



SFB/Transregio 266

ACCOUNTING FOR TRANSPARENCY

Research on Corporate Transparency Element 6: Cheap Talk

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TRR 266 Accounting for Transparency

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Motivating question

Can there be value in non-verifiable disclosure?

Intuitive answer

Yes

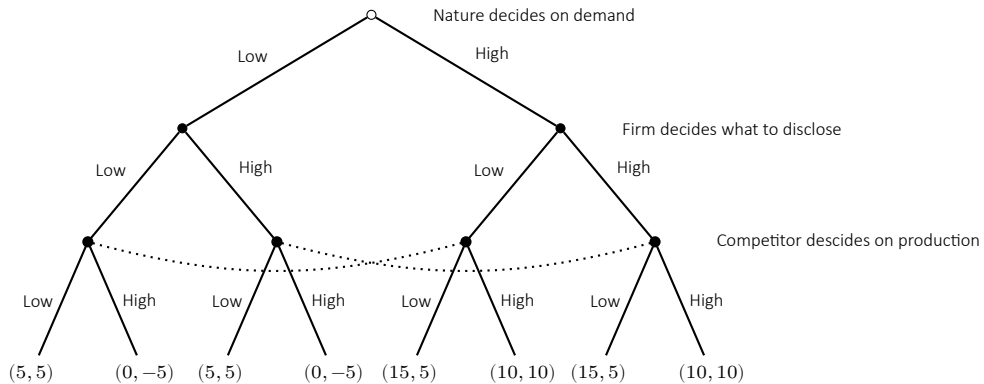
(if objectives are or can be aligned)

Why can this be a big deal?

Consider the setting of Gigler (JAR, 1994)

- A firm facing Cournot competition has private information about aggregate demand
- It has the option to disclose its information but the disclosure cannot be verified
- Would it disclose this information?
- Assuming that it would, would the competitor act on the disclosure?

A game tree

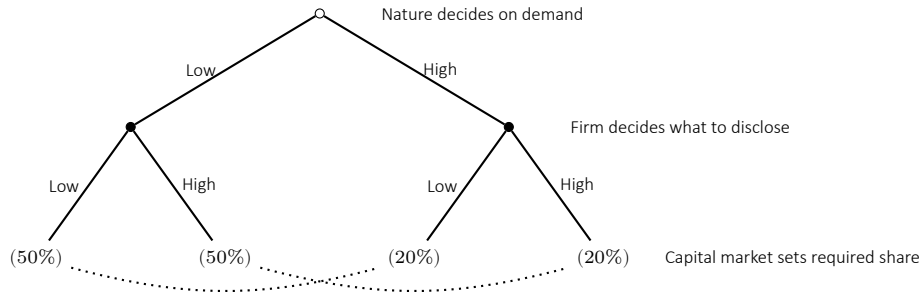


OK. Now for something different

Now consider that there is a rational competitively pricing capital market and that the owner of the firm needs to sell a part of the firm to finance production

- Would the firm disclose its information to the capital market?
- Would the market act on this information?

A somewhat simpler game tree



And now: Together

Assuming that both, the competitor and the capital market trust the disclosure of the the firm, the firm has an incentive to report truthfully.

Strategy (demand/disclose)	L/L, H/H	L/L, H/L	L/H, H/H	L/H, H/L
Payoff for firm low demand	5	5	0	0
Payoff for firm high demand	10	15	10	15
Share to investor low demand	50%	50%	20%	20%
Share to investor high demand	20%	50%	20%	50%
Expected payoff to firm owner	5.25	5.00	4.00	3.75

Tadaa: The incentives are aligned and we have an informative cheap talk equilibrium!