CHAPTER 3: THEORETICAL FRAMEWORK AND LITERATURE REVIEW
3.1 Theoretical Models: Capital Structure

3.1.1 Modigliani and Miller's Propositions

A. M&M proposition I with no taxes

In 1958, Franco Modigliani and Merton Miller published their original article concerning capital structure. They have a convincing argument that a firm cannot change the total value of its outstanding securities by changing the proportions of its capital structure. The value of the firm will be the same, regardless which type of capital structure that is chosen. This is a strong argument where the authors explicitly or implicitly assume that:

- Capital markets are frictionless, which means that securities can be purchased and sold costless and instantaneously.
- Individuals can borrow and lend at the risk-free rate.
- There are no costs to bankruptcy.
- Corporations can issue only two types of securities, risky equity and risk-free debt.
- All corporations are assumed to be in the same risk class.
- There are no corporate or personal income taxes.
- There is no growth, all cash flow streams are perpetuities.
- Corporate insiders and the public have the same information, no signaling opportunities.
- There are no agency costs and managers always maximize shareholders' wealth.

This model is called the M&M proposition I, where the value of the unlevered firm is the same as the value of the levered firm. This means that the total value of any firm is independent of its capital structure (Modigliani and Miller, 1958). At first, with all the assumptions, the model seems unrealistic, but we will later show that even when some of the assumptions are relaxed the argument still holds.
B. M&M proposition II with no taxes

The M&M proposition II argues that the expected return on equity is positively related to leverage, and also that risk increases with leverage. Since we know that is constant for any capital structure, and that the return on debt is assumed to be constant, we can calculate the return on equity for different kinds of capital structure. The larger the amount of debt is, the larger required return on equity.

C. M&M proposition I with taxes

One of the more critical assumptions in the M&M Proposition I and II is that there are no taxes. This assumption is not very realistic, since basically every country taxes company income. The government has chosen to “subsidize” interest payments to providers of debt capital, which means that debt financing is tax deductible. In other words, a levered company pays less tax than an all-equity company does. When the assumption of no taxes is relaxed, the market value of the company increases by taking on more risk-free debt. Consequently the company should take on 100% debt to optimize company value. This is the M&M proposition I with taxes (Modigliani & Miller, 1963).

D. M&M proposition II with taxes

The firm value will increase with higher leverage since WACC will decrease, assuming that corporate taxes exist. It is seen that the larger the amount of debt, the higher the value of the firm, which implies that a 100% debt financing should be implemented (Copeland & Weston, 1992). It is important to keep in mind the restrictive assumptions that must be fulfilled for the M&M propositions to hold. The most important assumption is that the M&M propositions ignore bankruptcy costs, which have been found to exist in reality.
The M&M propositions have created a starting point for capital structure theory and today there are three models that have made it into the mainstream of corporate finance. Out of these models it is only the Tradeoff Model that provides an actual formula for calculating the optimal capital structure. The Pecking Order Hypothesis and the Signaling Hypothesis only try to explain observed patterns, not calculate an optimal capital structure level (Copeland & Weston, 1992).

3.1.2 The Trade-off Model

According to Modigliani & Miller (1963), firms would prefer to be 100% debt financed, to take full advantage of the tax shield. However, a 100% debt financing is not what can be seen in the real world, which is due to the fact that there is a cost to going bankrupt. In the M&M propositions it is assumed that there are no bankruptcy costs, and this has been shown to be an important determinant of capital structure. The trade-off model is based on the value of an unlevered firm, where the optimal capital structure is found at the trade-off point where the gain from adding additional debt is offset by the extra incurred cost of financial distress.

3.1.3 Pecking order hypothesis

While the trade-off model of corporate leverage has to be considered the “mainstream” choice as the dominant capital structure theory today, there are several embarrassing regularities in observed corporate behavior that it cannot explain.

Three real-world patterns are particularly hard to reconcile with even the most sophisticated trade-off model:

a. Within almost every industry, the most profitable firms have the lowest debt ratios, which is exactly opposite of what the trade-off model predicts;

b. Leverage increasing events, such as a stock repurchase and debt-for-equity
exchange offers, are almost invariably associated with large positive abnormal returns for a company's stockholders, while leverage-decreasing events lead to stock price declines. According to the trade-off model, these events should both net out to zero abnormal returns, since some firms will be below their "optimal" debt level when they increase leverage, while others will be above the optimum;

c. Firms issue debt securities frequently, but seasoned equity issues are very rare. Announcements of new issues of seasoned equity are invariably greeted with a decline in the firm's stock price (Myers & Majluf, 1984).

3.1.4 Agency Theorem

Another factor that can be added to the trade-off model is the agency cost, which arises due to conflicts of interests. There are two types of agency costs: agency costs of equity and agency costs of debt. Agency cost of equity has its roots in the simple argument that you will work harder if you are the owner of the company than if you were an employee. Also, if you own a larger percentage of the company, you will work harder than if you owned a smaller percentage of the company (Copeland & Weston, 1992).

Agency costs of debt occur because there is a conflict of interest between stockholders and bondholders. As a firm increases the amount of debt in the capital structure, bondholders begin taking on an increasing fraction of the firm's business and operating risk, but shareholders and managers still control the firm's investment and operating decisions. This gives managers a variety of different ways for selfish strategies, which will increase their own wealth, on behalf of the cost of the bondholders.

3.1.5 Signaling hypothesis

When valuing a company we cannot be sure that the market knows the return stream of the firm and can value this stream to set the value of the firm. What is valued in the market place is the perceived stream of returns for the firm.
However, managers of the firm have access to information about the firm that the public does not have access to. Therefore managers might elect to use financial policy decisions to convey this information to the market. The signaling hypothesis suggests that a higher financial leverage can be used by managers to signal an optimistic future for the firm. Unsuccessful firms cannot mimic these signals because such firms do not have sufficient cash flow to back them up (Ross, 1977).

3.2 Theoretical Models: Working Capital Management

This Section in fact, deals with the theoretical aspects of different Working Capital Policy and their Practical Implication for Pharmaceutical Firms. We have gone through four main dimensions of Working Capital Management: Cash Management, Management of Accounts Receivables, Management of Inventory and Management of Accounts Payables.

3.2.1 Cash Management

The most important of all the liquidity responsibilities of the financial manager is the managing of cash, both flows and balances. Cash is the benchmark of liquidity. This underscores the fact that the most important test of a financial manager is to maintain an adequate reserve of cash for all times so as to absorb the shocks of sporadic receipts and payments and meet the needs of emergency situation, otherwise paucity of cash even on a temporary phase may be cause a trouble. Concentration banking: It refers to a system of centralizing corporate cash with a goal of controlling the movement of funds and minimizing idle cash balances.

3.2.2 Cash Forecasts

A firm should forecast cash to anticipate cash surplus and shortage, estimate timing of borrowing and lending of funds and have better control over funds. Hedging Strategies: Hedging is important to protect the uncertainty associated with obtaining cash balances in time. One common strategy for hedging is
funding the firm's expected financing needs by the establishment of a reserve credit line with a bank or group of banks.

3.2.3 Receivable Management

Receivables occupy the second place, in order of investment, among the various components of working capital in manufacturing concerns. The manipulation of receivables is to push up sales and ultimately profits by allowing certain credit to the potential customers who otherwise may find it difficult to make cash purchases. Moreover, receivables are being near cash item improved the liquidity position of an enterprise. The financial significance of credit transaction is evidenced by statistics reporting that 20 to 25 percent of the typical manufacturer's total asset is receivables. As we know, the emergence of receivables in business operation cerates revenue and cost. Hence, the volume, composition and movements of receivables are required to be so designed and maintained that these ultimately helps maximization of the value of a firm which is the long standing and accepted principle of financial management.

3.2.4 Inventory Management

Inventory represents an investment and must, therefore, compete with other investment of the firm's. As a consequence, total investment in inventories must be related to some optimum investment level that contributes to the overall wealth maximization object of the shareholders. Since the proper management of inventory has a significant influence on profitability and liquidity, to a large extent, the success and failure of a business depends upon its inventory management performances.

3.3 Literature Review

Guthmann, Harry G.(1934)The author discusses changes in the working capital position of leading industrial corporations in the United States during the business recession of the 1920s and 1930s. Financial strength of the
largest business units outside of the public service and financial institutions;
Chief working capital items for leading industrialists.

