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Corporate Liquidity, Governance, and Agency Costs

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A central theme in financial economics is that incentive conflicts (or governance problems) within the firm lead to distortions in corporate policies and, as a result, affect economic growth. A prevalent view in the academic literature and in the popular press is that these incentive conflicts lead managers to make decisions that do not always maximize corporate performance. Corporate policies should then be determined not only by market frictions -- such as corporate taxes, bankruptcy costs, adjustment costs, and the like -- but also by the severity of incentive conflicts within firms. A large empirical literature has examined the potential effects of manager-shareholder conflicts on corporate policies. In addition, recent corporate scandals have provided anecdotal evidence on the effects of self-dealing behavior by managers on corporate decisions. However, after decades of research on corporate governance, we still know very little about the magnitude of manager-shareholder conflicts, about their effects on corporate behavior and economic growth, or about the effectiveness of various governance mechanisms (such as performance based compensation or monitoring by the board of directors) in alleviating these conflicts. One of the main objectives of this research project is to address these central questions in financial economics. In particular, the project will address the following questions:

1) How large are incentive conflicts within firms?
2) How do these conflicts depend on the firms' macroeconomic and legal environment?
3) How do they depend on their governance structure?
4) How do they vary across countries?
5) What are the appropriate policy responses to these conflicts at the corporate and at the country level?

Another important question that has received a lot of attention in financial economics relates to the effects of capital market frictions on corporate decisions and economic growth. The global financial crisis of 2008 has provided a dramatic illustration of some of these effects, demonstrating in particular the impact of capital supply frictions on firms' ability to fund profitable investment projects. A second objective of the research project is to deepen our understanding of the effects of capital market frictions on corporate policies by developing dynamic models that allow both for a study of corporate decisions and for a consistent pricing of corporate securities. In particular, we will be interested in answering the following questions:

1) How do capital supply frictions affect corporate policies?
2) What level of corporate cash holdings would be optimal for firms facing capital supply frictions?
3) How do capital supply frictions affect the type of securities issued by firms, the frequency of capital structure changes, and the risk of default of corporations?

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Fields of Research

Corporate Finance, International Finance, Financial Regulation