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Daniel Hoang, Martin Ruckes

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Corporate Risk Management, Product Market Competition, and Disclosure*

Daniel Hoang and Martin Ruckes†
Karlsruhe Institute of Technology

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Abstract

This paper studies the effects of hedge disclosure requirements on corporate risk management and product market competition. The analysis is based on a model of market entry and shows that to prevent entry incumbent firms engage in risk management when these activities remain unobserved by outsiders. In the resulting equilibrium, financial markets are well informed and entry is efficient. However, potential attempts for more transparency by additional disclosure requirements introduce a commitment device that provides incumbents with incentives to distort risk management activities thereby influencing entrant beliefs. In equilibrium, firms engage in significant risk-taking. This behavior limits entry and adversely affects the nature of competition in industries.

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†Hoang and Ruckes are with the Karlsruhe Institute of Technology (KIT). Address correspondence to Daniel Hoang, Institute of Finance, Banking, and Insurance, Karlsruhe Institute of Technology, Kaiserstraße 12, 76131 Karlsruhe, Germany, Phone: +49 721 608-44768, Fax: +49 721 359-200, or e-mail: daniel.hoang@kit.edu.

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