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Efficiency-Promoting Aggregate Disclosures and Multiple Layers of Information Asymmetry

Swaminathan Sridharan and Bala V. Balachandran
Northwestern University

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ABSTRACT

This paper demonstrates that disaggregate disclosures for each line of business cannot always eliminate privately-informed firms' attempt to impress capital markets, which endeavor of firms produces inefficient investments in equilibrium. However, in the presence of multiple layers of information asymmetry between the firm and the capital markets, we show that providing aggregate reports for multiple projects can sustain efficient investments in equilibrium. Aggregate disclosures discourage firms from attempting to mislead capital markets about the realized economic circumstances being always highly favorable for the more a-priori-profitable project. Consequently, firms decide on investments that are efficient given their true realized economic potential. In this way, less informative aggregate disclosures can actually make firms better off than more informative disaggregate disclosures.

We also find that more profitable firms can choose reporting systems of a lower quality in equilibrium and still sustain efficient investments with aggregate reporting. Finally, we show that socially efficient resource allocation and informationally efficient market prices can coexist at the same time only when supported by the aggregate reporting system.

[For full text of the paper, please contact Bala V. Balachandran
<b-bala@kellogg.northwestern.edu>]