Executive Summary

The identification of financial constraints as the source of cash flow sensitivity of investment (ICFS) has been intensively debated in the literature and appears to understate the complex relationship of firm's ICFS with its environment. Recently, the impact of the macro-environment on ICFS has been established and confirms the need in further analysis of the interactions that drive firms' ICFS. This research intends to uncover the effects of the country and firm's characteristics on investment and ICFS, and extend the understanding of firms' sensitivity according to the cross effect of micro-characteristics and macro-environment.

A new perspective in the field of ICFS is provided in this research by considering two dimensions that potentially impact firms' ICFS. The first dimension concerns the macro-environment of firms and, therefore, the sample is expanded to 11 countries with contrasting levels of financial and economic development as well as 9 economic sectors with different levels of capital expenditures. The second dimension refers to the firm's characteristics that can be associated to different steps in the corporate life cycle and, therefore, the analyses are performed with a methodology allowing the allocation of firms according to their ICFS level. Consequently, this new perspective enables a global assessment of the determinants of ICFS.

The findings of this research reveal the importance of a cross effect of the micro-characteristics and macro-environment of the firm on investment and ICFS. Firstly, the country has an impact on the level of investment and the effects of firm's characteristics on investment differ across countries. Secondly, only in some countries, firms appear to display distinct level of investment or ICFS when the observations are pooled per country. However, when firms are segregated according to their level of ICFS, they show either distinct level of investment or ICFS which unveils the importance of the firms' micro-characteristics on ICFS. Thirdly, every country and every industry appear to be associated with different levels of ICFS which demonstrate the importance of the macro-environment on ICFS. Therefore, the determinants of ICFS are significantly related to the micro-characteristics and the macro-environment of firms, and this finding reveals the cross effect underlying the level of ICFS.

The results are consistent with the literature related to the impact of the financial development and the financial system on investment. They also accord with the recent findings that uncovered the importance of the financial development and the creditworthiness of the industry on ICFS. Some caution is needed with the novel methodology used in this research as it partially capture the intended effects only. Essentially, by the means of this new perspective, the cross effect of the micro-characteristics and macro-environment of the firm on the level of ICFS is demonstrated and gives a new empirical background for further research about the cash flow sensitivity of investment.