JOURNAL ARTICLE

The Real Effects of Short-Selling Constraints

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Gustavo Grullon , Sébastien Michenaud , James P. Weston

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Abstract

We use a regulatory experiment (Regulation SHO) that relaxes short-selling constraints on a random sample of U.S. stocks to test whether capital market frictions have an effect on stock prices and corporate decisions. We find that an increase in short-selling activity causes prices to fall, and that small firms react to these lower prices by reducing equity issues and investment. These results not only provide evidence that short-selling constraints affect asset prices, but also confirm that short-selling activity has a causal impact on financing and investment decisions.

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