

Abstract

This paper investigates the effect of short-sale constraints on price efficiency. We use a global dataset collected from several custodians, with over 85.7 million lending supply postings and 46.4 million lending transactions from January 2004 to June 2006. This information is available weekly for 17,015 stocks in 26 markets around the world. For each stock we estimate the supply of shares available for short-selling and the borrowing fee. Our main findings are as follows. First, shortsale constraints are associated with lower price efficiency. Stocks with limited lending supply and high borrowing fees respond more slowly to market wide shocks. Second, short-sale constraints affect the distribution of weekly stock returns. Limited lending supply is associated with higher skewness, but not with fewer extreme negative returns. Third, stocks with limited lending supply and higher borrowing fees are associated with lower R^2 s on average. This finding challenges the claim that low R^2 s are associated with higher price efficiency.