Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have

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This paper considers a firm that must issue common stock to raise cash to undertake a valuable investment opportunity. Management is assumed to know more about the firm's value than potential investors. Investors interpret the firm's actions rationally. An equilibrium model of the issue-invest decision is developed under these assumptions.The model shows that firms may refuse to issue stock, and therefore may pass up valuable investment opportunities.The model suggests explanations for several aspects of corporate financing behavior, including the tendency to rely on internal sources of funds, and to prefer debt to equity if external financing is required. Extensions and applications of the model are discussed.

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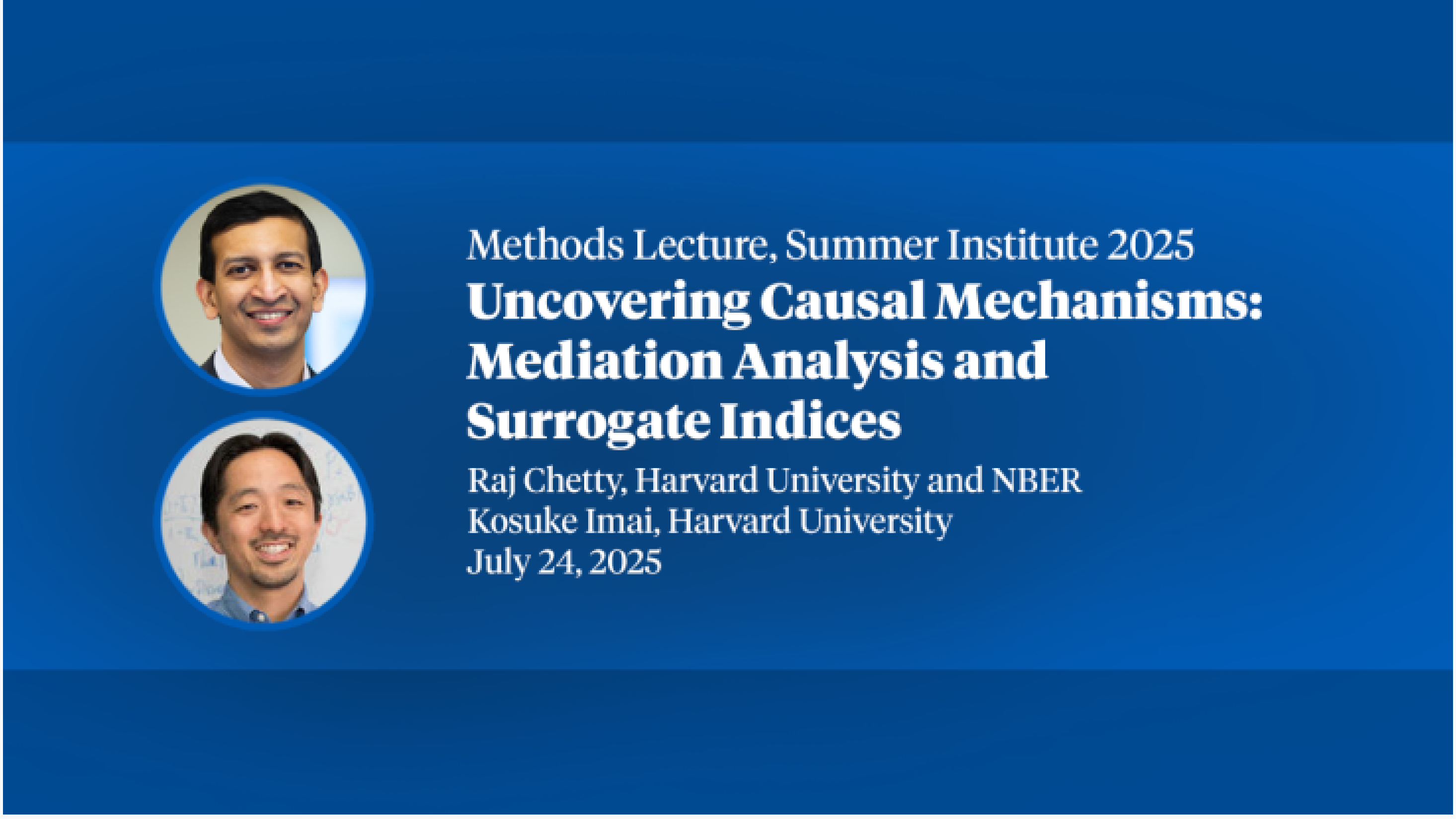

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