Understanding the Heterogeneous Relationship between Insider Ownership and Corporate Performance

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Abstract
Recent theoretical models suggest that the relationship between insider ownership and corporate performance may be firm specific or heterogeneous. More specifically, the relationship between insider ownership and corporate performance can be positive for some firms but negative for others. Guo and Ou-Yang (2005) argue that it is this type of heterogeneity that may help explain the mixed and puzzling results in the empirical literature. We find that the heterogeneous relationship depends on the firm's idiosyncratic risk and risk endogeneity. In particular, both idiosyncratic risk and risk endogeneity have a negative impact on the sensitivity of corporate performance to insider ownership. The former is consistent with the prediction of Ou-Yang (2005) and Jin (2002), while the latter is consistent with the prediction of Guo and Ou-Yang (2005). Finally, we also find that both the number of insiders and the amenity potential have a negative impact on the sensitivity of corporate performance to insider ownership. The former is consistent with the free-rider argument of Holmstrom (1982), while the latter is consistent with the amenity potential argument by Demsetz and Lehn (1985).

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