Pensions, corporate finance, and public policy

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Abstract
This dissertation consists of three papers that explore the links between corporate finance and corporate pension policy. The first chapter exploits the funding rules for defined benefit pension plans in order to identify the dependence of corporate investment on internal financial resources. Capital expenditures decline with mandatory pension contributions, even when allowing for very generalized correlations between the pension funding status itself and the firm's unobserved investment opportunities. The effect is particularly evident among firms that appear to face financing constraints based on observable variables such as credit ratings. There is some evidence suggesting that firms which do not sponsor defined benefit pension plans may undertake some of the capital investment that pension sponsors in their industry are unable to take up when required contributions are high. The second chapter tests a corporate control hypothesis to explain why managers might encourage employees to hold company stock in their 401(k) plans. Since employees often vote for incumbent managers in proxy contests, managers may encourage them to hold stock as a defense against a change in corporate control. When a state's laws change to provide more takeover protection for managers, employee ownership of firms incorporated in that state would be expected to decline relative to employee ownership at other firms. I find that the validation of the poison pill through Delaware case law in the mid 1990s had a statistically significant negative effect on employee ownership shares of up to 1.7 percentage points.

(cont.) The third chapter, co-authored with Daniel Bergstresser and Mihir Desai, analyzes variation in firms' assumed long-term rates of return on pension assets. We show that this is a lever that can affect reported earnings and provide evidence that managers use this mechanism opportunistically. The sensitivity of reported earnings to the pension return assumption is an important determinant of the assumption itself. Managers increase assumed rates of return as they prepare to acquire other firms and as to exercise stock options. Decisions about assumed rates of return, in turn, influence asset allocation within pension plans.

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