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Investment, firm performance and securitization: Evidence from industrial companies ☆

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A B S T R A C T

Asset-backed securitization (ABS) can generate substantial cash inflows to the firm and thus a worthwhile source of financing when other sources become very costly. Using a hand collected sample of ABS transactions done in the US, we estimate the sensitivity to ABS proceeds of both investment and firm's performance, arguing that if both investment and firm's performance are increasing in ABS cash flow, this will be consistent with the underinvestment mitigation hypothesis. Alternatively, if ABS activity leads to increasing investment and decreasing firm's performance, this will provide support to the overinvestment hypothesis. Consistent with the first hypothesis, we find that ABS proceeds are associated with more investment and better market performance in firms with high financial distress probability. Furthermore, after exploring other uses of ABS proceeds, we show that high-growth firms mainly use ABS to finance their acquisitions while low-growth firms spend ABS proceeds to increase both investment and stock repurchases, which allows them to signal to the market the improvement of their growth prospects.

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1. Introduction

Industrial firms have increasingly made use of asset-backed securitization (ABS) as a financing instrument. The process consists of selling assets such as trade accounts receivable to a newly created special purpose vehicle (SPV), which in turn uses the assets as collateral for securities issued to investors. According to Demica (2006), 17% of top 500 US non-financial companies had used trade receivables securitization during the period 1995–2005. Moreover, for many firms, the proceeds from ABS have increased to become one of the largest items of their cash flow statement. However, despite the level of these cash flows, their impact on firm's investment policy and ultimate performance has received little attention in academic research.

Building on the extensive literature regarding agency problems and their effect on managerial investment behavior, we examine the role of ABS financing in mitigating underinvestment (Myers, 1977) when other traditional external sources of financing become very costly. While securitization, similar to traditional secured debt, implies the use of assets as collateral for the capital obtained, the key distinguishing feature of ABS is the transfer of assets' ownership to a legally separate entity (the SPV) from the originating firm (Ayotte and Gaon, 2011). This structure allows establishing the bankruptcy remoteness of the SPV, which insulates transferred assets from the bankruptcy risk of the originating company and enables some firms access to a cheaper capital that could help them to mitigate underinvestment. On the other hand, it has been argued that securitization, unlike traditional borrowing, provides management with cash proceeds that are not subject to direct monitoring from ABS investors since the device allows separating the risk of securitized assets from that of the originating firm (Yamazaki, 2005). This could represent opportunities for management to engage in overinvestment of ABS proceeds (Yamazaki, 2005), which makes ABS exacerbating the agency cost of free cash flow.

Although the above potential effects of ABS have been pointed out in previous studies (see, e.g., Yamazaki, 2005), to our best knowledge no empirical evidence has yet been provided. Thus, the purpose of this paper is to fill this gap by examining the impact of this form of funding on investment policy using a hand collected sample of 466 ABS transactions done in the US over the period 1993–2006. Following Aggarwal and Samwick (2006), we estimate the sensitivity to ABS proceeds of both investment and firm's performance, arguing that if investment is increasing in ABS cash flow, this could indicate either a reduction of underinvestment or an increase in overinvestment. An examination of ABS impact on both investment and firm's performance allows identifying whether the observed effect is one related to over- or underinvestment. If both investment and firm's performance are increasing in ABS cash flow, this will be consistent with the underinvestment mitigation hypothesis. Alternatively, if ABS activity leads to increasing investment and decreasing firm's performance, this will provide support to the overinvestment hypothesis. By controlling for executive incentives, we aim at understanding how these two mechanisms interact in the context of ABS. With this respect, the compensation literature provides conflicting point of views regarding the effect of pay-for-performance on managerial investment behavior (Begley and Feltham, 1999a,b; John and John, 1993; Aggarwal and Samwick, 2006; Broussard et al., 2004) With these previous findings in mind, one should expect that the two devices can be used in concert to achieve the optimal effect on investment and firm's performance.

Our empirical analysis provides the following results. Despite important variations in the use of securitization, the device represents a substantial source of financing for the firms in our sample. Annual proceeds realized from securitization average 260% of beginning-of-period capital stock with 50% of our firms generating ABS cash flows exceeding 16% of capital stock. The mean and median values of investment are 25% and 19% of capital stock respectively. Thus, based on the median values, ABS proceeds are sufficient to finance 64% of investment spending in our firms sample.

We find that ABS activity is associated with higher investment and better performance in firms with high financial distress probability. This provides support to the underinvestment mitigation hypothesis. Furthermore, when controlling for growth opportunities of the firm, we find that the impact of ABS proceeds is insignificant on investment spending and positive and significant on market performance for firms with high growth options, which does not provide evidence on the role of ABS in mitigating underinvestment in these firms. On the other hand, surprisingly, our results regarding low growth