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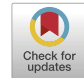

Impact of managerial ownership on investment and liquidity constraints: Evidence from Chinese listed companies

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ABSTRACT

We examine the impact of managerial ownership on investment and financial constraints in the context of China. Using the system generalized method of moments estimation of an investment Euler equation, we find that investment decisions are related to managerial ownership in two ways. First, managerial ownership exerts a positive direct effect on corporate investment decisions by aligning management's incentives with the interests of shareholders. Second, managerial ownership helps to reduce the degree of financial constraints faced by firms, suggesting that managerial ownership acts as a form of credible guarantee to lenders, signaling the quality of investment projects to the capital markets. Our findings suggest that recent policies enacted by the Chinese government, aimed at reforming ownership structure and encouraging managerial ownership in listed firms, help reduce agency costs and asymmetric information; thereby facilitating firms' investment efficiency. Our findings will be of interest to scholars, practitioners, and policy makers interested in the financial impacts of management-compensation contracts.

1. Introduction

In a world of perfect capital markets, a firm's investment decisions are solely dependent on investment opportunities (Modigliani and Miller, 1958). However, in reality, the prevalence of a variety of market frictions such as information asymmetries between management and outsiders and agency conflicts between managers and shareholders as well as controlling shareholders and minority investors not only directly affects corporate investment but also makes financing decisions relevant to investments.[1]

More specially, it is argued that agency conflicts between managers and shareholders have a direct effect on investment decisions (Ross, 1973; Jensen and Meckling, 1976; Holmstrom and Costa, 1986; Aggarwal and Samwick, 2006). Self-interested managers have incentives to shirk or to divert corporate resources to their own benefits at the expenses of investors (Jensen and Meckling, 1976). While the former may lead to underinvestment problem, the latter takes the form of excessive consumption of perquisites and empire building (i.e., overinvestment). Additionally, firms' investment decisions are influenced by financial constraints arising from capital

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[1] Efficient resource allocation has implications not only for the firm but for the economy as a whole. At the microeconomic level, investment/capital expenditures affect a firm's production decisions, strategic plans, and performance (Bromiley, 1986; Nicholson, 1992; McConnell and Muscarella, 1985). At the macroeconomic level, firms' investments/capital expenditures have a significant effect on economic growth, and propagation of business cycles (Dornbusch and Fischer, 1987; Bernanke and Gertler, 1989; Carlstrom and Fuerst, 1997).

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