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# Cash holdings in SMEs: speed of adjustment, growth and financing



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## Abstract

This paper studies the effect of growth opportunities, financial constraints and financial distress on the speed of adjustment of small and medium-sized enterprises (SMEs) to their target cash holdings. We use a sample of Spanish SMEs from the period of 1998 to 2012. The results support the existence of a target cash holding level to which small firms attempt to converge. Additionally, consistent with the precautionary motive for cash holdings, the results show that SMEs with greater growth opportunities adjust more quickly to their target cash holding level to preserve their financial flexibility and to be able to take advantage of profitable investment opportunities when they arise. Moreover, for SMEs in financial difficulties, the adjustment speed of cash is higher to avoid financial distress costs. Finally, we observe a faster speed of adjustment for cash holding in

the crisis period for all firms, as a possible response to the credit restrictions faced by SMEs.

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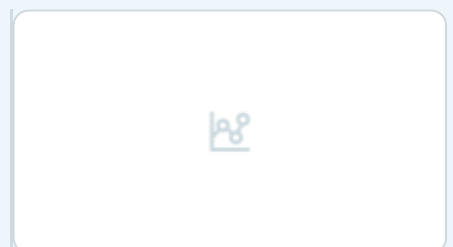
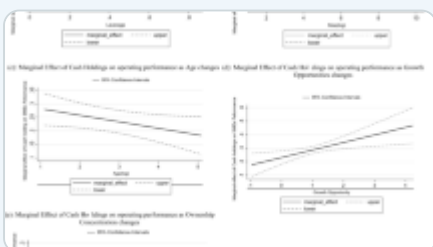
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## Notes

1. The agency problems associated with debt are most significant in SMEs (Berger and Udell [2003](#)).
2. According to the Additional Provision One of the Spanish Audit Law, 22/2015, of July 20, companies that exceed two of the following thresholds are not authorized to present abridged financial statements and, therefore, are obliged to audit their accounts: annual revenue of 5,700,000 €, total assets of 2,850,000 € and an average of 50 employees over the year, for two consecutive years.
3. NACE is the European classification of economic activities. NACE is a classification derived from the ISIC (International Standard Industrial Classification) to enable international comparability.
4. Significant at 1% level in further analyses.

5. The coefficient  $\delta_0$  for high sales growth firms will be the sum between the coefficient of lagged cash ( $CASH_{it-1}$ ) and the interaction with the dummy variable ( $CASH_{it-1} \times DHIGHGROWTH_{it}$ ). However, the coefficient  $\delta_0$  for the group of firms with lower sales growth will be determined by  $CASH_{it-1}$ . Note that the adjustment speed ( $\gamma$ ) is determined by 1 minus  $\delta_0$ .

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