

SFAS 123 (R), Managerial Ownership, and Non-Optimal

Investment: A New Evidence

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Abstract

This paper investigates the effect of the issuance of the SFAS 123 (R) on executives' inefficient investment decisions. We shed light on three conjectures. First, we address the effect of executive stock options (ESOs) and managerial ownership on the sensitivity of investment to cash flow. Secondly, we address the effect of ESOs on overinvestment problem and underinvestment problem. Finally, we address whether the SFAS 123 (R) mitigates over-investment problem or deteriorate under-investment problem. The findings show, first of all, that higher portion of ESOs compensation packages mitigates inefficient investment decision made by entrenched managers. In addition, we find that ESOs deteriorate overinvestment problem but ameliorate underinvestment problem prior to the issuance of the SFAS 123 (R), and this situation is more pronounced for entrenched firms. Finally, we find that the issuance of the SFAS 123 (R) ameliorate overinvestment problem but deteriorate underinvestment.

Key words: SFAS 123 (R); executive stock options; Underinvestment; Overinvestment; Managerial entrenchment; Expropriation