Capital market efficiency

Finance

Capital Market Efficiency al Affiliation: Capital Market Efficiency An efficient capital market plays a significant role in the financial management of the firm by providing the top-level managers with detailed and accurate information of the prices of the share. As a result, it becomes easy to make critical decisions that will improve the financial position of a public firm (Moyer, McGuigan, & Rao, 2015). The reason is that the financial markets are able to respond to the new information that has been released in the markets.

Another implication is that the sale or the purchase of any security at the current price in the market is zero NPV (Moyer, McGuigan, & Rao, 2015). The reason is that the information is reflected immediately in market prices while at the same time the firm's assets are not under or over-valued. Furthermore, companies can expect a fair value of the security that they sell in the market.

Question 2

The main goal of the firm is to maximize revenue. This is the main driving force of any business. Although there are other goals such as capturing more market share, and increasing the firm's sales, all these revolve around profit maximization.

Greed help allocate investment capital in an economy by overcoming the fear of taking risks. This explains why greedy investors are able to make immense returns because they are focused on the end results rather than loses they are likely to accrue in case the investment fails to bring the expected returns.

Efficient capital market plays a significant role in the allocation of capital by enabling an investor to select an investment with the best returns in the

market (Moyer, McGuigan, & Rao, 2015). This is after balancing the risks and uncertainties over the overall returns.

Public companies are able to support various projects through corporate social responsibility. These projects have a significant role in improving the living standards of the people in the society. On the other hand, increased certainty on the future prospects strengthens the competitive position of the company in the market (Moyer, McGuigan, & Rao, 2015). This makes it possible for the firm to diversify its operations and even invest overseas in order to reduce the risks and uncertainties associated with focusing on a single market.

Question 3

An efficient portfolio is one that brings in the highest returns with the lowest risks for any given return (Moyer, McGuigan, & Rao, 2015).

An efficient capital market enables the present value of the future cash flows to be indicated in the current prices of the securities. As a result, the information would be significant in enabling the investor to select the best portfolio to invest in which have the lowest risks. This would enable the investor to make immense returns.

In many cases, management team consult the shareholders on capital budgeting and capital structure decisions because of the risks associated with these decisions. However, managers can make these decisions in case they are certain about the outcome. This is through consulting professionals and insuring the decisions in order to be compensated in case they incur losses.

Efficient capital market provides both the firm and the investor with real time information (Moyer, McGuigan, & Rao, 2015). As a result, each party can

make independent decisions without relying on the other. The reason is that the information increases the level of certainty, an aspect that reduces the need for consultation.

References

Moyer, R. C., McGuigan, J. R., & Rao, R. K. (2015). Contemporary financial management. Mason, Oh[u. a.: Cengage Learning.