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Do Investment–Cash Flow Sensitivities Provide Useful Measures of Financing Constraints?

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Abstract

No. This paper investigates the relationship between financing constraints and investment–cash flow sensitivities by analyzing the firms identified by Fazzari, Hubbard, and Petersen as having unusually high investment–cash flow sensitivities. We find that firms that appear less financially constrained exhibit significantly greater sensitivities than firms that appear more financially constrained. We find this pattern for the entire sample period, subperiods, and individual years. These results (and simple theoretical arguments) suggest that higher sensitivities cannot be interpreted as evidence that firms are more financially constrained. These findings call into question the interpretation of most previous research that uses this methodology.

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