

Asset Pricing and High Cash Flow Investment

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Abstract

We find the validity of the investment-based asset pricing model only for high cash flow investment and the model is inappropriate for low cash flow investment based on the panel data of Japanese manufacturing firms from 1985 to 2007. Abel and Eberly (1994) construct the model which incorporate inaction region where capital investment does not respond to the average q . We insist inverse relation of Abel and Eberly that the average q responds only to the high cash flow capital investment. We also test the model specification and reject the linear capital investment function with q which is most popular in the empirical studies on capital investment.