

Abstract: Information Aggregation and Investment decisions

Elias Albagli, Christian Hellwig et Aleh Tsyvinski ,

We study a role of asset prices in aggregating information and guiding real investment. First, we develop a tractable, yet flexible class of noisy REE models of a financial market with a general specification of an asset's payoffs. We show that the firm's share price differs systematically from the firm's expected dividends. Second, we apply our framework to study the interaction between information aggregation in financial markets and corporate decision-making. The option value inherent in firm's use of the information contained in market prices implies that expected share prices exceed expected firm value from an ex ante perspective. Third, we show that these effects are reinforced when executive compensation is tied to market valuations. In that case, managers can manipulate the share price to their own benefit, by over-reacting to the information conveyed by prices. This results in excess investment volatility, higher prices, and lower expected firm value.