Grimes, William H. (1940) Commercial and social progress, highly exemplified in America's record, has called for successive steps in broadening and liberalizing the field of mercantile financing--for accompanying advances in banking methods to meet the needs of men of initiative and ability. Because of the strength of their capital structure, many enterprises found commensurate unsecured bank credit available which would be liquidated by the customary turnover of their operations. When, in the process of liquidation of a manufacturer or seller of merchandise obtained settlement by notes or acceptances which were readily bankable, he found his financing problems very much simplified. Recognition of the collateral value of open accounts brought about the development of open account financing. Installment selling divides itself into two categories. The first, to which no great objection has been made, is found in the industrial field in connection with those products which may be termed income producing, or, in other words, which pay for themselves over a reasonable term through savings or earnings.

May, George O. (1943) The article focuses on corporate structures and federal income taxation. The extent, to which forms of capital structure have been allowed to affect liability for Federal income taxes, has long been a matter of surprise to many of those interested in theories of taxation. With the rise of tax rates it has become a matter of crucial significance. Quite apart from the excess profits tax, an American corporation, which today has outstanding, a 6% preferred stock of $1,000,000 must earn $100,000 before taxes in order to pay income taxes of 40% and have $60,000 left, with which to pay the dividend. By replacing the preferred stock with an issue of 5% bonds, the amount to be earned before taxes would be cut to $50,000 or exactly in half, since there would be no taxes but only the interest to be paid. Under present and recent laws such a difference would result even if the new bond were an income bond, interest on which would be payable only if earned. The tax paid by the individual recipient of interest, however, would be no different from that paid by the recipient of dividend. In England, on the
other hand, the tax liability of the corporation as well as of the individual would be unaffected by the fact that the capital took the form of bonds rather than stock.

Abbott, Charles Cortez (1944) This article discusses the working capital of manufacturing business during the transition from war to peace. It analyzes three aspects of the subject, the types of working capital that have been used to finance production during the war and their sources; the relation of contract termination to working capital; and the nature of working capital problems during the confusing period. The essence of the working capital problem of manufacturing industry during the transition period is that many firms will have to finance the liquidation of one type of business at the same time that they are financing the development of another type of undertaking.

Silverman, Herbert R. (1949) This article reports that Financing of accounts receivable represents a potential source of working capital of tremendous magnitude. Yet in many, perhaps most, industries this practice is not utilized to any great extent and indeed is avoided, largely because the average businessman is not familiar with this kind of financing or believes mistakenly that it carries an inevitable connotation of financial weakness on the part of the individual manufacturer using it. It is the purpose of this article to satisfy the desire for fuller knowledge of factoring which apparently exists in many quarters, and also to stir up some new curiosity about this particular method of financing accounts receivable for the sake of its broader implications. Several of the leading old-line factors have become publicly owned companies during the last 20 years, and considerable information is available about the volume of receivables acquired by these companies during that time, from their published annual reports and the information required to be furnished to the stock exchanges and the Securities and Exchange Commission.

Silbert, Theodore H. (1952) The paper defends the use of financing or factoring accounts receivable to facilitate the growth of a business. Access of
the business owner to additional working capital; Flexibility of the financing arrangement; Elimination of the need to attract outside capital.

Morton, Walter A.1(1954) The article investigates how bond, stock, and overall capitalization rates are affected by the capital structure of the individual corporation and by the structure of the capital market. There are inherent tendencies in the economy making for low interest rates on high-grade securities. These tendencies are re-enforced by the structure of the money market, by monetary policy, and by high personal income tax rates, and tax-exempt securities. Given this structure, a large supply of investment funds is likely to be continuously available for high-grade bonds even during periods of slack business, and corporate financial policy should be adapted to use such funds. Cheap money and so-called "tax savings," however, cannot be, and thus far have not been, the sole or even main determinants of corporate financial policy. The capital structure of individual companies, in their own and in the public interest, should be guided by cost of capital, by continued availability of funds, by preservation of credit standing, and by the objective of maintaining their continued solvency as a going concern.

Fan, Dennis K. K., So, Raymond W. (2000) In this paper, the results of a survey on capital structure decisions of Hong Kong listed firms are reported. It is found that Hong Kong firms conformed more to the "pecking order" principle than a target long term debt-equity mix in their financing decisions. Financial managers' preferences over alternative capital raising instruments are also investigated. The degree of information asymmetry and firm size are found to have impacts on the ranking of some factors governing capital structure decisions. However, signaling motivation does not play a role in managers' financing decisions.

Reierson, Roy L.1(1955) This article examines the future of the money market in the U.S. One of the major results of the Treasury Federal Reserve accord of March, 1951, was to make interest rates more responsive to fluctuations in economic conditions. Since that time, the economy has passed through a moderate cyclical movement encompassing a rise to the peak of a boom, a
subsequent decline and, now, signs of a renewed advance. Since the relationships among the many factors acting upon interest rates are affected with considerable complexity and interdependence, any appraisal of the money market outlook must be subject to a broad margin of uncertainty.

Perhaps the most far-reaching development of recent years is the renewed freedom of interest rates to respond to changing economic conditions. The improvement in business in the last quarter of 1954 was again accompanied by some slight firming of rates both in the bond and the money markets. That short-term rates should fluctuate with business conditions is not surprising, since changes in production and sales almost necessarily affect business borrowings from the banking system for inventory and other working capital purposes.

Sagan, John1(1955)This article discusses the role and function of the individual who is directly concerned with the management of cash that has been generated by the productive process. This can be restated as follows: raw materials are processed or services are channeled resulting in a product or service that is more valuable as measured by our price system than the original materials or the unchanneled services. In this productive process, labor is applied to raw materials which then become the finished inventory of the business. The net working capital of any corporation is the net current asset position or the excess of current assets over current liabilities. All cash, short-term investments, receivables, and inventories are totaled and this total is compared to the current liabilities such as short-term debt, accounts payable, federal income tax, and other current liabilities. While the basic working capital ratios are important to the financial analyst or to the creditor, they are of less importance to the money manager. On the other hand, the money manager who has a sizable net working capital that is primarily in inventories or accounts receivable might be forced to borrow funds in order to meet early obligations.

Dearden, John(1961) This article describes the techniques used in calculating the investments of a company division. Estimation on the amount of cash;
Calculations of the assets and liabilities; Estimation of the intracompany receivables and payables; Problems in using traditional techniques of calculating investment; Importance of reviewing the functions of working capital; Steps to follow in assigning working capital to the divisions.

Law, Warren A., Crum, M. Colyer (1963) This article focuses on the increase in the popularity of negotiable certificates of deposit (CD) among banks in the U.S. Trends on cash management and corporate finance; Factors contributing to the rise of CD; Nature and behavior of the market for CD.

Lerner, Eugene M.1, Carleton, Willard T.2 (1964) The article focuses on the integration of capital budgeting and stock valuation. It is widely recognized that a corporation's cost of capital cannot be determined until an analysis is made of how the market values the firm's common stock. There is, however, no widely accepted theoretical apparatus linking the market valuation of common stock to a corporation's investment, opportunities schedule, dividend payout function, and capital structure. The paper proposes that a fundamental reason for the current stalemate over the theoretical apparatus is the single-equation nature of recent capital-budgeting and security-valuation models. Since one equation can determine at most one unknown, manipulation of these models has, for the generation of results, necessitated a variety of ad hoc restrictions to reduce each equation to a relationship between two variables only, as, for example, between share price and capital structure. Two consequences emerge from the situation. Since there is no consensus, such restrictions tend to be different. More importantly, such variables as share price, capital budget, dividend payout and capital structure are in the real world jointly determined and the suppression of this dependency unnecessarily limits the relevance of any theoretical results.

Blumberg, Phillip I. (1965) The article explores the utilization of interim financing for providing short-term capital funds. Difference of interim financing from other financing methods; Effectiveness of interim financing; Provision of direct loans; Participation with banks and other conventional sources
of funds through the mechanism of a stand-by commitment; Kinds of collateral.

Corcoran, A. Wayne, Ching-Wen Kwang1,2(1965) This article discusses the set theory approach to funds-flow statement. Regardless of the definition of funds adopted, the usual first step in preparing a funds statement is the computation of the net change in funds. This requires a separation of balance sheet accounts into fund accounts (which enter directly into the computation of funds) and non-fund accounts (which do not). For convenience, funds are defined as working capital unless otherwise stated. Thus, current assets and current liabilities are the fund accounts and all other non-current accounts are the non-fund accounts which are referred to as non-current. Since accounts are defined in accounting, and since each is distinct from the others, the totality of all balance sheet accounts constitutes a set. The current accounts is referred to as the current set and the non-current accounts as the non-current set. The subdivision of a set into subsets in such a way that every element belongs to one, and only one, of the subsets is called a partition of the set. In other words, every member of the original set must be contained in one of the subsets and no member must belong to more than one subset.

