Short Interest and Stock Price Crash Risk

Jeffrey L. Callen and Xiaohua Fang

Using a large sample of U.S. public firms, we find robust evidence that short interest is positively related to one-year ahead stock price crash risk. The evidence is consistent with the view that short sellers are able to ferret out bad news hoarding activities by managers. Additional findings show that the positive relation between short interest and future stock price crash is more salient for firms with weak governance monitoring mechanisms, excessive risk taking behavior, and high information asymmetry between managers and shareholders. Empirical support is provided showing that the relation between short sale interest and stock price crash risk is indeed driven by bad news hoarding.

JEL Classification: G12; G32; G34; D82

Keywords: crash risk; short interest; agency conflict