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A Unified Theory of Tobin's *q*, Corporate Investment, Financing, and Risk Management

PATRICK BOLTON, HUI CHEN, NENG WANG

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ABSTRACT

We propose a model of dynamic investment, financing, and risk management for financially constrained firms. The model highlights the central importance of the endogenous marginal value of liquidity (cash and credit line) for corporate decisions. Our three main results are: (1) investment depends on the ratio of marginal q to the marginal value of liquidity, and the relation between investment and marginal q changes with the marginal source of funding; (2) optimal external financing and payout are characterized by an endogenous double-barrier policy for the firm's cash-capital ratio; and (3) liquidity management and derivatives hedging are complementary risk management tools.

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