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Does stock pledging affect corporate risk taking in debt maturity decision?

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Abstract

This paper investigates whether stock pledging activity by the shareholder influence firms' debt maturity decision. Stock pledging is a special kind of financial contract by which shareholders can raise personal loan from banks or financial institutions by mortgaging the stocks of the firm. Using Indian data, the study confirms that shareholders' stock pledging minimizes managerial risk taking incentives in debt financing resulting in longer-term public debt maturity. In order to counter different forms of biasness and endogeneity problems, a series of tests including PSM (Propensity Score Matching) and 2SLS (Two Stage Least Square) are performed and the study finds consistent results. It, further, checks the authenticity of the result by investigating the role of stock pledging on the refinancing of the debt; similarly, the firms with stock pledging preferred longer term refinancing of debt over the sample period. Since discretionary motive of managers leads to their endeavor to be less monitored, this study describes that the relationship between stock pledging and debt maturity is stronger for the firms that are engaged in earning management. Moreover, the study also shows the impact of stock pledging on debt maturity to be less prevalent when the firm produces sufficient private information.

Keywords: Stock Pledging, Debt Maturity, Managerial Discretion, Controlling Shareholder, India