Non-executive Ownership and Private Loan Pricing

Jun Chen
College of Business
North Dakota State University
Fargo, ND 58102
(701) 231-5708
Jun.chen1@ndsu.edu

Tao-Hsien Dolly King
Department of Finance
Belk College of Business
University of North Carolina at Charlotte
Charlotte, NC 28223
(704) 687-7652
tking3@uncc.edu

Min-Ming Wen
Graduate School of Business Administration
Hitotsubashi University
Tokyo, Japan
+81-042-580-8513
wen.mm@r.hit-u.ac.jp

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Abstract

This paper examines the link between non-executive ownership and the pricing of private loans. We find that on average firms with non-executive ownership pay a loan spread that is 31.59 basis points (or 24%) lower than those without. The rate-reducing effect of non-executive ownership on loan spread remains significant after we adopt a variety of measures of non-executive equity holding, control for other documented determinants, and address the issue of endogeneity. In addition, rather than a U-shape effect, the effect of non-executive ownership on loan rates is consistently negative across ownership levels. Our findings suggest a more pronounced impact when non-executive ownership is from ESOP accounts or when firms have weaker corporate governance. Further exploration reveals that non-executive ownership mitigates the managerial risk-taking incentives and information risk associated with firm opaqueness, resulting in a lower cost of loan financing. The results of this study provide strong support that non-executive ownership plays an important role in the pricing of private loans and serves as an effective governance mechanism.

Keywords: Non-executive Ownership; Loan Spread; Risk Reduction; Governance

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