Advertisement

European Financial Management / Volume 9, Issue 2 / pp. 163-177

The Underinvestment and Overinvestment Hypotheses: an Analysis Using Panel Data

Artur Morgado, Julio Pindado

First published: 29 May 2003

https://doi.org/10.1111/1468-036X.00214

PDF

Abstract

We study the relationship between firm value and investment to test the underinvestment and overinvestment hypotheses. The results obtained, using panel data methodology as the estimation method, indicate that the abovementioned relation is quadratic, which implies that there exists an optimal level of investment. As a consequence, firms that invest less than the optimal level suffer from an underinvestment problem, while those investing more than the optimum suffer from overinvestment. The quadratic relation is maintained when firms are classified depending on their investment opportunities, the optimum being in accordance with the quality of investment opportunities.

References

Adedeji, A., 'Does the pecking order hypothesis explain the dividend payout ratios of firms in the UK?', *Journal of Business Finance & Accounting*, Vol. **25**, 1998, pp. 1127–55.

Google Scholar

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Blundell, R., Bond, S., Devereux, M. and Schiantarelli, F., 'Investment and Tobin's *Q*: evidence from company panel data', *Journal of Econometrics*, Vol. **51**, 1992, pp. 233–57.

Web of Science® | Google Scholar

Chen, S. and Ho, K., 'Market response to product-strategy and capital-expenditure announcements in Singapore: investment opportunities and free cash flow', *Financial Management*, Vol. **26**, 1997, pp. 82–8.

Web of Science® | Google Scholar

Cleary, S., 'The relationship between firm Investment and Financial Status', *The Journal of Finance*, Vol. **54**, 1999, pp. 673–92.

Web of Science® | Google Scholar

Del Brio, E., Perote, J. and Pindado, J., 'Measuring the impact of corporate investment announcements on share prices: the Spanish Experience', *Journal of Business, Finance and Accounting*, 2003, forthcoming.

Google Scholar

Doukas, J., 'Overinvestment, Tobin's *q* and gains from foreign acquisitions', *Journal of Banking and Finance*, Vol. **19**, 1995, pp. 1285–303.

Web of Science® | Google Scholar

Fazzari, S., Hubbard, R. and Petersen, B., 'Financing constraints and corporate investment', *Brooking Papers on Economic Activity*, Vol. **1**, 1988, pp. 141–95.

Google Scholar

Hubbard, R., 'Capital-market imperfections and investment', *Journal of Economic Literature*, Vol. **36**, 1998, pp. 193–225.

Web of Science® | Google Scholar

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Web of Science® | Google Scholar

Kaplan, S. and Zingales, L., 'Do investment-cash flow sensitivities provide useful measures of financing constraints?', *Quarterly Journal of Economics*, Vol. **112**, 1997, pp. 169–215.

Web of Science® | Google Scholar

Lang, L. and Litzenberger, R., 'Dividend announcements. Cash flow signalling vs. free cash flow hypothesis?', *Journal of Financial Economics*, Vol. **24**, 1989, pp. 181–91.

Web of Science® | Google Scholar

Lang, L., Ofek, E. and Stulz, R., 'Leverage, investment and firm growth', *Journal of Financial Economics*, Vol. **40**, 1996, pp. 3–29.

PubMed | Web of Science® | Google Scholar

Lewellen, W. and Badrinath, S., 'On the measurement of Tobin's *q*', *Journal of Financial Economics*, Vol. **44**, 1997, pp. 77–122.

Web of Science® | Google Scholar

Miguel, A. and Pindado, J., 'Determinants of capital structure: new evidence from Spanish panel data', *Journal of Corporate Finance*, Vol. **7**, 2001, pp. 77–99.

Web of Science® | Google Scholar

Modigliani, F. and Miller, M., 'The cost of capital, corporation finance and the theory of investment', *American Economic Review*, Vol. **48**, 1958, pp. 261–97.

Web of Science® | Google Scholar

Moulton, B., 'Random group effects and the precision of regression estimates', *Journal of Econometrics*, Vol. **32**, 1986, pp. 385–97.

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Myers, S., 'Determinants of corporate borrowing', *Journal of Financial Economics*, Vol. **5**, 1977, pp. 147–76.

Web of Science® | Google Scholar

Myers, S. and Majluf, N., 'Corporate financing and investment decisions when firms have information that investors do not have', *Journal of Financial Economics*, Vol. **13**, 1984, pp. 187–221.

PubMed | Web of Science® | Google Scholar

Nohel, T. and Tarhan, V., 'Shares repurchases and firm performance: new evidence on the agency costs of free cash flow', *Journal of Financial Economics*, Vol. **49**, 1998, pp. 187–222.

Web of Science® | Google Scholar

Stiglitz, J. and Weiss, A., 'Credit rationing in markets with imperfect information', *American Economic Review*, Vol. **71**, 1981, pp. 393–410.

Web of Science® | Google Scholar

Stulz, R., 'Managerial discretion and optimal financing policies', *Journal of Financial Economics*, Vol. **26**, 1990, pp. 3–27.

Web of Science® | Google Scholar

Vogt, S., 'The cash flow/investment relationship: evidence from U.S. manufacturing firms', *Financial Management*, Vol. **23**, 1994, pp. 3–20.

Web of Science® | Google Scholar

Vogt, S., 'Cash flow and capital spending: evidence from capital expenditure announcements', *Financial Management*, Vol. **26**, 1997, pp. 44–57.

Web of Science® | Google Scholar

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Download PDF

ABOUT WILEY ONLINE LIBRARY

Privacy Policy
Terms of Use
About Cookies
Manage Cookies
Accessibility
Wiley Research DE&I Statement and Publishing Policies

HELP & SUPPORT

Contact Us
Training and Support
DMCA & Reporting Piracy
Sitemap

OPPORTUNITIES

Subscription Agents
Advertisers & Corporate Partners

CONNECT WITH WILEY

The Wiley Network
Wiley Press Room

Copyright © 1999-2026 John Wiley & Sons, Inc or related companies. All rights reserved, including rights for text and data mining and training of artificial intelligence technologies or similar technologies.

WILEY

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences
Accept All
Reject Non-Essential