DISSERTATION PROPOSAL

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"Essays on Strategic Financial Disclosure"

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9:00am
Tepper 4243

Chapter 1: Short Reports and Firms' Responses When Considering Public Attention

Empirical evidence suggests firms attacked by activist short sellers mostly won't respond. We develop a theoretical framework to explain the motivation for the firms to stay silent against the attack. We establish an information environment where firms interact with both rational and inattentive investors. In this setting, firm disclosures serve a dual purpose: conveying information about fundamentals and "alerting" inattentive investors to update their beliefs. The model demonstrates that firms adopt threshold-based disclosure strategies, withholding unfavorable signals to avoid triggering broader scrutiny—an "awareness effect" that endogenously creates ex-ante value by skewing market expectations upward. We apply this framework to incorporate the interaction between activist short sellers and targeted firms with the coexistence of rational and inattentive investors. We find that there exists an equilibrium in which the short seller only attacks the firm with the worst news, and the firm only responds to the attack by releasing the best news. The analysis underscores that disclosure incentives depend critically on the interplay between information precision (firm vs. short seller) and the magnitude of the awareness effect.

Chapter 2: Optimizing the Role of External Auditors in Fraud Detection

The difference between accounting errors and accounting fraud is subtle. However, the differentiation between these two situations means a lot to investors and the litigation system. Errors can be excused, but frauds will undergo severe punishment from three parties: the SEC, the litigation system, and the capital market. There is a trend that both the Public Company Accounting Oversight Board (PCAOB) and the SEC are enhancing the auditors' fraud detection role by requiring them to act more proactively when there's potential for fraud. While the regulators' proposal is benevolent in terms of increasing market transparency and protecting the investors, the auditors' incentive might not always be perfectly aligned because of the increased workload and their willingness to maintain good client relationships. this research aims to develop a model to evaluate whether strengthening auditors' fraud detection role effectively reduces the incidence of accounting fraud.

Proposed Committee: Pierre Liang (Co-Chair), Gaoqing Zhang (Co-Chair), Yucheng Liang, and Chester Spatt (External Reader)

Proposal Documents: https://cmu.box.com/s/oyu93vc7mcrralkit1oyn05akdji2edp