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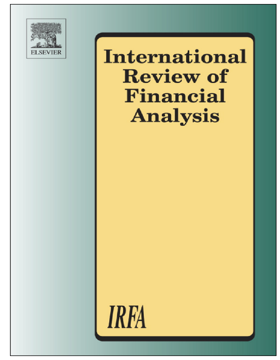

Cash holdings and CEO risk incentive compensation: Effect of CEO risk aversion

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Cash holdings and CEO risk incentive compensation: Effect of CEO risk aversion

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Abstract

Liu and Mauer (2011) document that firm cash holdings are positively related to the risk incentive component of CEO compensation and attribute this relation to bondholder-shareholder conflicts. We propose that the positive relationship could be due to a managerial risk aversion effect and find supporting evidence for this view. In our study, we focus on zero debt and negative net debt ratio firms in order to minimize the possibility that the risk incentive effect on cash is driven by bondholder-shareholder conflicts as suggested by Liu and Mauer (2011). We find that vega is positively related to cash holdings and that this relationship is enhanced for firms with greater managerial risk aversion. We conclude that managers appropriately respond to risk incentives by taking on riskier projects but increase cash holdings to reduce their undiversified risk to the firm as a consequence of greater risk incentive compensation.

JEL Classification codes: G00, G30
Keywords: Cash holdings; CEO compensation; Risk incentives; Managerial risk aversion

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