Abstract

Introduction

The development in Corporate Finance theory can be reviewed in two distinct phases. The first phase is up to 1950 and the later phase is post 1950. The Pre 1950, finance literature was comprised of ad hoc theories. These theories were riddled with logical inconsistencies and normatively oriented. Till 1959 the main focus of the theory was on Optimal investment, Financing and Dividend policies.

1950 onwards, the major development in the corporate finance theory began. Development gave rise to Efficient market Theory, Portfolio Theory, Capital Asset Pricing Theory, Option Pricing Theory, Agency Theory and like.

The techniques traditionally used in economics were harnessed to solve the problems in Finance. This led to the transition from normative questions to Positive theories capable of better understanding of consequences of choices made. In presence of a positive theory one can judge (weigh) the probable result, when an alternative course of action was favored.

The focused changed from normative questions like “What should be Financing, Investing, Dividend policies should be?“ to positive theories addressing to the questions like “What are the effects of alternative Financing, Investing, Dividend decisions on the value of the Firm?“ The Value preposition started gaining higher Significance.

The efficacy of theory is depends on understanding of the consequences of the choices made. Rational decisions are made with the help of explicit and implicit use of Positive theory. A Positive theory helps in analyzing the effects of alternatives available, on the objective.
The theory and evidence are rich and sensible enough to provide satisfactory redressal to many problems.

But all the questions are not answered by the corporate finance theory. A few of the unresolved questions are like…

1. The extent of Dividend to be paid to the Share holders.
2. The proportion of Debt and Equity in firm’s capital structure.
3. The maturity structure of firm’s debt instruments.

These are some of the unresolved questions, the theory has no satisfactory solution to these questions in corporate finance.

In this study an attempt is made, by the researcher, to ascertain whether select corporate finance theories lead to clarity of thought or not?

**Objective of the Study**

The above cited representative problems, as riddles, are being studied by many researchers. The exploratory research helps to address to these questions.

The researcher considered *Miller & Modigliani Approach* and *Net Operating Income* Approach (N O I Approach) as a **pilot study**.

A detailed review of the research papers / research articles was made. It was found that both the approaches are neither proved nor disproved. The findings of these approaches are not totally accepted neither totally rejected. There is no uniformity in the findings.
This inconsistency found in acceptance of theory/approach, in the pilot study result, lead the researcher to study further. The entire study is in the form of exploratory research. After studying many research papers and research articles pertaining to select corporate finance theories the researcher got convinced to make a hypothesis as “The development of theory of Corporate Finance is leading towards chaos and Confusion.”

There are several areas where the clarity of thought is lacking. For instance the standard text books in corporate finance considers preference shares in networth. The International Financing and Reporting Standards treats Preferred stock as Debt. Whether unsecured Loans are Considered in Current liability ? While evaluating the Capital budgeting decisions what should be the discounting rate ? Can cost of Capital be evaluated precisely ? Which method should be used to depreciate an asset and at precise what rate ? these are some of the persistent questions, which strengthen the hypothesis. What are the stages for the development of a theory is narrated as under.

The development of any theory takes places in a pattern, this pattern has a chronology viz.

Hypothesis → Concept → Approach → Theory → Facts (based on scientific base).

The development of corporate finance theory is no exception to this.

Any research study commences with the Hypothesis, which is an intellectual statement about an event, object or phenomenon. It is a supposition or proposed explanation based on the basis of limited evidence as a starting point for the further investigation.
Concept is a general idea derived or inferred from the specific instances or occurrences, something formed in mind, a thought or a notion.

Approach is a way of dealing with a situation or problem.

Theory- There is intricate relationship between theory and fact. Theory is confused with speculation, and theory remains speculation until, it is proved.

Facts- are thought to be definite, certain, without question and self-evident. Facts are empirically verifiable observations. Theory and fact are in constant interaction.

_Facts redefine and clarify theory._ Theory is a general expectation, while demographic facts are specific.

An effort has been made to study the select corporate finance theories, pertaining to viz.

