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Local happiness and firm behavior: Do firms in happy places invest more?

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ABSTRACT

We examine a previously unexplored relationship between local happiness and firm investment. We looked at investment in general and R&D intensity in particular, as the relatively intangible nature of the latter may make it more subject to the effects of sentiment and affect. We find that average local happiness is positively correlated with both R&D intensity and firm investment, after controlling for firm and local area characteristics. This positive relationship may be due to the optimism and longer term perspectives that are typically associated with higher levels of life satisfaction/happiness. We also look at inequality in happiness levels and find that the effect of local happiness is stronger in places with more equal happiness distributions. Younger firms' investment behavior is also more strongly correlated with local happiness levels. The results remain robust to a battery of robustness tests including the use of residual and hedonic measures of happiness, analysis of a sample of relocated firms, and a test for reverse causality.

1. Introduction

The traditional paradigm in finance and economics has long assumed that economic agents are rational and maximize their self-interest by making unbiased decisions independent of the effects of non-monetary factors such as mood and sentiment. However, substantial evidence shows that sentiment and affect indeed influence economic behavior (Ifcher and Zarghamee, 2011; Puri and Robinson, 2007; Kuhnen and Knutson, 2011). As mood and affect as well as well-being more generally are known to influence decision making, the emotional state of company decision makers may have an impact on firm policies. In the corporate finance setting, it has been documented that certain biases and characteristics of managers such as optimism and overconfidence influence firm outcomes (Graham et al., 2013; Malmendier and Tate, 2005, 2008; Hackbarth, 2008). However, the effects of managerial subjective well-being and local level well-being more generally on firm behavior have not been examined.

Happiness and the more over-arching concept of subjective well-being have attracted significant attention in recent years, and happiness economics has developed into a burgeoning field. The emergent literature has identified certain determinants

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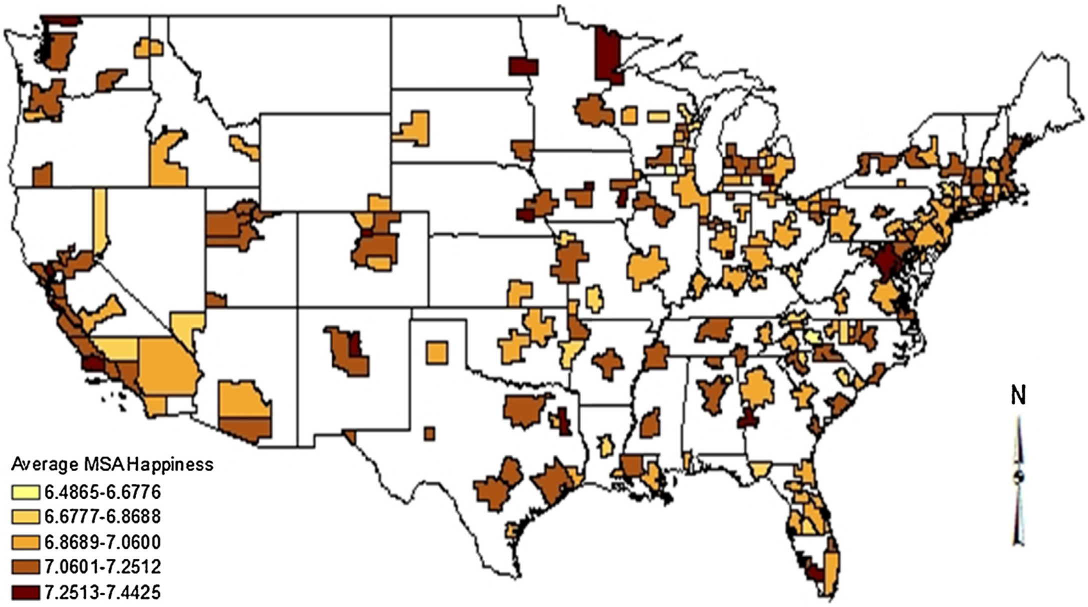

Fig. 1. Average MSA happiness across the U.S. This figure illustrates the average happiness of 207 Metropolitan Statistical Areas (MSA) that are included in our sample during Apr 2012–Mar 2013. Happiness is measured by the best possible life question from the Gallup Daily Poll, which asks respondents to compare their life to the best possible life on a scale of 0–10 with 0 corresponding to the worst possible and 10 to the best possible life in terms of how the local residents view their well-being. The map contains white areas because some rural areas do not belong to any MSA and also happiness data is not collected from some MSAs.

and externalities of happiness that are found to be remarkably consistent across communities and countries. For example, research shows that happier people are both healthier and more productive (Graham, 2009; De Neve and Oswald, 2012). Other research suggests that happier people tend to be more optimistic. Recently, a small number of these studies have started examining how happiness affects financial decision making at the individual level. For instance, Kaplanski et al. (2015) show that happy people expect higher returns. Since it is people who make decisions at firms and set corporate policies, findings from happiness economics can shed further light on firm behavior. However, whether happiness affects financial decision making at the firm level has not been studied.

In this paper, we explore whether there is any relationship between firms' decisions to invest in general – and to invest in research and development (R&D) in particular – and average levels of local happiness. We are not aware of any direct survey data that measure managerial happiness. However, people are subject to the effects of their environment and local culture since an individual's preference and decision making are often influenced by the actions of a reference group, which tends to be localized. In finance, studies that examine the effect of location on firm behavior are recently emerging. In these papers, location and distance often proxy for access to credit, information and monitoring cost, shock propagation, and transmission of corporate practices,[1] but only occasionally for non-economic local characteristics such as culture and religiosity.[2] In this paper, we focus on the effect of a previously unexplored aspect of local culture—local happiness—on firm behavior.

Local happiness varies across the U.S. as shown by the persistent differences in self-reported subjective well-being in cities across the country (Glaeser et al., 2014). As an example, Fig. 1 illustrates the average reported happiness of Metropolitan Statistical Areas included in our sample during Apr 2012–Mar 2013. We hypothesize that firms located in happier places are likely to invest more, especially in R&D, because happiness impacts risk tolerance, time preference, and expectations, and hence, the management of firms located in happier places may be more optimistic and more willing to think about the future. In addition, there seem to be positive externalities associated with higher levels of aggregate happiness, such as more trust, more sociability, and better public goods (discussed below), externalities which may play a role here.

We use data from the Gallup Daily Poll and merge it with firm accounting data and local area characteristics to explore if there are additional effects of local happiness on firm behavior. In short, we ask whether the positive externalities related to happiness at the societal and individual levels also relate to firm decisions. We also examine the effect of inequality in local happiness levels given the increased inequality of happiness in the U.S. and the emerging literature exploring this aspect of happiness.

[1] Examples of these studies include Loughran (2008), Arena and Dewally (2012), Tian (2011), Mian (2006), Saunders and Steffen (2011) and John et al. (2011) among others.

[2] Examples include Hilary and Hui (2009), Becker et al. (2011), and Jha and Chen (2013).