An empirical test of the precautionary motive: Is the conventional characterization correct?

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This paper examines whether the conventional characterization of the precautionary motive—that firms hold cash to avoid missing investment opportunities in the face of future liquidity shocks—is empirically supported using a firm–bank matched panel dataset of 21,061 firms in Japan. The major findings of this paper are as follows. First, firms hold cash for future investment. Second, this tendency is more pronounced for firms that face liquidity shocks and have more investment opportunities. Third, firms hold cash not to avoid missing investment opportunities per se, but to avoid missing such opportunities in the face of future liquidity shocks.

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