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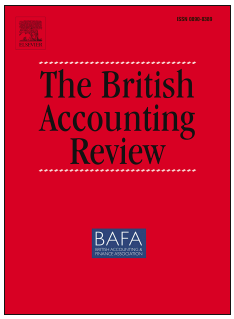

Monitoring mechanisms, managerial incentives, investment distortion costs, and derivatives usage

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Monitoring Mechanisms, Managerial Incentives, Investment Distortion Costs, and Derivatives Usage

Abstract

We relate derivatives usage to the level of corporate governance/monitoring mechanisms, managerial incentives and investment decisions of UK firms. We find evidence to suggest that the monitoring environment, e.g., board size, influences the use of both currency and interest rate derivatives usage. Managerial compensation also influences derivatives usage. Investment decisions are affect by the governance and managerial compensation of firms, which in turn impact on derivatives usage. We find a strong tendency for UK firms to reduce derivatives usage in situations where derivatives usage should be increased. There is limited evidence that firms use hedging substitutes to avoid monitoring from external capital markets.

Key words: Corporate hedging; corporate governance (CG); agency problem; under/overinvestment; logistic regression

JEL Classification: G32; G33; G34; C12; C35

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