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Managerial ability, investment efficiency and stock price crash risk

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Abstract: We examine empirically the effect of managerial ability on firm-level investment efficiency and how this affects future stock price crash risk. Using a managerial ability measure developed by Demerjian et al. (2012), the paper documents consistent evidence that the more able managers over-invest compared to their not-so-able counterparts, even after controlling for the effects of financial reporting quality and other firm specific determinants of investment efficiency. This evidence is robust to alternative proxies for investment efficiency. The empirical evidence also suggests that crash risk increases for firms with more able managers, primarily through the investment inefficiency channel. Overall, the study contributes to a better understanding of the influence of managerial ability on investment decisions in the context of diverging opinions regarding manager-specific effects on organizational outcomes.

Keywords: Managerial ability; investment efficiency; financial reporting quality; stock price crash risk.

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