Malloy, John P. (1968) According to the authors Modern Machine Works Inc. lost $58,000 on sales of $1,220,000 in the fiscal year 1964. By the end of the year its working capital had fallen to $94,000, its current assets to liability ratio was 1.6 to 1, and stockholders’ equity was $116,000. Those cold figures tell only part of the story of the turnaround achieved by this small manufacturer. This turnaround did not just happen. Contributing factors were many, but perhaps the vital one in the financial revival was the establishment of a computerized information system by which quality control was improved and costs were lowered. The company suffered its seventh year of losses in 1694 and recruited several capable and experienced managers and technicians. The executive group made an intensive survey of the company’s operations. Based on its analysis, management formulated a detailed five-year financial plan. Results were encouraging, and losses got reduced. The article
discusses this case to bring out the functioning and benefits of computerized cost control systems.

Haves III, Samuel L., Reiling, Henry B. (1969) The article focuses on the use of warrant as a financial tool for raising capital and implementing acquisitions. The business and financial communities have made increasing use of warrant options over the last few years, particularly in acquisitions and new debt offerings. The increased use of the warrant is in part a response to the same factors that produced the tide of convertible securities, and its use represents a natural extension of the use of convertible securities. Wider understanding of the warrant—particularly of its capacity to be tailored to specific corporate needs—has led issuers and their advisers to innovate in their use of it. For corporations, issuing warrants is much more attractive in certain circumstances than appending conversion features to debentures and preferred stock; and for public and private investors, the warrant has certain advantages not available in convertibles. Top executives and their advisers should become familiar with the factors behind this trend, since these factors could have far-reaching implications for capital structure planning and for the methods by which companies carry out new financings and make acquisitions.

Vance, Jack O. (1969) The purpose of this article is to review the important financial and nonfinancial danger signs for any management team to watch out for. Historical analysis indicates that four financial ratios, all of which can be calculated from data found in the financial statement alone, are the principal indicators of the degree of corporate vulnerability to a takeover attempt, liquidity, or percentage of working capital to total assets, debt position, or percentage of long-term debt to net worth, price-earnings ratio, usually calculated on the previous year's earnings until year-end forecasts begin to appear, and stability of earnings, usually figured on the basis of three years or more of near-level earnings. One of the most significant intangible factors that can make any company an acquisition target is a dominant market position in an attractive growth sector of the economy.
Lemke, Kenneth W. (1970) This article evaluates the need of liquidity measures for the analysis of predictive power of financial ratios. Empirical investigation of the predictive power of financial ratios has recently received considerable attention. Prognostic efficiency should, of course, be a function of analytical integrity. The apparent analytical simplicity of some financial ratios is deceptive, and searching reexamination of their rationale is a needful complement to empirical investigation of their utility. The need for liquidity measures is well known. If space permitted, evidence could be cited to show that from early this century to recent years, the current ratio has been almost venerated by accountants and other financial decision-makers as a prime criterion of liquidity. Numerous empirical studies in the U.S. report the current ratio as a key consideration in assessing creditworthiness or eligibility for a loan, and a certain minimum ratio has sometimes been mandatory. Contracts with lending institutions, bondholders, mortgages and preferred stockholders, often specify that the current ratio and/or the absolute amount of working capital must not fall below a certain level. To the extent that businessmen respect allocative criteria in order to obtain financing more easily, the current ratio may also help determine the firm's internal allocation of resources.

Curry, Dudley W. (1971) The article compares Opinion 15 with a financial reporting method for convertible debt. Corporate capital structures often include such securities as convertible debentures, convertible preferred stocks, and stock warrants. In many cases, these instruments possess a dramatic potential for suddenly creating a huge increase in the number of outstanding common shares and a severe dilution in earnings per share (EPS). In 1969 the Accounting Principles Board of the AICPA issued its lengthy Opinion 15, which utilized the common stock equivalent concept in prescribing when and how the dilutive effects on EPS in such cases should be shown on the face of the income statement. In order to illustrate some of the implications of this controversial Opinion and to offer a solution to the complex problems of satisfactorily reporting convertible securities in the financial statements of issuers, this article focuses on convertible debentures (CVDs). CVDs are unsecured bonds that may be exchanged for common stock of the
issuer at the option of the holder at a certain ratio and during a specified period.

Sihler, William W.1 (1971) This article is for the financial executive who would like to take advantage of the work of scholars and theorists but who has no time to absorb the literature himself. The debt equity issue that is how much debt a company should carry in its capital structure has been attacked in two ways. The more pragmatic approach puts its emphasis on the following factors sometimes known as flexibility, risk, income, control and timing in smaller companies. Control may be more important but, in any case, it is a straightforward problem to analyze. In smaller companies, control may be more important, but in any case, it is a straightforward problem to analyze. It is easy to see that adding debt to the capital structure, in the vast majority of instances, increases earnings per share more than does raising the same amount of money from common stock. Once interest is paid, all additional income goes to the existing shareholders and it does not have to be shared with newcomers. Risk can be associated with events that have happened in the past and that could happen again in the future. Because there are historic data, management can assess the probability and impact of these events. For example, it is not unreasonable for management to expect a recession from time to time.

Lyda, Thomas B. (1972) This paper presents guidelines for determining the working capital requirement for an expansion project of a business enterprise. Importance of realistic estimates of working capital requirements in venture analysis; Effect of accruing liability.

Gupta, Manak C.(1973) According to the authors most financial models make the traditional, and to a large extent arbitrary, distinction between short-term and long-term sources of finance and concentrate on two or at most three asset dimensions of the problem, mainly, cash, marketable securities and bank loans. Maintaining such strict correspondence between maturities of fund requirements and sources of finance has been found in the context of bank asset management to be clearly suboptimal. The arbitrary demarcation
of the fund requirements and financing into short and long term and the rigid imposition of constraints requiring matching of their maturities is unnecessary and leads to infra-optimal results. The notion of matching maturities, unfortunately, overlooks the important difference between the volatility of any particular investment and the minimum level of that investment. The notion that working capital, because of its highly volatile and short-term nature, can be financed only by short-term bank loans ignores the portfolio considerations of the problem, can be shown leading to suboptimal policy decisions, and is rejected in this article. The article discusses a portfolio approach to the whole problem and presents a multi-period optimization model that yields the cost minimizing sequence of financial policy decisions.

Merville, L. J.1, Tavis, L. A.2 (1973) According to the authors the current assets and current liabilities of a firm are the stock reflections of closely interrelated operational and financial cash flows. The net effect of these combined flows must be recognized in searching for the optimal credit, inventory, or short-term borrowing policies. Yet, the vast majority of models for short-term investment and borrowing decisions do not allow for the interrelationships of this system. This article presents a time-interlocked planning model wherein optimal credit, inventory, and borrowing decisions are selected as part of a "short-term funds subsystem." First, the critical credit-inventory linkage is outlined, followed by the borrowing component. The model is then formulated in a chance-constrained programming format with a transformation into a mixed-integer programming problem.

Herbst, Anthony F.1 (1974) This paper presents analytical evidence on the determinants of trade credit for a particular industry. As the empirical medium for investigation, the U.S. Lumber and Wood Products Industry is employed. Not only is it one of the 20 largest U.S. industries, but it approaches the norm of pure competition, at least in the output markets. The latter factor suggests that implications stemming from this research may more readily be integrated with that existing body of economic theory which provides a benchmark for comparison of divergent forms. Complications which in other industries spring from brand competition, impediments to entry to or exit from the industry, and
effects of any one firm's output decisions on market price, will be minimal in this industry. Further, since output is quite homogeneous across the industry and thus little basis for brand competition exists, we might a priori expect that other, more subtle means may be employed, such as different and changing trade credit terms.

Stern, Joel M.(1974) The article discusses key issues and developments relevant to earnings per share (EPS). Impact of corporate policies on EPS; Use of EPS as an indicator for making decisions on acquisition pricing and financing and capital structure planning; Determinants of a company's share price; Acquisition analysis; Benefits of debt financing; Implications for market efficiency.

Bierman, H.1, Chopra, K.2, Thomas, J.1(1975) This article is an attempt to interrelate working capital and capital structure decisions with working capital used not only as a buffer to avoid ruin but also to affect sales via changing inventory levels and credit policies. The possibility of ruin introduces a discontinuity that precludes perfect elimination of leverage effects via a market. In this article the acquired working capital serves as a buffer against ruin, as well as a means of increasing earnings, while the debt used to finance the working capital increases the size of the fixed payment obligations, and the cost of debt tends to reduce the total earnings of stockholders.

