ECONOMIC POLICY UNCERTAINTYAND CORPORATE FINANCIAL POLICIES

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Abstract - We study the effects of economic policy uncertainty on corporate financial policy. The sample covers the S&P 1500 firms during 1986-2015. The result suggests that when the uncertainty of government economic policies increases, the company will reduce its total liability and long-term liability, increase short-term liability, and reduce cash holdings.

Index Terms - Economic policy uncertainty; financial policy

I. INTRODUCTION

Unlike prior studies, which focus mainly on investment uncertainty or examine how corporate managers take financial decisions in reaction to an extreme credit crunch in the short term (e.g.,Reference [2]; Reference [1]), we extend the research scope to study the relationship between the uncertainty associated with government's economic policy and the financing, dividend, and cash decisions taken by corporate managers. We identify empirically the causal effects by examining the impact of policy uncertainty on several financial variables that proxy for corporate financing, payout, and liquidity management decisions. To the best of our knowledge, there have been no studies so far that examine the long-term relationship between economic policy uncertainty and corporate financial decisions. Thus, the empirical results have broad applications and contribute to a deeper understanding of the impact of macroeconomic conditions on corporate financial decision-making.

II. SAMPLE AND METHODOLOGY

We collect the S&P 1500 firms from January, 1986 through December, 2015, excluding financial companies and utilities because of their unique financial characteristics. The information of financial statements and stock prices of sample firms are also collected from the Datastream database.

The measurement of economic policy uncertainty is based on the economic policy uncertainty index compiled by Reference [3].

To assess the relationship between economic policy uncertainty and corporate financial policies, we use a panel regression with firm and year fixed effect as follows:

$$FinPolicy_{i,t} = \alpha_i + \beta_1 EPU_{t-1} + \beta_2 ASSET_{i,t-1} + \beta_3 ROA_{i,t-1} + \beta_4 ROE_{i,t-1} + \beta_5 CAPEX_{i,t-1} + \beta_6 NI_{i,t-1} + \eta_t + \varepsilon_{it} \quad (1)$$

where $FinPolicy$ denotes corporate financial policies; EPU denotes the index of economic policy uncertainty; a set of variables regarding a corporate financial policies are included as control variables, including the firm size, profitability, capital expenditures; α_i denotes firm fixed effects; η_t denotes year fixed effects.

III. EMPIRICAL RESULTS

Table I presents the estimated results of Equation (1), where dependent variables are total debt (TDTA), long-term debt (LTDTA) and short-term debt (STDTD). The coefficients on EPU are both statistically significant at the 1% level in Columns (1) and (2), suggesting that economic policy uncertainty leads to firms reducing their total debt and long-term debt. In contrast, the coefficient on EPU in Column (3) is positive and significant at the 5% level, indicating that the company will increase the use of short-term debt in the face of uncertainty.

Table I Relationship between economic policy uncertainty and corporate financing policy

	(1)	(2)	(3)
	TDTA	LTDTA	STDTD
EPU	-0.0014***	-0.0014***	0.0012**
	(0.0005)	(0.0004)	(0.0005)
ASSET	0.0096***	0.0092***	-0.0258***
	(0.0034)	(0.0032)	(0.0057)
ROA	3.5434*	3.4114**	-2.4558***
	(1.8118)	(1.6793)	(0.5133)
ROE	0.0025**	0.0021**	-0.0005
	(0.0010)	(0.0009)	(0.0008)
CAPEX	-0.0340	-0.0404	-0.0469
	(0.0661)	(0.0599)	(0.1203)
NDTS	-3.7723**	-3.5953**	2.7355***
	(1.8139)	(1.6829)	(0.5153)
Intercept	0.2137***	0.1987***	0.4205***
	(0.0738)	(0.0695)	(0.1211)
Year FE	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
N	16,614	16,829	14,582
R^2	0.7422	0.7243	0.4272

Table II Relationship between economic policy uncertainty and corporate payout and liquidity management policy

	(1)	(2)	(3)
	PAYOUT	YIELD	CASH
EPU	-0.2348	-0.0016	-0.0009***
	(0.1669)	(0.0010)	(0.0003)
ASSET	-7.0802**	-0.0967***	-0.0257***
	(2.8129)	(0.0225)	(0.0036)
ROA	-91.9088***	-1.0440	-0.5479*
	(26.8568)	(0.7477)	(0.2793)
ROE	-0.0759	-0.0022**	-0.0009**
	(0.0489)	(0.0011)	(0.0004)
CAPEX	5.8768	-0.1597	-0.3527***
	(16.3867)	(0.2050)	(0.0483)
NDTS	57.3465***	0.5271	0.6713**
	(17.1686)	(0.7680)	(0.2776)
Intercept	135.8637**	1.7655***	0.6079***
	(56.5036)	(0.4142)	(0.0732)
Year FE	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
N	11,630	11,492	16,817
R^2	0.1244	0.1920	0.7199

Table II presents the estimated results of Equation (1), where dependent variables are payout ratio (PAYOUT), dividend yield (YIELD) and cash holdings (CASH). The coefficient on EPU in Column (3) is statistically negative at the 1% level, suggesting that the company reduce the cash holding facing the economic policy uncertainty. The coefficients on EPU in Columns (1) and (2) are insignificant, indicating there is no association between corporate payout policy and economic policy uncertainty.

CONCLUSION

Most previous studies have explored the relationship between economic policy uncertainty and corporate investment policy. This paper focuses, however, on corporate financing, payout, and liquidity management policies. The evidence suggests that The result suggests that when the uncertainty of government economic policies increases, the company will reduce its total liabilities and long-term liabilities, increase short-term liabilities, and reduce cash holdings.

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