


Chapter 3

How Do Geopolitical Risk and Global Trade Shape Corporate Cash Policy? Evidence From the Financial Crisis of 2008–2009

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ABSTRACT

This chapter investigates the influence of geopolitical risk (GPR) and global trade on cash holdings with the existence of the global financial crisis 2008-2009 (GFC) for 11,960 non-financial firms in 18 markets from 2002 to 2017. Findings show that firms in countries with higher GPR and lower trade volume have higher cash balances confirming the predictions of the precautionary motive of cash. The implications of the findings are manifold. Managers should shape their cash policies considering the uncertainties, GPR, and trade level. Investors should consider countries' financial crises and GPR in specifying where and which firms to invest in. Policymakers can reshape the regulations and policies related to holding cash rather than paying dividends not to hurt firms in times of turbulence like the pandemic. Researchers and practitioners should count the macro-specific factors and market turmoil and their influence on cash holding in risky countries. The implications are particularly relevant to the post-pandemic era when exogenous shocks and uncertainties are further expected.

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INTRODUCTION

Firms may understand the importance of cash retention during the exogenous shocks when the accessing finance becomes costly (Duchin et al., 2010). However, financial market turmoils are not only factors affecting the corporate cash policy, but geopolitical risk (GPR) is also another factor. Therefore, this chapter answers the question of how GPR impacts cash holding before, during and after the global financial crisis 2008-2009 as well as questioning the possible impact of international trade.

Geopolitical risks may be defined as *the risks associated with wars, terrorist acts, and tensions between states that affect the normal and peaceful course of international relations* (Caldara & Iacoviello, 2022: 1195). Geopolitical incidents such as military attacks, terrorist acts or diplomatic tension are sources of great concern to business, public media and policy makers. For instance, when the trade wars happened between the United States and China, the economy of China suffered a terrific loss (Jiang et al., 2020). Moreover, geopolitical risk is also seen as an important matter influencing decision-making in multinational firms (Kotcharin & Maneenop, 2020). Also, geopolitical risks are essential factors of investment policies for especially corporate managers and policy makers (Demiralay & Kilincarslan, 2019).

International trade is one of the most noticeable issues in economic development. Also, according to Foley & Manova (2015), global trade has an impression on financial policies of firms. Research about international trade usually concentrates on the effect of productivity of trade and cross-country differences in predicting the gains from trade. One of the most important roles of firms' export possibility and capacity is the internal finance ensured by cash holdings or profit (Huang & Liu, 2017).

While the importance of geopolitical risk and global trade on corporate decisions grows over time, limited research analyzes their effect on corporate cash policies (Demir et al., 2019; Kotcharin & Maneenop, 2020; Lee & Wang, 2021; Tekin, 2021b; Wang et al., 2021). The contribution of this research to previous research by analyzing the consequences of geopolitical risk and international trade on cash retention in times of the recession.

Employing 127,775 firm-years from 18 economies empirical findings show that GPR has a positive effect, but global trade has a negative effect on cash hoardings. The positive influence of GPR on cash holdings increases during the GFC and does not differ in the post-GFC. Moreover, the impact of international trade on cash retention does not change in time of the GFC and its aftermath.

This chapter first proposes a theoretical framework and empirical studies related to the GPR, trade, the GFC, and cash holdings. Next, this study empirically evaluates the question of how the GPR, as well as trade, impacts cash policy across countries in the GFC context.

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