Skomp, Stephen E.1(1975) This study reviews and analyzes the developments in the commercial paper market from two standpoints. The total market is first divided into two sub-markets, directly placed paper and dealer placed paper. Then each submarket is analyzed according to market sectors consisting of institutional categories that best represent market participants within the given sub-market. This analytical approach assists in the development of empirical models for explaining behavior of each market sector. After completing this first stage of investigation and upon acceptance of a logical theoretical framework based on the theory underlying working capital management, empirical models are developed. Then ordinary least
squares is applied to financial market transactions data pertinent to each market sector to obtain empirical estimates of market supply and demand relationships for commercial paper within each sub-market. This empirical division of sub-markets into market sectors, more than any other factor, distinguishes the present study from those previously undertaken by others.

Townsend, James E. (1975) Reports of firms with working capital problems have been widespread in recent years, particularly since the Penn Central debacle, whose failure caused a genuine confidence crisis which spread rapidly throughout all segments of the financial markets. A survey of the literature produced little evidence which had sought to determine the impact of a company’s liquidity position on the market price of its common stock. This study first laid a theoretical framework for explaining possible effects of various levels of liquidity on equity values.

Archer, Simon1(1976) This article discusses on the information on a study which explores variables affected by the replacement cost adjusted accounting method. The foregoing analysis leads the authors to conclusions about Net Capital Maintenance Accounting using Specific Indices not dissimilar to those described by Coenenberg and Macharzina. They constitute a reassertion of the viewpoint expressed by Godley and Cripps and Kennedy, the main refinements being the demonstration that net holding gains are not part of operating profit, and the treatment of deferred tax. These conclusions represent a rejection of the position of Merrett and Sykes and Lawson, and indicate that Bourn had no sound theoretical basis for excluding holding gains and losses on debt-financed assets from his system of Asset Maintenance Accounting. The analysis casts further light on the deficiencies of the RCA approach was well justified. Two mutually reinforcing caveats are required with regard to the reporting of net holding gains/losses. First, while it has been shown that the creation of asset-based debt capacity gains entails the creation of net holding gains over time, it was also pointed out that the latter might be reported incorrectly in any one financial period, though in general one could expect them to be reported late rather than early. Second, the net
holding gains for any financial period are calculated by reference to the value of shareholders' equity and the gearing level at the start of that financial period.

Hagen, Kåre P.1 (1976) The article presents views of an economist, David Baron, who uses a stochastic dominance argument in an attempt to prove the validity of the M.H. Modigliani and H. Miller (M-M) approach. He uses the familiar two-firm paradigm where both firms have identical probability distributions for gross returns, and one firm is financed entirely by equity capital. If all equity investors in the levered firm also hold bonds in that firm or if all investors can borrow at the same nominal interest rate as firms, then he shows that in equilibrium both firms must have the same total market value. According to Baron, at an equilibrium in a perfect capital market two firms with identical probability distributions for gross returns must have the same total market value. This does not imply, however, that the equilibrium value of a firm is independent of its capital structure. In fact, the common market value of the two firms will in general be dependent on the debt-equity ratio in the levered firm. Thus, if the above conditions are not satisfied, firms' equilibrium values will depend on their capital structures.

Renner, Elmer J.(1976) This paper examines the physical and financial dimensions defining the operation of plants at full capacity. Variables of plant operation; Allocation of working capital using marginal income-marginal investment chart analysis; Profit-loss-financial effects of exercising options available in a company's business environment.

Morris, James R.1(1976) This paper explores one dimension of the risk associated with different maturity policies: the effects of bond maturity upon the variance of net income, and subsequently on the firm's cost of equity capital.
Carleton, Willard T.1, Silberman, Irwin H.2 (1977) Many studies in recent years have noted that—contrary to intuition and received theory—financial leverage (measured as the book value of debt/capital or debt/equity) and mean rates of return on equity vary inversely among firms and industries. Hall and Weiss (1967) and Gale (1972) found this phenomenon using corporate book earnings to compute rate of return, whereas Arditti (1967) and Nerlove (1968) generated similar results using stockholder returns. Recently, Baker (1973), utilizing corporate profits as his measure, also found the "wrong" sign for leverage effects in a single equation model but the "correct" sign in a simultaneous equations model. Unfortunately, the book rate of return on equity already reflects corporate financing choices made in light of underlying operating profit and risk characteristics. It is a principal proposition of this study that a more fruitful line of approach is to examine the relationship between these characteristics and the capital structure decision.

Belt, Brian1 (1978) This article describes the cash break-even point analysis, a technique that uses basic income projection data and represents a first step forecast of fund flows for the first year of operations of a business. This technique has a substantial ramifications for other areas such as required initial capital, working capital policy, capital structure, and other policy concerns. The cash break-even analysis is a forecasting tool which utilizes information used in projecting operating profits and scheduled returns of capital to determine the level of sales necessary to generate sufficient cash to cover fixed cash operating and financial requirements. The cash break-even point (CBEP) extends traditional break-even analysis into the critical area of the solvency of the firm. On the other hand, CPEB is the point where cash inflows from operations just equal cash outflows from operations plus returns of capital. The formula for CBEP and some sample computations are detailed in this article. It is also discussed the effect of taxation on CPEB.

Donaldson, Gordon1 (1978) The purpose of this article is to stimulate dissatisfaction with present-day conventions regarding debt capacity and to suggest the direction in which the opportunity for improvement lies. As long as long-term debt is avoided or kept to minor proportions, crude decision flies
providing wide margins of safety are quite adequate. As the proportions of
debt increase, however, the need for a sharper pencil and a more careful
analysis grows. This need is further reinforced by the increase in other kinds
of fixed cash commitments such as lease payments and the non-contractual
but nonetheless vital steady flows required for research dividends and the
like.

Kim, Yong H.1, Atkins, Joseph C.2(1978) This article provides a method for
evaluating investments in accounts receivable that is consistent with a wealth
maximization objective. The standard method of analysis, as found in
numerous financial management textbooks and articles, fails to adequately
measure the incremental net benefits of credit lengthening strategies. A
review of the literature on working capital reveals that the standard textbook
approach, or some variations thereof, continues to be indiscriminately
employed. A discounted net cash flow procedure for evaluating the profitability
of prospective credit programs circumvents the conceptual difficulties
surrounding the standard decision making framework. In particular, the net
present value approach permits an explicit specification of the exact timing of
cash inflows and cash disbursements associated with particular credit-sales
programs. Equally important, the discounted net cash flow approach does not
arbitrarily separate the pricing decision with respect to goods sold from the
credit decision. It is conceptually incorrect to analyze credit programs in
isolation of pricing schemes.

Yardeni, Edward E.1 (1978) This article estimates general disequilibrium
models of the various sub-sectors of the financial sector in the U.S. These
financial sub-sector models are primarily motivated by a dissatisfaction
with the single asset approach used to expand the financial sector of the
major macro-econometric models of the U.S. economy. The principal
shortcoming of these models is that they do not properly specify important
general equilibrium effects implied by portfolio wealth constraints and
substitution effects. Since the short-run coefficients are influenced both by
equilibrium and disequilibrium behavior their magnitudes and signs are rather
difficult to interpret. So as a starting point, the plausibility of the long-run
coefficients is first analyzed since these coefficients reflect purely equilibrium behavior. The short-run coefficients are examined to determine if the dynamics of the portfolio system leads to perverse short-run adjustment behavior. Moreover, the t-statistics of the short-run coefficients are then scrutinized for additional evidence regarding the significance of the estimated behavioral relationships.

Bhattacharya, Sudipto (1979) This paper assumes that outside investors have imperfect information about firms' profitability and that cash dividends are taxed at a higher rate than capital gains. It is shown that under these conditions, such dividends function as a signal of expected cash flows. By structuring the model so that finite-lived investors turn over continuing projects to succeeding generations of investors, we derive a comparative static result that relates the equilibrium level of dividend payout to the length of investors' planning horizons.

Cascino, Anthony E. (1979) This paper offers advice on more productive use of working capital. Causes of neglect in the control of working capital; Analysis of financial ratios; Effects of recession on a firm's finances; Importance and benefit of inventory management; Dilemma posed by price and sales volume.