A. The Financing Decisions

B. The Investing Decisions

C. The Dividend Decisions and

D. Other Decisions (Other Decisions are the theories which cannot be classified in A, B Or C)

in the light of the above mentioned points with respect to exploratory research carried out by various researchers, globally over a long period of time span.
The Methodology

Entire study is in the form of qualitative research. This study attempts to compile/ conclude the findings of other researchers, w.r.t. the select corporate finance theories.

The peculiarity of qualitative research can be cited as,

Qualitative Research is warranted where the **topic needs to be explored thoroughly and should not be viewed as a substitute for “Statistical “or “Quantitative Study”**. The researcher starts with a single idea or a problem, that he / she seeks to understand not a causal relationship of variables. The data is analyzed using multiple levels of abstraction that is researcher’s work is presented in a way that moves from particulars to general level of abstraction. The Presentation (Writing) is clear and full of unexpected ideas.

The modus operandi followed for the study is based on exploratory research carried out by global researchers and their research papers is the data for the presentation.

About 1500 Research Papers / Research Articles are accessed from Sources like Jstor, Science Direct, Scirus, SSRN etc., covering big period map. Then Papers, which can be classified as seminal papers, as well as their important critiques are selected.

The number of Research Papers thoroughly analyzed is 216. The Papers / Articles, having strong research methodology, which means clearly defined objective, Research Gap, Reliable and Adequate Data as well as exhaustive literature survey are selected and then chronologically sorted.

Normative statements were drafted for Analysis.

**Hypothesis Testing**

After thoroughly assessing the selected Research papers, the **Acceptance** of the Theory / Approach / Concept was denoted by \( A \). The **Rejection** of Theory / Approach / Concept was denoted by \( R \).

The Horizontalization technique was used to analyze the data.

Descriptive Statistics was used and mean values were calculated. When the value is 1 that signifies the Theory / Approach / Concept is accepted. Where as -1 value denotes, total rejection of the theory, and 0 value means the Theory / Approach / Concept is neither accepted nor rejected.

From the data analysis it was revealed that, in all the Theories / Approach / Concept, the mean value is negative and tending towards zero, which signifies neither total acceptance nor total rejection. This result proves the hypothesis of the study.

**Findings**

- Methodologically all the research papers are correct, yet no empirical universalization of any theory is observed.
- The Theory is developed on empirical evidence and for empirical evidence, large and reliable data is essential. In Corporate finance function, such large & reliable data is not
available. By data we mean Factual information, especially information organized for analysis or used to reason or make decisions.

- Historical Vs. Notional Data- Historical data is a past and notional data is a guess, at times not even an intellectual guess.

- Journey from conceptualization to theory is not getting momentum. In Corporate finance words are being loosely used for instance, M M Approach / M M Hypothesis, Signaling Theory etc, all these are in reality concepts.

- Finance is circularly moving from hypothesis to concept and back.

The present state is, Assumption + Assumption = Confusion.

This is the very reason that, there appears to be a state of confusion leading towards chaos. In the event of theoretical development, the process of demystification takes place and clarity in thought emerges. After thoroughly reviewing the data, researcher finds the lacuna between the theoretical wisdom and real life evidence, with respect to select corporate Finance Theories. The revisit to the corporate finance theory is not leading to definite conclusive inference. No Common thread is found while researcher made an effort to study the select corporate finance theories

**Conclusion**

What could be the major reason/s behind such a state of confusion, researcher assigned following reason/s, The notion of ‘Wealth is personal’ is a deterrent for availability of Data. At personal as well as Corporate level the data pertaining to wealth is not available, so notional data is used by almost all the Researchers. Data which needs to be made open in public domain, as a matter of
statutory requirement is revealed. The lack of data is a major limitation for the development of clarity.

However notional data can be rationalize, if the academic fraternity has an access to a large Data Repository. Economics has a large National Level data available hence the Science of Economics became more powerful.

While concluding the study some unresolved issues in corporate Finance theory have been cited.