Essays on Corporate Investment and Macroeconomics
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1 Uncertainty, Financial Frictions, and Investment Sensitivity to Cash Flow (job market paper)

This paper introduces investment timing options into the long-standing discussion regarding the relationship between corporate investment sensitivity to cash flow (ISCF) and financial frictions. I develop a dynamic, stochastic model in which firms possess an option to delay investment. My model predicts that a higher degree of financial frictions decreases ISCF by reducing firms’ borrowing capacity. Meanwhile, more financial frictions also diminish the option value of delaying, encouraging firms to invest sooner rather than later; as a result, ISCF increases. The relative strength of these two countervailing forces depends on the distribution of heterogeneous agents. Furthermore, I introduce uncertainty as an additional determinant of ISCF. Heightened uncertainty decreases ISCF as it enhances the option value of delaying. Empirical work studying U.S. listed firms over the past 30 years confirms these predictions. In addition, I investigate the Bonus Depreciation policy (which boosted after-tax cash flow); results suggest that reducing uncertainty improves policy effectiveness.

2 Financial Shocks and Corporate Investment in Emerging Markets (joint with Nicolas E. Magud and Fabian Valencia)

We examine how cross-firm and cross-country heterogeneity shapes the responses of corporate investment in emerging markets to U.S. monetary policy and financial-market volatility shocks. Specifically, we find that in response to external financial shocks, financially weaker firms reduce investment by more than financially strong firms. We also demonstrate that firms with stronger balance sheets tend to delay investment voluntarily following volatility spikes. Finally, we demonstrate that stronger macroeconomic fundamentals (lower public debt or higher foreign reserves) help to buffer corporate investment from U.S. financial shocks.

3 On Bank Consolidation in a Currency Union (joint with Fabio Di Vittorio and Hanlei Yun)

We focus on the impacts of diversification on bank performance and how consolidation through mergers and acquisitions (M&A) affects the banking sector’s stability in the Eastern Caribbean Currency Union (ECCU). We find that a lower level of loan portfolio diversification explains higher non-performing loans, higher earnings volatility and higher bankruptcy probability of indigenous banks, as compared to foreign competitors in the ECCU. We then simulate bank mergers both within and across ECCU countries by combining individual banks’ balance sheets. Our simulation shows that a typical indigenous bank could better diversify against its idiosyncratic risk by merging with other banks across the border. In addition, we assess the potential consequences of M&A, which lead to a more asymmetric banking sector, on systemic risks.