Findlay III, M. Chapman1 (1979) The article discusses the valuation of components of a cash flow stream. An assumption of market inefficiency is necessary to invoke the Capital Asset Pricing Model. The application of the constant cost of capital is an alternative in subcontracting or leasing. However, a rough division followed by the application of the appropriate rates would be preferable. The systematic risk of an equity can be expressed as the systematic risk of revenue stream magnified by operation and financial leverage terms. This allows the manager to trade-off operating and financial leverage in common terms and accommodates the risk of working capital. Higher discount rates are employed on variable cost flows than on fixed costs because they are more desirable.
Goldman, Robert I. (1979) The paper discusses the widening acceptance of factoring and commercial finance as financing mechanisms for companies of small and medium size in the United States. Traditional use of commercial finance and factoring; Companies' use of the financing techniques to provide additional working capital.

Jochim, Timothy C. J. (1979) This article explores the economic viability of employee stock ownership programs (ESOP) in the U.S. ESOP operate through the trust instrument in order to qualify for tax deductions and preferences granted by Internal Revenue Code sections 401(a) and 501(a). The former makes company contributions to qualified pension, profit sharing and stock bonus plans deductible and gives tax preferences to the beneficiaries when the benefits are paid out, while the latter excepts qualified trusts from taxation on income when earned. Depending on how the transactions are viewed, tax dollars are either purchasing the stock for the employee trust, or providing the increased working capital for the corporation, or a combination of both. These same tax dollars could be used in alternative ways to stimulate employment or capital formulation. An increase in working capital should reasonably translate into increased investment or debt reduction and additional employment. Equity holdings for employees should contribute to increased employee commitment and loyalty to the company and thus improve productivity. The economic viability of employee ownership for the moderate-sized firm at a level comparable to if not slightly higher than conventional firms of the same size and industry is sound in theory and highly probable in fact.

Rappaport, Alfred J. (1979) A financial statement based on historical costs does not, of course, provide an adequate economic picture of a business during a time of inflation. But neither does the replacement cost information recently prescribed by the SEC, the author of this article asserts. He advocates the use of a distributable funds measure for more effective management control systems. 'Distributable funds' is defined as the maximum amount that the company can pay out to its stockholders during the fiscal
period without impairing its business capability. Distributable funds thus represent the total amount made available during the period for dividends and expansion of business capacity. The components of distributable funds are aftertax income during the fiscal period, a cost increase provision for productive capacity, any change in working capital required, and any change in debt capacity. A company's distributable funds depend on return on sales, growth in sales, net working capital requirements, the rate of cost increases in productive capacity, dividend payout percentage, and the company's target debt-equity ratio. The recommended approach enables management to assess the effects of its operating, investment, financing, and dividend decisions on corporate performance.

Larry Y. Dann (1981) This paper examines the effects of a common stock repurchase on the values of the repurchasing firm's common stock, debt and preferred stock, and attempts to identify the dominant factors underlying the observed value changes. The evidence indicates that significant increases in firm values occur within one day of a stock repurchase announcement. These value changes appear to be due principally to an information signal from the repurchasing firm. Common stockholders are the beneficiaries of virtually all of the value increments, but no class of securities examined declines in value as a result of the repurchase.

Wallace, Neil1 (1981) This article shows that the alternative paths of the government's portfolio consistent with a single path of fiscal policy can be irrelevant in precisely the sense in which the Modigliani-Miller theorem shows that alternative corporate liability structures are irrelevant. Irrelevance here means that both the equilibrium consumption allocation and the path of the price level are independent of the path of the government's portfolio. In section II of the article, the author describe conditions for a perfect-foresight and competitive equilibrium. The irrelevance proposition is presented and proved in section III of the article. The proposition establishes conditions under which the amount of the consumption good purchased by the government in the open market for fiat money and stored by the government is irrelevant. The
article also discusses the relationship between the fiscal policy assumptions used to obtain irrelevance and assumptions that are usually used to characterize an unchanged fiscal policy. The author considers by way of examples departures from assumptions of the irrelevance proposition.

Churchill, Neil C.1,2 (1982) Mr. Churchill examines eight serious financial problems small companies face during periods of inflation. He notes, for instance, that profits can wind up being overstated when depreciation expenses associated with fixed assets are understated. Similarly, revenues may rise, giving the appearance of steady growth, while unit sales are unchanged. Among the solutions he offers are closely monitoring profit margins and considering interest on working capital in the gross profit calculation. By taking inflation into account in reporting financial results and planning strategy, he suggests, a serious problem can sometimes be turned into an opportunity.

Gailen L. Hite and James E. Owers (1983) The study examines security price reactions around the announcements of 123 voluntary spin-offs by 116 firms between 1963 and 1981 involving a pro-rata distribution of the common stock of a subsidiary to the stockholders of the parent firm. The median spin-off in the sample is 6.6% of the original equity value and is associated with an abnormal return of 7.0% from 50 days prior to the announcement through completion of the spin-off. No evidence is found to indicate the gains to stockholders represent wealth transfers from senior security holders. Over the entire event period we find positive gains for firms engaging in spin-offs to facilitate mergers or to separate diverse operating units but negative returns to firms responding to legal and/or regulatory difficulties. In the two-day interval surrounding the first press announcement the study finds positive average excess returns for all groups.

Harrison, David D.1, Hernandez, William H.1 (1983) The article discusses how the impact of inflation on cash flow is being managed at Borg-Warner Chemicals Inc. Offseting the impact of inflation on working capital is its main
goal in improving productivity. To evaluate working capital performance, traditional measures that include days' sales in receivables, inventory turns, and payables turnover are used. But reliance on trends becomes difficult when data are compared during inflationary times, so the firm decided to refine the working capital measuring process to obtain a better period-to-period picture. Details on the formulas used to analyze productivity changes, sales volume changes, and inflation impact are presented.

Morris, James R. (1983) In the world of practical finance, the management of working capital—cash, marketable securities, receivables, and inventories is, perhaps, the most pressing and most frequently encountered problem for financial managers. Yet, in the realm of theoretical finance, and even at the level of "textbook" finance, working capital is given minimal attention. The reason this important field is treated as an unwanted stepchild is that, with the exception of a few papers such as Copeland and Khoury's, it has never been incorporated into the mainstream of the theory of finance that emphasizes the maximization of the value of the firm. For example, the existing cash balance models are derived with the objective of minimizing the expected cost of managing the cash account. Miller and Orr [18] are, perhaps, the best known, with the stated objective to determine the upper limit (h) and restoration point (z) for the cash balance so as "to minimize the long run average cost of managing the cash balance." However, this objective has not been shown to be consistent with value maximization. In spite of the elegant mathematical structure of inventory theory on which these cash balance models are based, such models are ad hoc from the viewpoint of the financial theory of valuation that weighs the trade-off between risk and return. The inventory theoretic models do not consider such trade-offs and focus only on the return aspect—that is, expected cost—taking no account of the effect of the risk on the value of the firm. Consequently, the cash management policies derived with the inventory framework may be suboptimal with respect to value maximization.

Sartoris, William L. 1, Hill, Ned C. 1 (1983) This paper focuses on the cash flow cycle part of working capital. This focus allows us to view policy decisions as
they impact the timing and amount of cash flows which, in turn, are amenable to standard present value analysis. The paper develops first a certainty model for working capital decisions. The model is shown to be robust with respect to various sales patterns and cost assumptions. Uncertainty is then introduced and three methods are suggested for dealing with it: simulation, explicit pricing, and neutralization. The latter method was illustrated for credit policy decisions and "rational" credit policies were discussed.

Casey, Cornelius J, Bartczak, Norman J.(1984) The article discusses about the growing number of securities analysts, financial writers, and accounting policymakers contend that financial statements providing information of a company's cash flows yield a better measure of operating performance than do the company's income statement and balance sheet. According to recent surveys, corporate and government officials have accepted this view; they rated cash flow data the most important piece of information contained in published financial statements. Since 1981 the Financial Executives Institute (FEI) has been encouraging companies to voluntarily report cash flows in their statements of changes in financial position, that is, "funds flows" statements. Preliminary results of an FEI-sponsored study on the structure and use of the funds flows statement suggest a growing preference for a cash-basis definition of funds over the traditional focus on working capital. A study of nearly 300 companies raises serious doubt about the reliability of operating cash flow as a financial indicator.

Pohlen, Terrance L.1 Coleman, B. Jay(1984) This article evaluates an organization's internal operations and supply chain performance using a general framework that can help operations managers achieve supply chain objectives such as increased shareholder value and improved customer service by providing a concrete roadmap. The focus is on increasing shareholder value for each firm in the supply chain by establishing within-company and cross-company links between actions and profits. The framework employs a dyadic economic value added (EVA) analysis and activity-based costing (ABC). The dyadic EVA analysis evaluates how
process changes simultaneously drive value in each firm and develops measures that align operations performance with supply chain objectives. Whereas, ABC determines what drives costs and performance and also translates nonfinancial performance into activity costs and financial measures.

