The Cultural Origin of Preferences: CEO Cultural Heritage and Corporate Investment

Yihui Pan
University of Utah

Stephan Siegel
University of Washington

Tracy Yue Wang
University of Minnesota

November 10, 2014

Preliminary – Please email the authors for a copy of the paper if interested.

Abstract

Does culture shape risk preferences? While economic models of the origins of preferences point to an important role of culture, supporting empirical evidence is largely missing for risk and time preferences. In this study, we exploit variation in cultural heritage across CEOs of public U.S. companies and demonstrate an important effect of CEOs' culturally transmitted risk preferences on corporate physical investment. CEOs' uncertainty avoidance negatively affects corporate investment, and the effect is larger for acquisitions than for capital expenditures (Capx). Our finding is robust to controlling for economic and institutional differences as well as genetic differences across countries of origin, and it does not depend on first-generation immigrant CEOs. CEOs' risk preferences seem to have a causal influence on riskier and more discretionary corporate decisions such as acquisitions. But the association between CEO risk preferences and more routine investment decisions such as Capx is largely explained by firm-CEO matching. Our results provide novel evidence of important social transmission of risk preferences, their effect on corporate investment policies, and the interplay of the culturally transmitted preferences of CEOs, corporate boards, and other top executives.

JEL classification:
Key words: Culture, corporate culture, risk preferences, corporate investment, CEOs

We would like to thank Masood Ahmed, Rui Han, and Seong Lee for excellent research assistance. We thank Jeff Coles, Michael Cooper, Amy Dittmar, Campbell Harvey, Mark Grinblatt, Geoffrey Tate, and seminar participants in University of Minnesota, University of Hong Kong, Chinese University of Hong Kong, and University of Utah for helpful comments. We thank Vineet Bhagwat, Joey Engelberg, Cam Harvey, and Romain Wacziarg for sharing their data with us. We also thank the behavioral research committee at the David Eccles School of Business, University of Utah, for providing research funding. Contact information: Yihui Pan, Department of Finance, David Eccles School of Business, University of Utah, Email: yihui.pan@business.utah.edu; Stephan Siegel, Department of Finance and Business Economics, Michael G. Foster School of Business, University of Washington, Seattle, WA 98195, Email: ss1110@uw.edu; Tracy Yue Wang, Department of Finance, Carlson School of Management, University of Minnesota, Email: wangx684@umn.edu.