CONDITIONAL INVESTMENT-CASH FLOW SENSITIVITIES AND FINANCING CONSTRAINTS

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Abstract
We study the sensitivity of investment to cash flow conditional on measures of q in an adjustment costs framework with costly external finance. We present a benchmark model in which this conditional investment-cash flow sensitivity increases monotonically with the cost premium for external finance, for firms in a financially constrained regime. Using simulated data, we show that this pattern is found in linear regressions that relate investment rates to measures of both cash flow and average q. We also derive a structural equation for investment from the first order conditions of our model, and show that this can be estimated directly. (JEL: D92, E22, G31)

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