THREE ESSAYS ON CORPORATE FINANCIAL POLICIES

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The first essay addresses the recent mixed evidence on the relationship between interest rates and corporate 'cash'. I revisit and find support for the predictions of the transactions model of liquidity management that high (low) interest rates are associated with high (low) short-term investments and low (high) cash and cash equivalents due to the opportunity cost of holding the latter. Further, I show that interest rates are not directly related to the level of liquid assets, i.e., the sum of cash and cash equivalents and short-term investments. This result suggests that the traditional definition of 'cash' masks an important relationship predicted by the transactions model and challenges explanations of the corporate 'cash puzzle' based on changes in interest rates.

In the second essay, I study how firms set their capital structures in response to staggered changes in the enforceability of non-compete agreements (NCAs) in the U.S. over the 1978-2014 period. I find that following an increase in the enforceability of NCAs, which increases executives' unemployment risk by limiting their outside options, firms in affected states decrease their leverage relative to otherwise similar firms in non-affected states. The decrease in leverage is concentrated among firms with greater profit variability and among financially constrained firms. The results point to an unintended consequence of increased enforceability of NCAs – the emergence of a risk-related agency conflict.

The third essay proposes and empirically tests an agency explanation of the corporate 'cash puzzle'. We document that after an exogenous increase in corporate governance measured by a staggered passage of state Majority Voting laws, which enhance shareholder power in director elections, there is a decrease in total 'cash' holdings. The result is entirely driven by the decrease in the risky component of 'cash', while the safe component is unchanged. We obtain similar results using two other exogenous shocks to governance – staggered adoption of state antitakeover laws and a firm-level takeover index. The negative relation between strong corporate governance and corporate 'cash' is driven entirely by hi-tech firms whose 'cash' policies are widely recognized as a key contributor to the 'cash puzzle'.