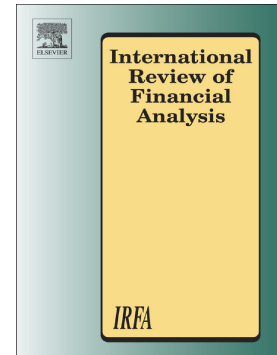


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Asset Liquidity and Firm Innovation

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Abstract

In this paper, we examine the effects of asset liquidity on innovation investments. We show that firms with highly liquid assets tend to invest more in research and development (R&D) and to generate higher numbers of patents and patent citations. These findings hold even after controlling for cash holdings, stock liquidity, and firm characteristics. We hypothesize that the positive effect of asset liquidity on innovation is because this liquidity can help firms reduce the cost of capital. Consistent with this hypothesis, we find that the effect is more pronounced for firms with high cash-flow uncertainty or less capacity to access external equity capital. Overall, our findings show that asset liquidity is an important determinant of innovation.

JEL classification: G31, G32, O32

Key words: asset liquidity, cash flow uncertainty, cost of capital, innovation, R&D investment

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