The Uncertainty of Economic Policy, Working Capital and Innovative Investment

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Abstract: The uncertainty of economic policy makes it difficult for enterprises to judge the development trend of the market, and at the same time causes the problem of financing, so enterprises will give priority to meeting the normal business needs of enterprises and reduce the investment in innovative activities. Based on the background of Epidemic Situation, this paper discusses the impact of economic policy uncertainty and working capital on enterprises’ innovative input.

1. Introduction

Today, China’s economy faces many uncertainties. Domestically, China is in a crucial period of transition, with slower growth, a worsening economy exacerbated by the spread of the epidemic, and companies facing problems such as insufficient productivity, falling domestic demand and falling exports. Gulen et al [1] that in a stable market environment, macroeconomic policy will affect the operation of micro-economies [1]. There are potential risks caused by uncertain events in the operation of micro-enterprises, and innovation is the internal power of long-term development of enterprises. The sino-us trade friction causes our country to realize in the core technology the disparity with the developed country. Huo Yuan et al [2][5][7] hold that it is important to study how micro-enterprises enhance their independent innovation ability in the new period for the high-quality development of China's macro-economy [2]. In recent years, China has stepped up its support for innovative projects, and President Xi has repeatedly stressed that “key core technologies are of great importance to the country”. Technological innovation as a measure of the core competitiveness of countries around the world, is one of the important factors affecting contemporary economic development. The frequent changes of national macro-economic policy increase the uncertainty that micro-enterprises face, and then affect the development of enterprises. The degree to which the uncertainty of economic policy affects the innovative investment of enterprises is related to the achievement of China’s economic transformation.

2. Literature Review

There are abundant studies on the impact of economic policy uncertainty on micro-enterprises. The relevant scholars start from the aspects of enterprise investment, enterprise financing, resource allocation and cash holding, etc [3-4], this paper explores the mechanism of the impact of economic policy uncertainty on micro-enterprises from different perspectives, and holds that economic policy uncertainty has a positive impact on the investment, financing and resource allocation of enterprises. On the impact of economic policy uncertainty on enterprises’ innovative input, based on financing constraint theory and real option theory, this paper mainly studies from the perspectives of government subsidy, enterprise financialization, financial flexibility, labor cost [5-6] and media attention, but there are few studies on the relationship between enterprise working capital and innovative input. The Enterprise investment includes the basic investment and the expansionary investment. The working capital of the enterprise first meets the needs of the basic investment. Because there is a squeeze effect between the use of funds, the investment of both sides can not be guaranteed at the same time, that ultimately leads to less innovation. Therefore, the study of the
impact of working capital on innovative investment under the uncertainty of economic policy will help enterprises to better resource allocation.

2.1 Uncertainty of Economic Policy and Enterprise Innovation

The domestic economy is sluggish due to the development of the epidemic and the warming of trade between China and the United States, and the government may introduce some policies to stabilize the market, such as the soaring of the M2 of the central bank in May. Governments usually use various means to regulate the economy, but too frequent regulation will lead to policy uncertainty, not to achieve the effect of regulation will harm the normal development of the economy. At the same time, the change of government officials will also cause economic policy uncertainty. Different officials have different styles of governing, and different ideas will shape different economic policies.

Scholars at home and abroad have different views on the impact of economic policy uncertainty on enterprises’ innovative input. As economic policy uncertainty rises, management is likely to be more concerned about the potential benefits and therefore to invest more. At the same time, innovative output can improve the core competitiveness of enterprises, so enterprises tend to increase innovative input. Gu Xiaoming found that firms with high productivity and high innovation ability can significantly increase their long-term total revenue by increasing R&D investment when the uncertainty of economic policy increases[8]. Some scholars have found that the replacement of local mayors leads to the increase of investment in local enterprises, while others have found that the level of investment in non-state-owned listed companies has decreased significantly in the year of the replacement of municipal party secretaries[7]. There have been few studies on the promotion effect of economic policy uncertainty, and have not formed a more mature view. Based on the theory of real option, the investment opportunity of the firm is regarded as an option. When the uncertainty of economic policy is rising, the firm may delay investment to get more ideal option value, so it will reduce investment[9]. According to the mechanism of financial friction, the rising uncertainty of economic policy leads to the pessimistic attitude of financial institutions. In order to prevent risks, interest rates on loans and liquidated damages are raised, leading to an increase in the financing cost of enterprises, and therefore enterprises reduce their investments, financial frictions are likely to be greater for projects that are highly uncertain, such as innovative investment. Because of the asymmetry of information, the external investors can not know the internal R&D status, especially when the economic policy is uncertain, there is no guarantee that the enterprises will invest in R&D, so the external investors will reduce their investment in the enterprises, this in turn leads to companies not having sufficient funds to undertake innovative activities, thus reducing this type of investment. Under the precautionary savings mechanism, when economic policy uncertainty rises, firms increase cash reserves and reduce investment to avoid the impact of cash flow uncertainty[10]. Therefore, the uncertainty of Economic Policy will restrain the innovation input of enterprises.

2.2 Working Capital and Innovation Investment

In order to maintain the normal operation of an enterprise, it is necessary for an enterprise to have an appropriate amount of working capital. Therefore, working capital management is an important part of enterprise financial management. The influence of working capital on enterprise investment is mostly carried out from the smooth point of view, and it is not connected with macro-policy. The external financing restriction may cause the enterprise to the Internal Fund allocation unreasonable, thus appears the investment insufficient phenomenon. According to Fazzari et al. (1993) , there is a competitive relationship between working capital investment and long-term capital investment in the use of funds[11], that creates a crowding-out effect. In the face of economic policy uncertainty, enterprises will generally put the normal operation of enterprises in the first place, when working capital for enterprises’ innovative investment crowding out effect will be more obvious. Therefore, under the uncertainty of economic policy, enterprises will increase working
capital and reduce innovation investment in order to ensure normal operation. Working capital aggravates the inhibition of economic policy uncertainty on enterprise innovation input.

3. Conclusion

By combing the existing literature, domestic and foreign scholars based on the theory of Information asymmetry, from the quality of information, institutional environment, and other aspects of enterprise investment behavior. However, it is rare to combine the uncertainty of economic policy with working capital to study investment behavior. Based on the uncertainty of economic policy, this paper studies the impact of economic policy on enterprise innovation and working capital. Companies should be aware of the importance of innovation in the face of the epidemic and the impact of trade between the US and China. In order to realize sustainable development and deal with frequent changes of economic policy, we should innovate constantly and strengthen the construction of internal governance mechanism. In addition, we should strengthen the consciousness of working capital management, improve the level of working capital management, improve the use efficiency of internal funds, and increase the liquidity of internal funds.

References


