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Sunmin Kang, Intae Hwang, Sooyoung Song

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Cash hoarding: Vice or virtue

Sunmin Kang[1], Intae Hwang[1], and Sooyoung Song[1,*]

[1] College of Business and Economics, Chung-Ang University, 84 Heuksog-ro, Dongjak-gu, Seoul, Republic of Korea 06974.

ABSTRACT

A neo classical model is proposed to highlight the firm's endogenous allocation decision over the liquid asset versus capital asset to the extent of firm size and liquidity shortage. Liquidity shock has a long lasting vestige on the firm's cash holding policy in the aftermath of Great recession. We conduct difference in difference regression to test the effect of firm size and the severity of economic crisis on the cash hoarding. Encompassing 85,559 firm-years from the eight countries spanning from 2002 to 2015, we find precautionary demand prevails among the small firms while transaction cost concern matters for large firms a posteriori 2008 as postulated in the proposed model. As the declining capital asset return entails liquidity hoarding, unilateral governmental sanction against the cash-hoarding may exacerbate investment among the small firms.

JEL classification: D92, F38, G01, G15, G18, M48

Keywords: Cash-hoarding, Precautionary demand for Liquidity, Transaction cost, Diminishing Capital asset return, Liquidity dry-up, Difference in Difference method.

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* Corresponding author
Sooyoung Song Ph.D.
Chung-Ang University
84 Heuksog-ro, Dongjak-gu, Seoul, Republic of Korea 06974
82-10-3036-5645
sosong61@cau.ac.kr

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