Sheridan Titman (1984) A firm's liquidation can impose costs on its customers, workers, and suppliers. An agency relationship between these individuals and the firm exists in that the liquidation decision controlled by the firm (as the agent) affects other individuals (the customers, workers, and suppliers as principals). The analysis in this paper suggests that capital structure can control the incentive/conflict problem of this relationship by serving as a pre-positioning or bonding mechanism. Appropriate selection of capital structure assures that incentives are aligned so that the firm implements the ex-ante value-maximizing liquidation policy.

Viscione, Jerry A.1(1986) The article discusses how smaller companies can maximize their ability to tolerate short-term debt and how they can determine when the financing risk from short-term debt is great enough to warrant forgoing profitable opportunities. The matching principle argues that long-term needs ought to be financed with long-term capital and temporary requirements met by short-term loan. When a business violates the matching principle it incurs interest rate risk, refinancing risk, and risk of the loss of operating autonomy. Details on the experience of a small distributor of industrial products which will help illustrate the principle are presented.

Wayne H. Mikkelson and M. Megan Partch (1986) This study examines the stock price effects of security offerings and investigates the nature of information inferred by investors from offering announcements. Changes in share price are unrelated to characteristics of offerings such as the net amount of new financing, relative offering size, and the quality rating of debt issues. The type of security is the only significant determinant of the price response. The opposite patterns of abnormal stock returns following the announcement of completed versus cancelled offerings suggest that
managers issue common stock or convertible debt when in managers’ view shares are overpriced.

Wilson, G. Peter1(1986)This paper investigates the information content of two accrual variables which have been central to this debate: these are the current accruals variable, CA, and the noncurrent accruals variable, NA. Each is the aggregate of several accrual items listed separately in financial statements. The current accruals variable is defined here as cash from operations less working capital from operations, while the noncurrent accruals variable is working capital from operations less earnings. The sum of the current and noncurrent accruals variables is referred to as the total accruals variable, TA. This study investigates the relative information content of total accruals and cash from operations. It also considers separately the relative information content of noncurrent accruals and working capital from operations and of current accruals and cash from operations. None of the tests here considers jointly the relative information content of cash from operations, current accruals, and noncurrent accruals. This study differs from previous work by considering the implications of various hypotheses about information content of accruals on the joint behavior of stock returns at two information releases—the Wall Street Journal earnings announcement and the date the annual report arrives at the SEC. A model is introduced which structures the way information about the accrual and cash components of earnings is extracted from earnings when they are published in the Wall Street Journal and links the association between this component information and stock returns at the earnings announcement to the association between stock returns and component information released at a later date when the annual report arrives at the SEC. By restricting the parameters in this model, it is possible to test for the incremental information content of accruals over funds and for the incremental information content of funds over earnings. This study finds that the cash and total accruals.

Stancill, James McNeill1(1987) The article explores the significance of cash in the overall workflow of business enterprises. Any company, no matter how big or small moves on cash. One can’t pay employees with profit but only through
cash. No matter how big an enterprise one is involved with, he should have enough money to pay his/her obligations. Many executives get caught in the realm of cash flow. The reason is that when the corporate pendulum swings on the direction of faster sales or impending recession, the measures may make it seem as if a company has more cash or less cash than it does. To project your capital requirements, you can use a cash flow statement like the one opposite. In one substracts operating cash outflows, from operating cash inflow, you get the net operating cash flow. What’s interesting about this statement is that two models can be derived from it to answer important questions that all managers ask much money will I have for my discretionary outflows (capital expenditures and dividends)? How much money will I have in service my debt?

Blann, Jack1, Balachandran, B. V.2 (1988) This article presents an empirical test of the statistical association of market risk and financial accounting allocation. Cost allocation seems to be one way of motivating the proper choice of investments by an effort and risk-averse manager as a decision maker. The author empirically measures the extent to which accounting allocations appear to be potentially relevant to equity investors, one of the principal user groups that financial accounting purports to serve, by measuring the statistical association between accounting and market-based measures of systematic risk.

John Polonchek, Myron B. Slovin and Marie E. Sushka (1989) This paper provides event study evidence on securities issuance by commercial banks, a set of firms in which capital structure is regulated. The evidence supports the information hypothesis of securities issuance but also indicates that capital regulation interferes with information transfer. The study finds that: one, the negative impact of equity issues on bank stock prices is much weaker than for non-financial firms; two, the impact of securities issuance is uniformly less negative after the imposition of stricter capital requirements in 1981; and three, the impact of securities issuance is further attenuated after 1981 for non-multinational banks, which faced more specific capital requirements than multinational banks.
Mautz Jr., R. David, Hogan, Thomas Jeffrey (1989) This article focuses on the preparation of earnings per share (EPS) disclosures for public companies with complex capital structures. Reflection of the effects of potentially dilutive securities; Deficiency of EPS reporting standards; Discarding the Treasury stock method; Abandoning the three percent materiality standard.

Chinmoy Ghosh, Raj Varma and J. Randall Woolridge (1990) Exchangeable debt is convertible into the common stock of a target firm in which the issuing firm has an ownership position. It signifies a potential change in the issuing firm's asset composition through the divestiture of the ownership stake in the target firm. The study finds that announcements of exchangeable debt offers are associated with insignificant abnormal returns for the shareholders of issuing firms. The target firm's share price declines, however, when an exchangeable debt offer is announced. This result is consistent with the offer's potential to reduce the ownership concentration of the target firm's common stock.

Moses, O. Douglas (1991) This study examines the relationship between the cash flow and accrual components of reported earnings and forecasts of future earnings made by security analysts. Empirically the question of interest is whether analysts' forecasts impound cash flow information. Alternative cash flow measures (working capital from operations, cash from operations, cash flow after investing activities) are examined. Regression and portfolio tests reveal that, after controlling for earnings signals, all three cash flow signals are associated with analysts' earnings forecasts, although the association is strongest for working capital from operations. The results are consistent with the separate cash flow and accrual components of earnings providing analysts with information concerning the 'quality' of earning.

Jerris, Scott L. (1992) This article shows that the association between excess returns and unexpected earnings for the alternative, probabilistic earnings per share numbers is significantly greater than that for the two required earnings per share numbers. U.S. Accounting Principles Board Opinion No. 15 clearly
states that, "Neither conversion nor the imminence of conversion is necessary to cause a security to be a common stock equivalent." Yet actual dilution of the earnings per share metric only takes place through conversion. It has been shown in prior research that the two-thirds rule of classifying securities as common stock equivalents is a very poor predictor of future conversion. This research has concluded that the two currently reported earnings figures, primary and fully-diluted earnings per share, are not as highly correlated with stock returns as some non-reported alternatives. These alternative earnings per share numbers were computed using the option pricing model, a technique that better gauges the impact of potentially dilutive securities on earnings. This research found that an earnings per share figure based on conversion probabilities is more correlated with security returns than the reported numbers, and also provides incremental explanatory power in explaining the variation in security returns after controlling for the currently reported numbers. Regarding the two reported measures, results show that primary earnings per share is more correlated with market movements than fully-diluted earnings per share. Whether a future accounting standard should be promulgated requiring firms with complex capital structures to disclose an earnings number that specifically incorporates future conversion probability is a matter of debate involving cost-benefit considerations and further research.

Davis, Harry Zvi1, Peles, Yoram C.2,3 (1993) The study tests several categories of ratios—short-term liquidity, performance measures, earnings per share (EPS), capital structure, and the gross margin ratio—to determine if they have equilibrium values or follow a random walk. For ratios with an equilibrium value, the speed at which the ratio returns to equilibrium from out-of-equilibrium conditions is measured. Since equilibrating forces may differ with firm size, the study also tests for differences in adjustment speeds between small and large firms. An accounting ratio may have an equilibrium value if management targets a certain ratio so that any deviation from the target causes management to initiate actions that will return the ratio to target. Also, although management may not be targeting a ratio, the interaction of management's actions with external market industry forces may lead to an
equilibrium value. The authors investigate the total adjustment over time and then assess both the relative adjustment speed and the relative weights of the two main equilibrating forces: industry and management. The statistical technique used allows each firm to have its own, unknown equilibrium value. In addition, the study removes an important sampling bias in measuring the autocorrelation coefficient. The results show that when firms experience a liquidity shock, equilibrating forces counterbalance a little more than a third of the shock in the next period. This finding suggests that firms' liquidity ratios have a fast adjustment to equilibrium values. EPS ratios also have a high adjustment rate to equilibrium value; about one-third to one-half of the shock is adjusted within one period. For performance measures (net operating income over sales or assets), for the equity to debt and gross margin ratios, the findings imply a relatively long adjustment process to equilibrium values. Supplementary tests suggest that smaller firms adjust their ratios to the optimal target more swiftly than large firms. Separating the ratios' total adjustment effect.

