Macroeconomic Risk and Financing Asset Sales*

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Abstract

This paper investigates the role of financing asset sales in an economy with macroeconomic risk. Compared to issuing new equity, selling assets increases leverage which transfers value from bondholders to equity holders. We explore the implications of this value transfer on the equity holders' endogenous investment and financing choice. Our structural equilibrium model generates several novel predictions for typical firms and a model implied economy: First. the value transfer is particularly pronounced for firms with a high leverage compared to firms with a low leverage. Therefore, equity holders of highly leveraged firms are more likely to finance investments by selling assets than by issuing equity. Second, firms have a higher leverage during recession than during boom at the time of investment. Hence, asset sales are a more frequently used to finance investments during recession. Third, the latter prediction is more pronounced for firms with a relatively higher payout from investment during recession. To verify the predictions from our theory, we explore firm characteristics that determine financing asset sales using a large sample of U.S. Compustat firms.

JEL Classification Numbers: D92, E44, G12, G32, G33.

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