Managerial Reputation and Failure of Market Discipline

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Abstract

This paper studies delegated investment choices in which the managers are concerned with their reputations. Their reputation building is attributed to credit market imperfections that allow investors (i) to pour more their funds into managers with better reputation, and (ii) to run on ones with bad reputation below the threshold and fire them. In the monopolistic credit market, the manager with low pledgeability faces serious threat of withdrawals and thus become conservative. In the competitive credit markets, the growing demands for credit increase the interest rate and thereby even managers with low pledgeability engage in risk-taking.

JEL Classification: G01, G11, G2.

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