Managerial Behavior and the Link between Stock Mispricing and Corporate Investments: Evidence from market-to-book ratio decomposition

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Abstract

We examine three managerial behavioral explanations for the relation between s mispricing and corporate investments that are mentioned in Mørck, Shleifer and Vi (1990) and Stein (1996). We find evidence supporting all three explanations: ma timing, catering, and confusion about the aggregate state of the economy/industry. examine aggregate corporate investment behavior and its components: ca expenditures, R&D, acquisitions, and asset sales. By decomposing the market-to-l ratio into firm level mispricing, aggregate level mispricing, and growth components show that corporate investment decisions are determined by firm and aggregate l mispricing components after controlling for growth and financial slack. Specifically find that corporate investments in general are determined by market timing-motiv equity and debt transactions. Consistent with our predictions, we also show that relation between firm level mispricing and investment activity is more pronouncec financially constrained firms and that managers' investment decisions cater to s horizon shareholders. The significant impact of aggregate level mispricing on investi is consistent with the confusion hypothesis that managers are not very good at parsing aggregate level mispricing when making their investment decisions.

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Key words: Stock mispricing, financial constraints, investment horizon, corporate investments