Product Market Competition, Corporate Governance, and Corporate Cash Policy*

Azizjon Alimov
City University of Hong Kong
aalimov@cityu.edu.hk

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Abstract

How does competition in product markets affect the value and use of corporate cash holdings? How does competition alter the effect of corporate governance mechanisms on corporate cash policy? This study provides answers to these questions using a large panel of U.S firms over the period 1990-2008. The preliminary results show that the market value of cash increases with the intensity of product market competition, measured using several proxies. I also find that the value of cash is positively related to a measure of good corporate governance only for firms operating in a highly competitive environment. These result suggests an economically important role for product market competition as well as corporate governance in the determining the value of cash to investors. I also find that high level of excess cash can lead to lower performance for firms operating in high competition industries, although good corporate governance mitigates the negative effect of cash on performance. Overall, the results in this paper suggest that even in highly competitive industries, firms need to guard against the potential for excess cash reserves leading to firm activities that can harm future performance.

Keywords: Cash holdings; Firm Value; Product Market Competition; Corporate Governance.

Preliminary. Comments welcome.

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