

(3) Another reason why it is unfortunate that data could not be obtained on the smaller and less successful firms is that which is given as comment C-3 on Professor Cootner's statement.

(4) The industry rate of return is defined simply as the average rate over the entire period. But if there has been a significant upward or downward trend in an industry during the period, investors would react to the trend as well as the average. For example, the average might be 15 percent in two industries, but if one had declined from 20 to 10 percent, while the other had increased from 10 to 20 percent during the period, investors would be likely to regard the former industry as a much riskier investment even if both average rates of return and variances were the same.

(5) On page 16 the author states:

A company may be receiving monopoly returns (returns higher than justified by risk) on its book assets (i.e., monopoly real returns) while the holder of its equity instruments would receive a "normal" return if the monopoly profits were capitalized when the stock was issued.

In model No. I, we note that the drug industry's rate of return is significantly higher than the value given by the regression line for its variance. The computed value is about 14.75 percent, while the actual value is 17.52 percent, or about 20-percent higher.

Since this is the book value regression, one might conclude that some degree of monopoly returns are present, since the returns made are higher than those which would be justified by the risk versus rate of return relationship embodied in the regression line. (Here, a statement from page 5 of Professor Cootner's statement comes to mind: "If abuses are found, one must take care to eliminate only excessive, not not necessary returns on investment * * *." Hence one might conclude tentatively that about a 20-percent reduction in drug industry returns would still leave returns commensurate with the risks as measured by Conrad and Plotkin.)

In other words, as far as the investor, the stockholder is concerned, the rate of return he is receiving is just about the average on the basis of Conrad's—that is, the A.D. Little study's—regression line.

And at a glance at figure II, shows that the market value basis is slightly lower than the value indicated by the regression line. Hence one might interpret the two regressions as showing the presence of substantial monopoly returns on book value consistent with only competitive returns to stockholders due to the competitive nature of the capital market in distinction to the monopolistic nature of the market in which prescription drugs are bought and sold.

(6) The statement from page 16 quoted just above is not entirely consistent with the listing on page 11 of "the various phenomenon that might contribute to interindustry differences in basic riskiness." On page 16, monopoly returns are defined to consist of those which are higher than justified by risk. But on page 11, certain of the elements contributing to monopoly power—or conversely, to its absence—are listed as factors contributing to basic riskiness. These include, for example, differences in ease of entry, in elasticity of demand, in price flexibility, in exposure to foreign competition, and finally, differences in competition among existing, prospective, or potential new products. It would appear that there is serious confusion between the monopoly