Textual Analysis of Short-seller Research Reports, Stock Prices and Real Investment

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Short Sellers and Real Investment

1. Examines an important and understudied topic
   - Do research reports by short sellers affect real investment?
2. This paper: short seller reports do change firm behavior. They lead to
   - Lower stock prices
   - Higher cost of capital
   - Lower stock issuance
   - Lower future investment
3. Conclusion: short sellers are associated with changes in firm behavior

My take: potential to be a truly good paper

1. Important topic – do secondary markets matter for the economy? Yes!
2. Paper is still very early, but lots of potential
3. My comments are all easily addressable:
    1. Identification assumptions
    2. Contribution
    3. Econometrics
4. Big picture: paper shows that short sellers change firm behavior. I want to know if this is (on average) efficient?

Comment 1 - Short sellers do not randomly write reports

- Short sellers do not randomly write reports
  - Authors acknowledge this and say "we shy away from causality statements"
- Selection or treatment? Can't side step this!
  Need to think more about counterfactual
- Crucial question: does it matter if short sellers write these reports?
  - i.e., would these effects have occurred if short sellers had not written these reports?
- Think harder about control group – firms that committed fraud but nobody noticed *yet*
  - Do real effects happen when fraud uncovered eventually? If so, what is the cost of this delay?

Comment 2 - Contribution

- Related point: Wong and Zhao (2018 WP) show activist short sale campaigns have real effects
- This paper needs to differentiate from this
  - How? Examine whether these campaigns are, on average, correct
  - Put differently: do they improve allocation of capital in the economy?
- If short sale reports *cause* a change in the allocation of capital and this leads to improved efficiency, then short sales are crucial
  - This is the paper's potential. Discuss this!

Comment 3 - Econometrics

- Several addressable econometric concerns
  1. Table 10 argues that fraud not uncovered by short sellers does not lead to same effects
     - Important analysis: need to do MUCH more
     - Power? Show MDES – see my recent work :)
     - What happens when this becomes public?
  2. Dynamic diff-in-diff: show results prior to event
  3. Economic magnitude: careful about % change vs. change in percentage points

Comment 4 - Mostly minor comments

- Text is still quite rough (too many typos to list here)
- Standard errors are clustered by firm and year – but there is only ≈15 years of data
  - Clustered standards errors asymptotically consistent as number of clusters goes to infinity
- Combine Tables 5 and 6
- Table 9 – add interaction effect?
- I would cite Karpoff and Lou and remove cites to many irrelevant papers (lit review is boring)
- FINRA short vol is not total short vol

Conclusion - Important topic and interesting results

- Overall, paper makes a clear contribution
  - Shows that short sellers matter for the economy. This is IMPORTANT
- Most of my concerns are easily addressed
  - More on identification assumptions
  - Show if this is efficient!
  - Some (addressable) econometric concerns
- Still early, but will likely be a great paper!