Corporate Pension Funding Without Mandatory Contribution: Its Implications for Firm Fundamentals and Stock Returns

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Abstract

Traditional trade-off theories imply that the pension funding ratio (pension assets/pension liabilities) increase with the manager's private information about the sponsoring firm's prospective operating performance, if no mandatory contributions were enforced. We test this implication using a sample from Japan, where pension funding rules are enforced much less strictly than in the US. Consistent with the theory, the pension funding ratio significantly predicts the cross-section of operating performance measures in Japan beyond the stock market's valuation, but not in the US. Furthermore, by preceding the market, the funding ratio predicts the cross-section of stock returns significantly in Japan. (99 words)