firm's value (see Miller [1977]). Thus, Masulis' predictions for H2 are subject to question. H3 opens the issue of how management intends to get away with hurting the bondholders and maintain subsequent relations with the debt markets. Finally, H4 is the most curious of the four explanations. Frankly, I have difficulty understanding why management would ever make a tender offer with the motive and/or prediction that it would benefit the tendering stockholders (whom they will never see again) at the expense of the nontendering stockholders (to whom they will have to answer from then on). Furthermore, management who own shares will most likely not be tendering, and I have met very few managers who deliberately take actions to reduce their own wealth.

Given my inability to understand why these four hypotheses lead to the predictions posited by Masulis, or for that matter, why they are even valid, I do not find his interpretation of the empirical results to be very useful. Other hypotheses could be added, such as best use of excess cash and management signals as to the "true" value of the firm's stock. However each tender offer decision may be based on a somewhat different set of motives and predictions. And, as Masulis recognizes, "the observed price change can represent a combination of two or more of these predicted effects." Before we will be able to determine the causes of common stock price reactions to tender offers, we will need to be much more rigorous in our specifications of the relevant theory and the testable hypotheses.

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