

[← Working Papers](#)

Financing Constraints and Corporate Investment

Steven Fazzari, R. Glenn Hubbard & Bruce C. Petersen

SHARE



WORKING PAPER 2387

DOI 10.3386/w2387

ISSUE DATE September 1987

Most empirical models of investment rely on the assumption that firms are able to respond to prices set in centralized securities markets (through the "cost of capital" or "q"). An alternative approach emphasizes the importance of cash flow as a determinant of investment spending, because of a "financing hierarchy," in which internal finance has important cost advantages over external finance. We build on recent research concerning imperfections in markets for equity and debt. This work suggests that some firms do not have sufficient access to external capital markets to enable them to respond to changes in the cost of capital, asset prices, or tax-based investment incentives. To the extent that firms are constrained in their ability to raise funds externally, investment spending may be sensitive to the availability of internal finance. That is, investment may display "excess sensitivity" to movements in cash flow. In this paper, we work within the q theory of investment, and examine the importance of a financing hierarchy created by capital-market imperfections. Using panel data on individual manufacturing firms, we compare the investment behavior of rapidly growing firms that exhaust all of their internal finance with that of mature firms paying dividends. We find that q values remain very high for significant periods of time for firms paying no dividends, relative to those for mature firms. We also find that investment is more sensitive to cash flow for the group of firms that our model implies is most likely to face external finance constraints. These results are consistent with the augmented model we propose, which takes into account different financing regimes for different groups of firms. Some extensions and implications for public policy are discussed at the end.

[Download a PDF](#)

[Information on access](#)

Acknowledgements and Disclosures

Citation and Citation Data

Published Versions

Fazzari, Steven M., R. Glenn Hubbard, and Bruce C. Petersen. "[Financing Constraints and Corporate Investment](#)." From *Brookings Papers on Economic Activity*, Vol. 1, pp. 141-195, (1988). citation courtesy of [RePEc](#)

Related

PROGRAMS

Monetary Economics

Public Economics

More from the NBER

In addition to [working papers](#), the NBER disseminates affiliates' latest findings through a range of free periodicals — the [NBER Reporter](#), the

NBER Digest, the Bulletin on Health, and the Bulletin on Entrepreneurship — as well as online conference reports, video lectures, and interviews.



Martin Feldstein Lecture, Summer Institute 2025
The Fiscal Future

N. Gregory Mankiw, Harvard University and NBER
July 10, 2025

2025, 17th Annual Feldstein Lecture, N. Gregory Mankiw, "The Fiscal Future"

FELDSTEIN LECTURE

PRESENTER: [N. GREGORY MANKIW](#)

N. Gregory Mankiw, Robert M. Beren Professor of Economics at Harvard University, presented the 2025 Martin Feldstein...



Methods Lecture, Summer Institute 2025

Uncovering Causal Mechanisms: Mediation Analysis and Surrogate Indices



Raj Chetty, Harvard University and NBER
Kosuke Imai, Harvard University
July 24, 2025

2025, Methods Lecture, Raj Chetty and Kosuke Imai, "Uncovering Causal Mechanisms: Mediation Analysis and Surrogate Indices"

METHODS LECTURES

PRESENTERS: [RAJ CHETTY](#) & [KOSUKE IMAI](#)

SlidesBackground materials on mediation
Imai, Kosuke, Dustin Tingley, and Teppei Yamamoto. (2013). “Experimental Designs...



International Trade and Macroeconomics, Summer Institute 2025

Panel on The Future of the Global Economy

Oleg Itskhoki, Harvard University and NBER
Paul Krugman, City University of New York and NBER
Linda Tesar, University of Michigan and NBER
July 8, 2025

2025, International Trade and Macroeconomics, "Panel on The Future of the Global Economy"

PRESENTERS: [OLEG ITSKHOKI](#), [PAUL R. KRUGMAN](#) & [LINDA TESAR](#)

Supported by the Alfred P. Sloan Foundation grant #G-2023-19633, the Lynde and Harry Bradley Foundation grant #20251294...

National Bureau of Economic Research

Contact Us

1050 Massachusetts Avenue
Cambridge, MA 02138
[617-868-3900](tel:617-868-3900)
info@nber.org
webaccessibility@nber.org

Homepage

[Accessibility Policy](#)
[Diversity Policy](#)
[Privacy Policy](#)

FOLLOW



© 2026 NATIONAL BUREAU OF ECONOMIC RESEARCH. ALL RIGHTS RESERVED.