This dissertation aims at enhancing our understanding of the role of information in the interaction among economic agents in capital markets. In order to thoroughly evaluate the trade-offs involved in maximizing the real efficiency and the price efficiency of capital markets, economic incentives of those who prepare, disseminate, and use information must be understood. The research questions I attempt to answer in this dissertation center around two themes: (i) how various characteristics of accounting information as mandated by accounting standards influence investors’ assessment of a firm’s future profitability and their trading behaviors in financial markets, and (ii) what are the incentives of investors to publicly express their stock opinions on social media. Specifically, the first two chapters examine the desirability of accounting information characteristics such as comparability, transparency, and clarity. The last chapter moves to study individual investors’ voluntary expression of their polarized sentiments in a public communication network.

In the first chapter, I investigate how accounting comparability affects the monitoring role and the risk allocation role of capital markets. I develop the statistical and informational properties of accounting reports under varying degrees of comparability. A perfectly comparable accounting information system enables investors to perfectly infer the difference between any two firms’ future cash flows although investors remain uncertain about either firm’s cash flow. Comparability alleviates entrepreneurs’ moral hazard problem by strengthening the price response to the relative accounting performance, but can induce excessive price risk as well as residual systematic cash flow risk. Unlike the investors (users) who earn their surplus by bearing the residual systematic risk, the entrepreneurs (preparers) do not find perfect comparability desirable. Hence, a standard setter would mandate higher comparability than preferred by preparers, but not perfect comparability.

In the second chapter, I study how public information about a firm’s fundamental value affects the firm’s stock price behavior and efficiency in the presence of Keynesian beauty contests when investors heterogeneously interpret such information. In an overlapping generations rational expectations model of capital markets, I show that higher-order beliefs regarding other investors’ interpretations can induce investors to overweight their private interpretations. Moreover, while improving a public disclosure’s clarity generally increases price efficiency, improving its transparency can be detrimental. In the latter case, the interior level of transparency that maximizes price efficiency monotonically increases in clarity. In other words, the best attainable level of price efficiency hinges on the level of clarity.

In the third chapter, I examine individuals’ incentives to express their polarized sentiments and the efficiency of the subsequent aggregate action in the presence of coordination motives. I consider situations in which every agent would like to take an action that is coordinated with those of others, as well as close to a common state of nature. Agents have polarized sentiments in the sense that their beliefs about the state can be biased in opposite directions. Before the coordination game is played, agents decide whether to reveal to the others their polar type. In equilibrium, full disclosure takes place only when the population composition is expected
to be more balanced; otherwise, the minority group of agents have an incentive to mimic their majority counterparts. In addition, the analysis on the aggregate action indicates that a diverse yet unbalanced population can jointly make a more efficient decision, especially when the coordination motive is strong but little is known about the underlying state.