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The Relaxation of Financing Constraints by the Initial Public Offering of Small Manufacturing Firms

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Abstract

Capital market imperfections, such as information asymmetry, increase the cost of external funds compared to that of internal funds. This phenomenon creates financing constraints limiting the availability of external funds and making corporate investment excessively sensitive to cash flow. This study analyzes the effect of financing constraints on the investment by comparing the financial behavior of Korean firms before and after their stocks are newly listed on a stock exchange. The results show that the sensitivity of investment to cash flow will be higher during the period before initial public offering (IPO) than after IPO. In particular, the effect of financing constraints relaxation by IPO is more prominent in small than in large manufacturing firms.

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