Mangla, Bhupesh (1993) States India's Vice President K.R. Narayanan said in his statement inaugurating the Sun Pharma Advanced Research Centre in Baroda, Gujarat, that the government will be seeking modifications to the Dunkel (GATT) draft text so that drugs manufactured abroad are not merely dumped in India. Signal to Indian pharmaceutical industry to modernize and increase spending on research and development; Background of Sun Pharmaceuticals.

Ali, Ashiq1(1994)This article presents information on the incremental information content of earnings, working capital from operations (WCFO) and cash flows, allowing for a nonlinear relation between returns and each of three performance variables. Reviews of prior studies on the incremental information content of earnings, WCFO, and cash flows; Definition of variables and sample selection; Variation of persistence of earnings, WCFO and cash flows with the absolute value of changes in these variables.
Flannery, Mark J.1 (1994) This paper examines the capital structure of financial intermediary firms which finance illiquid, informationally intensive securities. These firms include commercial banks, thrifts, finance companies, and some insurance companies. Financial firms' investment incentives are influenced by debt in the same way as any other firm's, yet they operate with unusually high leverage. Though government regulation has surely exacerbated banks' exposure to illiquidity risk, this risk appears to be an intrinsic feature of banking-firm operations. This paper is organized as follows. Section I reviews the effects of debt on a firm's investment incentives, by presenting a model that summarizes earlier work initiated by researcher Stewart C. Myers (1977). Section II discusses why the informationally intensive nature of bank assets creates a particularly difficult funding problem for uninsured banking firms and describes the alternative means by which they can limit their investment distortions. The paper's basic conclusion is that banks' asset characteristics will lead them to mis-match their asset and liability maturities, thereby enhancing the financial services available to the economy. Liquidity risk thus reflects a bank's optimal response to the problem of financing its asset portfolio. The last section discusses the implications for bank regulation.

Kshitij Shah (1994) This study investigates the information conveyed by intrafirm exchange offers. This study finds that leverage increases and leverage decreases convey qualitatively different information. Leverage-increasing offers appear to lower investors' assessment of risk of the firm's common stock, but do not appear to change their expectations of cash flows; leverage-decreasing offers appear to lower investors' expected cash flows, but do not appear to change their assessment of risk. The nature of changes in leverage, capital outlays, and dividends is also asymmetric. Further, the study finds that, for leverage-increasing offers, corporate control activity does not explain the information content or its asymmetry.

Stephen C. Vogt (1994) A set of simultaneous equations for external financing and investment spending is developed that tests the pecking order hypothesis (Myers, 1984) against a partial stock adjustment model (Jalilvand and Harris,
1984 and Taggart, 1977). Consistent with a partial adjustment model, firms appear to adjust slowly to long-run financial targets. However, additional financing needs follow a pecking order. This study also supports work by Fazzari, Hubbard, and Petersen (1988) and others showing that internal funds have an important influence in firm investment decisions. Finally, pecking order behavior is most (and partial adjustment behavior is least) pronounced in firms that have low long-run dividend payout policies. This suggests that long-run dividend policy reflects the extent to which firms face differential costs of external finance and liquidity constraints.

Kovenock, Dan1, Phillips, Gordon2 (1995) According to the research, until the mid-1980's industrial economists had not considered the effects of capital structure on product-market behavior. Financial economists on the other hand, had largely ignored the role of product-market rivalry in assessing the choice of capital structure. Suppose that the availability of debt as a tool for increasing investment cost is not known a priori, so that optimal managerial contracts do not reflect this possibility. Furthermore, suppose that debt is a sufficiently flexible tool that the level of debt can be made contingent on the realization of the intercept term of the market demand curve. Quantities remain more flexible and can be set contingent on debt levels. In this environment, owners optimally compensate managers in part based on sales. The expectation of the intercept term determines the particular weight chosen the higher the expectation, the more the weight is on sales. In this context, the equilibrium compensation scheme leads to overly aggressive behavior when the realization of demand is low. The weight on sales in the manager’s contract is higher than is desired by the firm’s owners. The firm would like to be able to get its manager to behave less aggressively by producing a lower quantity for each quantity of the rival.

Richman, Tom (1995) The study reports that the working capital productivity turns out to be a good indicator of the overall effectiveness of the time-based and process-oriented programs that companies are using to improve their operations. It is the relationship between process improvement and working capital requirements that makes capital productivity such an
interesting and powerful tool. A company that is able to wring the same sales as a competitor out of substantially less working capital enjoys multiple cost advantages. Working capital productivity is also a powerful communication tool for senior management. Managers who try working capital productivity may gain a good back-pocket measure of organizational performance improvement.

Greg Clinch and Toshi Shibano (1996) this study documents that tax considerations influence whether and when a firm withdraws excess assets in its defined benefit pension plan through a reversion. Since a reversion impacts taxable income over many years and alternative methods of withdrawing excess assets exist, the study argue that the economically relevant tax-based decision criterion is its ‘differential tax benefit’, defined as the difference between the discounted tax savings of reversion versus those of the best alternative withdrawal method. This study develops a technique for directly estimating this decision criterion and documents that differential tax benefits are strongly correlated with the reversion decision and its timing.

Zwiebel, Jeffrey1 (1996) This paper develops a model in which managers voluntarily choose debt to credibly constrain their own future empire-building. Dynamically consistent capital structure is derived as the optimal response in each period of partially entrenched managers trading-off empire-building ambitions with the need to ensure sufficient efficiency to prevent control challenges. A policy of capital structure coordinated with dividends follows naturally, as do implications for the level, frequency, and maturity structure of debt as a function of outside investment opportunities. Additionally, the model yields new testable implications for security design, and changes in debt and empire-building over managerial careers.

the date of issuance. In contrast, current U.S. accounting rules for issuers of convertible debt. Accounting Principles Board Opinion No. 14 (APBO 14), Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants, require the "entirely debt until conversion" approach. U.S. issuers of convertible debt are not governed by IAS 32. However, the issuance of IAS 32 shows obvious international consensus for the separate components approach. In addition, there is substantial support among U.S. academic accountants for the components approach used in IAS 32. This article explains and analyzes the potential financial reporting impact of IAS 32 if it were applied to a sample of U.S. issuers of convertible debt. The results of this study show that reclassification of a portion of convertible debt proceeds to equity has the potential to materially increase interest expense and decrease earnings. This study provides important insights which should be of interest to the financial reporting community in the U.S. and internationally.

Meeting, David T., Law, David B., Luecke, Randall W. (1997) The article reports that many certified public accountants and financial statement users in the U.S. have considered the Accounting Principles Board Opinion no. 15, Earnings per Share (EPS), as arbitrary and unnecessarily complex. A major concern was the concept of common stock equivalent in computing primary EPS. Accountants and financial statement users believed primary EPS should reflect no solution. A new statement addresses this concern by simplifying the computation, eliminating primary EPS and common stock equivalents and replacing them with basic EPS.

Smith, M. Beaumont, Begemann, E. (1997) The article investigates the associations between traditional and alternative working capital measures and return of investment (ROI) of industrial firms listed on the Johannesburg Stock Exchange. Importance of working capital management in decision making; Measurement based on profitability and liquidity concepts; Large influence of traditional working capital leverage ratio on ROI.

Stevens, Michael G. (1997) The article reports on the publication by the Financial Accounting Standards Board of an overhaul of the rules for the
computation of earnings per share (EPS). Replacement of the primary/fully
diluted scheme; Elimination of the calculation of primary EPS; Requirement
for dual presentation of basic and diluted EPS on the face of the income
statement.

Lim Guan Hua1, Liew Mun Kiong2 (1998) The article focuses on credit
spreads in the Asian commercial paper market. Increasingly, companies have
looked towards the Asian debt markets for new sources of funds. One of the
fastest growing segment of this market is the Asian commercial paper market.
This is part of the broader Asian dollar market and only the Indonesian and
Thai segments of this market are active. Commercial paper provides the
larger companies in the region with a means, other than traditional bank
loans, for funding short-term working capital requirements. Currently, most
commercial papers are simply bought and held to maturity by investors.
These money market instruments are seldom traded in the secondary
market. Corporates wanting to enter this market should know how credit
spreads are determined in the commercial paper market. Unlike, the U.S.
market, commercial papers here are not the exclusive preserve of large
corporations with the highest credit ratings. Furthermore, while the
more developed markets of North America and Europe are well
supported by
rating agencies like Standard and Poor's and Moody's, Asia's lack of a
well developed rating process has often been cited as the single most
important obstacle hindering the growth of its debt market.

