

*Opinion Article***Productivity and liquidity control in the face of expensive funding**

Christoph Kirchler\*

Department of Banking, University of Innsbruck, Innsbruck, Austria.

Received: 14-Nov-2022, Manuscript No IJBEF-22-83969; Editor assigned: 16-Nov-2022, PreQC No IJBEF-22-83969 (PQ);  
Reviewed: 30-Nov-2022, QC No. IJBEF-22-83969; Revised: 14-Dec-2022, Manuscript No IJBEF-22-83969 (R); Published: 21-Dec-2022.**DESCRIPTION**

In the context of financial frictions, we investigate theoretically and empirically the connection between company productivity and liquidity management. We develop a dynamic investment model and demonstrate that, in contrast to conventional wisdom, more productive firms may hold more liquid assets compared to less productive firms when financing costs are sufficiently high and demand less capital assets. Using a large dataset of Chinese manufacturers, we empirically evaluate this hypothesis and discover that highly productive firms actually store less capital and more cash (Acemoglu 2012). However, we do not notice this for US producers. Our research reveals that markets with considerable financial frictions have a worse problem with capital misallocation than has previously been recognised (HammamiY 2014).

Allocating resources is one of the most important decisions that businesses make. In general, businesses either devote resources to holding liquid assets like cash, receivables, and inventory or to acquiring capital assets like land, factories, and machinery. The return on capital assets is typically risky and varies substantially among businesses with various productivity levels. Contrarily, liquid assets often produce a constant, risk-free return. The productivity of capital and the cost of financing naturally (HirshleiferD 2013) determine how much to invest in expansion versus liquidity. When funding is extremely expensive, as it is for businesses in emerging nations, this decision of how to best deploy limited resources is especially important (Hoggson 1926). This study looks at how organisations with varying levels of productivity divide their resources between capital assets and liquid assets in the presence of expensive financing, both theoretically and practically. To investigate the joint decision of capital investment and liquidity management, we create a manageable continuous time model. In the concept, businesses divide their resources between retaining cash, which generates a risk-free return for all businesses, and investing in capital, which provides hazardous returns that vary for businesses based on their productivity. Companies must refinance when their overall

assets are too low and pay dividends when their total assets are high enough. Companies like to distribute dividends early because future dividends are discounted (Lipton 2009). However, because refinancing is expensive, businesses want to keep reserve funds on hand. Therefore, a balance between paying out (and consuming) early and avoiding expensive refinancing is what optimal liquidity management entails.

When finance frictions are severe enough, it may be desirable for highly productive enterprises to have less capital and more cash, according to the model's startling finding. The fundamental process is that more productive enterprises endogenously decide to pay out at lower asset levels in equilibrium. Compared to less productive enterprises, they are able to accelerate consumption thanks to their higher output. The necessity for a refinance is accelerated as a result. As a result, high productivity companies are more risk adverse and rely on their financial reserves to lessen the danger of downsizing. The risk aversion of high productivity enterprises overrides their relative capital holding advantage when financing becomes sufficiently expensive. In underdeveloped markets, there is a positive link between company productivity and liquid assets/cash holdings, which is a theoretical prediction that may be empirically tested (Loutskina E 2011). This conclusion is in contrast to that reached in a situation where there is no financial friction, where fundamental economic intuition says that capital should be acquired by more productive enterprises. Using a sizable sample of Chinese manufacturing companies from 1999 to 2007, we test our hypothesis. According to our research, businesses in the greatest productivity decile typically have net liquid to total assets ratios that are 32% higher and cash to total assets ratios that are 21% higher than those in the lowest decile. No matter the firm's size, ownership structure, industry affiliation, or method used to gauge productivity and liquidity, this pattern is extremely strong and visible.

**REFERENCES**

1. Acemoglu (2012). The network origins of aggregate fluctuations. *Econometrica* 80: 1977-2016.

---

\*Corresponding author. Christoph Kirchler, E-mail: [christopk.kirchler@uibk.ac.at](mailto:christopk.kirchler@uibk.ac.at)

2. Hammami Y (2014). An intertemporal capital asset pricing model with bank credit growth as a state variable. *J Bank Finance*.
3. Hirshleifer D (2013). Innovative efficiency and stock returns. *J Financ Econ*.
4. Hoggson (1926). *Banking through the ages*, New York, Dodd, Mead & Company.
5. Lipton (2009). For banks, wads of cash and loads of trouble". *the new york times*. macon, ga. Retrieved.
6. Loutskina E (2011). The role of securitization in bank liquidity and funding management. *J Financ Econ*.