

[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



Download Citation



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 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 Retirement and Disability](#), the [Bulletin on Health](#), and the [Bulletin on Entrepreneurship](#) — as well as online conference reports, [video lectures](#), and [interviews](#).



15<sup>th</sup> Annual Martin Feldstein Lecture:

**The Next Flight of the Bumblebee:  
The Path to Common Fiscal Policy  
in the Eurozone**

Mario Draghi, former President, European  
Central Bank and former Prime Minister, Italy  
Summer Institute, 2023

**2023, 15th Annual Feldstein Lecture, Mario Draghi, "The Next Flight of the Bumblebee: The Path to Common Fiscal Policy in the Eurozone"**

#### LECTURE

Dr. Mario Draghi, who served as President of the European Central Bank and Prime Minister of Italy, presented the 2023...



Methods Lecture:

## **Linear Panel Event Studies**

Jesse M. Shapiro, Harvard University and NBER

Liyang Sun, CEMFI

July 28, 2023

### **2023 Methods Lectures, Jesse Shapiro and Liyang (Sophie) Sun, "Linear Panel Event Studies"**

#### LECTURE

Overview: Linear panel event studies are increasingly used to estimate and plot causal effects of changes in policies...



Panel Discussion:

## **Long-Term Dynamics of the Employment-to-Population Ratio**

Karen Glenn, Social Security Administration

Stephen Goss, Social Security Administration

Nicole Maestas, Harvard University and NBER

Julie Topoleski, Congressional Budget Office

July 26, 2023



### **2023, SI Economics of Social Security, Panel Discussion, "Long-Term Dynamics of the Employment-to-Population Ratio"**

Supported by the Alfred P. Sloan Foundation, the National Science Foundation, and the Lynde and Harry Bradley...

## **National Bureau of Economic Research**

### Contact Us

1050 Massachusetts Avenue  
Cambridge, MA 02138  
617-868-3900  
info@nber.org  
webaccessibility@nber.org

### HOMEPAGE

### Accessibility Policy

### Diversity Policy

### Privacy Policy

### FOLLOW

