Faculty Research Grant Report

Description of grant-supported activity.

Title: The Dot-com Bubble and Capital Structure Choices
The proposed study will extend our knowledge in the primary research area of capital structure in corporate finance. Capital structure planning is essential to help businesses not only survive but create wealth for their shareholders. The 1990-1999 period coincided with the dot-com bubble and significant investor hype followed by the market crash of 2000. In the years leading up to the crash, numerous companies including those with subprime ratings took advantage of the stock market frenzy and raised excessive capital despite shortcomings of to their balance sheet fundamentals. The main objective of this research project is to test major capital structure theories during the dot-com era. We will make a distinction between investment- and junk-grade firms because frequently, the former group makes external financing decisions enthused by different reasons than the latter group. For example, investment-grade companies, like Apple, would borrow not out of necessity but to benefit from market conditions created by the Fed’s easy-money policies. They can often negotiate cheaper debt due to their lower credit risk. They have better access to the capital markets (debt and equity markets) and because of their higher ratings face less obstacles when seeking external financing. On the other hand, junk-grade firms are more restricted when accessing the capital markets. In many cases, as a result of their subprime rating, they are unable to issue debt and are forced to issue undervalued equity which is a costlier form of capital.

As described above, the period leading up to the market crash of late 2000 provided an unprecedented opportunity for all companies, especially lower-rated firms, to gain easy access to the capital markets. In some cases, choosing a name with the dot-com postfix was sufficient to open the doors to a windfall of capital. Little effort was made by stock or bond investors to verify the solvency or the balance sheet strength of the issuers. Only after the market crash investors realized that some dot-com issuers (including IPOs) were inherently fraudulent. As an extension to the study, we will compare and contrast firms with dot-com postfix with their peer group.

Were you able to complete the project? Describe any difficulty you had.
The project is a work in progress research paper. Significant progress was made during the summer. The preliminary organization and analysis of the data were completed. The literature review was done and currently, the first draft is under construction.

Did, or will, the project result in a specific product -- a manuscript, composition, syllabus, etc? If so, please describe and indicate state of development.
The paper will be presented at an international conference in October 2017 and with the current speed, we hope to submit the paper to a peer-reviewed journal by mid-November the latest.

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