“Stock Market Misvaluation and Corporate Investment”

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ABSTRACT:
This paper explores whether and why misvaluation affects corporate investment by comparing tangible and intangible investments; and by using a price-based misvaluation proxy that filters out scale and earnings growth prospects. Capital, and especially R&D expenditures increase with overpricing; but only among overvalued firms. There is some indication that the sensitivity of capital expenditures to misvaluation is stronger among equity-dependent firms; for R&D this differential is strong and in the opposite direction. We identify several other factors that influence the strength of misvaluation effects on investment. Overall, our evidence supports several implications of the misvaluation hypothesis for the tangible and intangible components of investment.