Financial Constraints, Macroeconomic Fluctuations, and Targeting Behavior: Evidence from Financing Decisions

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Abstract

This study investigates whether financial constraints and macroeconomic fluctuations affect firms' rebalancing behavior of capital structures toward a target. Examining data for Japanese listed firms from 1980 to 2007, we find that the likelihood of adjustment by issuing debt is smaller for financially constrained firms than unconstraint ones during the economic boom of bubble and post-bubble periods but similar to that in the case of a recession. Our results indicate that larger firms adjust faster than smaller ones during an economic expansion, however, there is no difference during credit crunch periods. We also find that cash holdings have a positive effect on firms' debt-retirement for larger firms during the recession, but have no effect for smaller firms, suggesting that larger firms preserve the debt-capacity by using cash holding whereas smaller firms preserve cash for their future investment needs. These findings suggest that macroeconomic fluctuations, financial flexibility, and financial constraints affect firms' rebalancing behavior.

Keywords: Financial constraints, Debt capacity, Transaction costs, Financial flexibility, Supply Shock
JEL Classification: G10, G20, G32

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