Institutional Investor

Five Questions: Anjan Thakor on Strategic Disclosure Risk

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A steady drive toward transparency in financial information has won many followers in recent years, but new research warns that peril lurks in too much sunlight. “Information Disclosure and Fundamental Disagreement: Implications for Financial and non-Financial Firms” probes disclosure of strategic information with an eye to negative consequences on firm value. *Institutional Investor* contributor Steven Mintz spoke recently about the research with its author, financial economist Anjan Thakor, the John E. Simon professor of finance at Washington University in St. Louis’s Olin Business School.

1. Where do your findings clash with prevailing wisdom?

The conventional literature argues that unless information will aid competitors, companies should disclose everything. Transparency lowers the cost of capital by giving investors a clearer picture of the firm. But the picture changes when it comes to things like corporate strategy — as more and more details of a strategy are disclosed, the potential for disagreement typically increases. While the cost of capital, conditional on agreement, goes down, chances increase that investors who disagree will flee. This may not be best for the firm.

2. By withholding strategic information, won’t companies send negative signals to the marketplace?

When a company does not disclose hard, quantitative information, the only rational inference is that it has something unpleasant to hide. If companies suppress details on executive compensation or earnings per share, for example, I'd have to assume the worst.

Data show that a similar inference does not apply to softer subjective information prone to multiple interpretations. One takeaway for institutional investors is this: When it comes to strategic information, the decision not to disclose all the gory details should not be automatically tagged as bad news.

3. What's an example of "prudent restraint," if you can call it that?

Warren Buffett discloses that Berkshire Hathaway is sitting on over $40 billion in cash that is likely to be used "strategically" in the future, but not the details of what he will do with it. That is only revealed when he later takes positions in GE and Goldman.

4. Do findings apply across the board, equally to all firms?

No. A point the paper makes is that credibility can trump disclosure. Companies with more credibility can afford to disclose less. They can actually get away with giving away fewer details.

However, if the probability that investors will disagree is relatively high, it usually pays to disclose a lot. That may sound a little counterintuitive, but there is a tradeoff. The more you disclose about strategy, the higher the probability that some investors won't like it. That will force companies to adjust course or lose investors. That's the downside of additional disclosure — it might impede capital formation. You might have gotten the financing without disclosure. Conversely, less disclosure increases the cost of capital.

5. How should regulators read you conclusions?

We've got a society that is somewhat inordinately focused on additional regulation. Right now there are no regulations that govern strategic disclosure of the kind discussed in my paper. This paper strongly cautions against forcing firms to disclose more with respect to strategy. Let them disclose as much as they think is optimal. Investors will get compensated if companies elect to disclose less. Imposing regulatory requirements on strategic disclosures would seriously distort the marketplace. It's a very dangerous path that regulation could go down. We're not there yet, but it could go that way.