Financing Investment

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Abstract

We examine investment behavior when firms face costs in the access to external funds. We find that despite the existence of liquidity constraints, standard investment regressions predict that cash flow is an important determinant of investment only if one ignores q. Conversely, we also obtain significant cash flow effects even in the absence of financial frictions. These findings provide support to the argument that the success of cash flow augmented investment regressions is probably due to a combination of measurement error in q and identification problems.

Keywords: Investment, Financing Constraints, Cash Flow, Tobin's q.

JEL Classifications: E22, E44, G31

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