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Shadows in the Sun: Crash Risk behind Earnings Transparency

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Abstract

Prior studies suggest that earnings and non-earnings information can be complementary to each other (Lundholm, 1988). Given the co-existence of both components, a lack of non-earnings information can end up boosting earnings explanatory power on returns in certain circumstances, producing spuriously high earnings transparency (*ET*) in Barth et al. (2013). This scenario is plausible when insiders are motivated to exploit their information advantage and discretionarily alter non-mandatory disclosure strategy. Conditional on higher insider trading profit, we uncover a positive relation between the firm-specific earnings transparency and crash risk. In addition, the above relation is more pronounced with respect to selling and profitable insider transactions. Overall, we demonstrate a potential dark side of high earnings explanatory power on stock returns, conditional on higher likelihood of non-earnings information hoarding.

Keywords: Information Complementarity; Earnings Transparency; Crash Risk; Insider Trading

JEL Classification: G01, G14, M41, M48

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