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Determinants of share price movements in emerging equity markets: some evidence from America's past

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Abstract

Emerging equity markets are plagued by poor information, which is a barrier to outside shareholder participation. This paper examines the determinants of share prices of two United States companies over a 14-year period during the late 19th century, when America had an emerging equity market. These two companies withheld all information on profits and assets until the end of the period, yet traded regularly. Overall, the evidence suggests that outside investors received sufficient compensation for their ignorance, and that these outsiders set the market price. An event study shows that when information about company assets was revealed, market returns were significantly changed. © 2000 Bureau of Economic and Business Research, University of Illinois. All rights reserved.

1. Introduction

Limited, unreliable information is often cited as a major stumbling block to investment in emerging equity markets (Chuhan, 1992; Bekaert, 1995). Short run, unreliable information can lead to fraud with outside investors as the losers. In the longer term, if public information remains poor, it would seem likely that insider information and behavior would drive prices. Any other scenario raises the question: how would ill-informed outsiders price shares where the risk-adjusted present value of the return on those shares is mainly guesswork?

The question is difficult to answer with respect to contemporary emerging markets precisely because information is unreliable or unavailable. But archival data can provide a perspective on the behavior of past emerging equity markets. The United States in the 19th

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century was an example of such a market,[1] one that was notoriously plagued by poor information. Baskin (1988), for example, notes that accounting data were often "nonexistent or entirely unreliable" (p. 200). Yet with archival records, we can learn a great deal about the actual assets and cash flows of companies and can observe that information with respect to share price movements over time.

In this paper, I examine the share price behavior of two companies, the Adams Express and the American Express, from 1885 to 1898. This is admittedly a small sample, but these two companies (that still exist and trade) had a special distinction: at the start of the period (and for more than a decade previously), they released *no* public information about earnings and assets. Other firms, such as railroads, did make information on earnings and assets regularly available;[2] it is uncertain just how seriously investors considered published data. For the two express firms, the revenues and profits of which it is now clear equaled those of major railroads (Grossman, 1996), there was virtually nothing to cloud the issue of information reliability; it simply was not available. Moreover, the express provides an interesting test of the importance of information. In 1898, state laws forced Adams Express to reveal publicly the size of its assets. It is hypothesized that this event should have had little effect if all information — including that available only to insiders — had already been accounted for in the stock price.

Essentially, I will show in this paper: (1) that share price movements were systematically related to general movements in appropriate markets; (2) that market prices before the 1898 event did not contain all information known to insiders as well as outsiders; (3) that outside investors, who generally set the market price, demanded a substantial premium, probably because they did not have all relevant information; and (4) that the 1898 event, which had no real effect on company cash flows, did notably alter share prices and investor returns.

After a brief description of the two express firms and an explanation of how they controlled information, this paper tests for systematic influences and the importance of the 1898 revelation of asset information. For the latter, an event study was run. The results raised several issues including that of efficiency in emerging markets. These issues are discussed in a concluding section.

2. Control of information

As explained in Grossman (1996), Adams and American express companies were the leading firms in the 19th century railroad express industry that controlled the parcel post system of the United States.[3] The private express service leased space on railroad cars to provide rapid transport and delivery for all packages not suitable as bulk freight. Because the express insured the value of the contents it carried, the service specialized in the transport of money and high-valued items. For most of its history the express was dominated by a five-firm cartel, which carried over 80% of all traffic (Grossman, 1996).[4] Adams and American were the two largest firms, with almost half of all express traffic between them.

Adams and American both had an unusual form of legal organization. They were unincorporated joint stock companies chartered under the laws of New York State (Gross-