THE IMPACT OF MANAGERIAL OPTIMISM ON INVESTMENT-CASH FLOW SENSITIVITY

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ABSTRACT

In this paper, we create a novel measure of managerial optimism from investor’s asymmetric responses to quarterly earnings announcements. Managers educated by the market learn to be optimistic when they see positive earnings shocks are highly appraised, while negative earnings shocks were not disciplined with an equivalent extent. Using Taiwanese data, we explore the issue that external market-nurtured optimism is related to the use of internal resource. The market-nurtured optimism heightens a firm’s investment-cash flow sensitivity (ICF). This impact of the managerial optimism on ICF remains significant after the control of information asymmetry. A good governance structure can mitigates the influence of optimistic manager on ICF. Finally, managerial optimism, information asymmetry, and the agency cost, in isolation or in combination, contribute to the explanation of the heightened relationship between investment and internal cash flow.

KEYWORDS: Managerial optimism, Investment-cash sensitivity, Information asymmetry, corporate governance.