Abhay Abhyankar and Alison Dunning (1999) The study examines the wealth
effects of the announcement of issues of different types of convertible
securities by UK firms and finds significant negative effects on shareholder
wealth. This study however, also finds that when the sample is partitioned by
method of issue, privately placed convertible bonds, in contrast to previous
research, exhibit a negative impact on firm wealth. Further, the study also
finds negative wealth effects for firms that issue convertible securities to
refinance previous debt or finance specific acquisitions. However
announcements of convertible bond issues, for the purpose of financing
capital expenditure schemes, show significant positive wealth effects. Finally,
the study finds mixed support for testable predictions of the main theoretical models relating cross-sectional firm characteristics of convertible bond issuers to abnormal returns.

Burger, J. H., Hamman, W. D. (1999) According to the authors the accounting sustainable growth rate is used by financial managers and bankers to determine possible financing needs and investment opportunities for companies. However, the authors contend that as this rate is based upon accrual figures that do not reflect the cash position of a company, it could lead to situations in which the company could grow itself into cash problems. In this regard they suggest a cash flow sustainable growth rate (CFSGR), which is defined as the rate at which the company can grow whilst still maintaining a target cash balance in the balance sheet. The relationship between the accounting SGR and CFSGR is then investigated. The authors found that while the accounting SGR is not affected by the non-cash components of working capital, nor by any changes in the non-cash components of working capital, the CFSGR is. Both rates are influenced by the profitability of the company. The accounting SGR is influenced by the growth in sales, while CFSGR is not. The authors do not contend that the CFSGR should replace the accounting SGR, but that it is in the company's best interest to take cognizance of the CFSGR and its implications for the company's growth and cash position.

D. Katherine Spiess and John Affleck-Graves (1999) They document substantial long-run post-issue underperformance by firms making straight and convertible debt offerings from 1975 to 1989. This long-run underperformance is more severe for smaller, younger, and NASDAQ-listed firms, and for firms issuing speculative grade debt. They also find strong evidence that the underperformance of issuers of both straight and convertible debt is limited to those issues that occur in periods with a high volume of issues. In contrast to earlier event studies that found insignificantly negative abnormal returns at the time of debt issue announcements and concluded that debt offerings had no impact on shareholder wealth, their results suggest that debt offerings, like equity offerings, are signals that the firm is overvalued. As
with equity offerings and repurchases, the market appears to underreact at the time of the debt offering announcement so that the full impact of the offering is only realized over a longer time horizon.

Holdren, Don P., Hollingshead, Craig A.(1999) The paper studies the integration of inventory control issues with corporate financial management and commercial lending practices. Inventory management techniques used by inventory holding businesses; Use of inventory segmentation in financial credit management; Influence of inventory management on the cost of working capital to business.

Michael G. Williams and Charles W. Swenson (1999) An analytic model is developed to examine the role of rent-seeking expenses on tax legislation. Rent-seeking expenses are found to be only a fraction of the tax benefits at stake. Rent-seeking expenses increase when firms cannot cooperate, when very general tax legislation is proposed, and when there is legislative support for tax cuts.

Sarkar, Jayati, Sarkar, Subrata (2000) This paper provides evidence on the role of large shareholders in monitoring company value with respect to a developing and emerging economy, India, whose corporate governance system is a hybrid of the outsider-dominated market-based systems of the UK and the US, and the insider-dominated bank-based systems of Germany and Japan. The picture of large-shareholder monitoring that emerges from our case study of Indian corporates is a mixed one. Like many of the existing studies, while we find blockholdings by directors to increase company value after a certain level of holdings, we find no evidence that institutional investors, typically mutual funds, are active in governance. We find support for the efficiency of the German/Japanese bank-based model of governance; our results suggest that lending institutions start monitoring the company effectively once they have substantial equity holdings in the company and that this monitoring is reinforced by the extent of debt holdings by these institutions. Our analysis also highlights that foreign equity ownership has a beneficial effect on company value. In general, our analysis supports the view
emerging from developed country studies that the identity of large shareholders matters in corporate governance.

Garruto, Loren, Loud, Oliver, Lang, Eva M. (2001) The article discusses the issues that United States certified public accountants should address when performing health care valuations. Certain events or business necessities may require an independent appraisal of a business' capital structure. Accountants who perform health care valuations work in a very dynamic and challenging industry must be aware of marketplace issues and changes affecting value determinations for their clients. Valuators should analyze basic operating characteristics including how services are provided and reimbursed, patient referral sources, service area covered, and regulatory compliance.

Resnik, David B. (2001) This paper discusses the economic, legal, moral, and political difficulties in developing drugs for the developing world. It argues that large, global pharmaceutical companies have social responsibilities to the developing world, and that they may exercise these responsibilities by investing in research and development related to diseases that affect developing nations, offering discounts on drug prices, and initiating drug giveaways. However, these social responsibilities are not absolute requirements and may be balanced against other obligations and commitments in light of economic, social, legal, political, and other conditions. How a company decides to exercise its social responsibilities to the developing world depends on (1) the prospects for a reasonable profit and (2) the prospects for a productive business environment. Developing nations can either help or hinder the pharmaceutical industry's efforts to exercise social responsibility through various policies and practices. To insure that companies can make a reasonable profit, developing nations should honor pharmaceutical product patents and adhere to international intellectual property treaties, such as the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement. To insure the companies have a good business environment, developing nations should try to promote the rule of law, ethical business practices, stable currencies, reliable banking systems, free and open markets, democracy, and other conditions conducive to business. Overall, this
paper advocates for reciprocity and cooperation between pharmaceutical companies and developing nations to address the problem of developing drugs for the developing world. In pursuing this cooperative approach, developing nations may use a variety of other techniques to encourage pharmaceutical companies to act responsibly, such as subsidizing pharmaceutical research, helping to design and implement research protocols, providing a guaranteed.

Copeland, Thomas E.1,2(2002) This article discuss classroom deficiencies in investment decisions, performance measurement, risk management, and capital structure. Performance measurement is very important for most CFOs. The article provides evidence that earnings, the growth in eps, economic value added, and its growth are all uncorrelated with the total return to shareholders. The author then shows that the difference between expected and actual performance, called Expectations-based Managementâ„¢, is significantly related to TRS. Furthermore, changes in long-term expectations are more important than are changes in short-term expectations.

Crowley, Peter(2002) This paper focuses on the declining market share of large pharmaceuticals in the U.S. Reduction in market capitalization; Expiration of product patents; Failure to delay generic introduction through court process.

Moore, Marty1(2002) This paper presents advice on cash management under a leveraged capital structure. Components of cash flow; More focus on freeing up cash than producing operating profit; Discussions with top decision makers; Usefulness of reports that forecast cash availability; Features of a weekly cash flow projection report and a short-term projected future cash flow report.

Stephen P. Ferris, Hoje Jo, John M. Pinkerton and Atulya Sarin (2002) This paper examines the risk-shifting and delayed equity hypotheses concerning the use of convertible securities by Japanese firms. The popularity of equity-linked debt instruments in Japan where institutional arrangements can
mitigate the transfer wealth from bondholders to stockholders appears inconsistent with the risk-shifting hypothesis. Further, the study finds that the probability of selecting convertible securities over common equity is not positively related to the potential for a wealth transfer from bondholders to stockholders. They obtain similar results when they examine convertible debt ratios. However, they find evidence consistent with the delayed equity hypothesis that firms use convertibles to delay equity when they have favorable information about the firm. The stock price increases preceding and following convertible issuance are positively related to offering size and growth opportunities as predicted by the delayed equity hypothesis. Overall, their findings endorse the delayed-equity hypothesis as an explanation for the use of convertible securities by Japanese firms.

Steyn, W., Hamman, W.D., Smit, E.V.D.M. (2002) This paper analyzes the hypothesis that high growth rates for a company with a non-cash working capital component, may lead to financial difficulties. Factors influencing the cash from operating activities; Reconciliation between the net profit after taxation and the cash flow from operating activities before payment of dividends; Illustration of the effect of growth and non-cash working capital. 

Trombetta and William (2002) This paper examines the financial statements along with more intangible market metrics to assess what determines successful economic performance in the pharmaceutical industry in the U.S. Sales and market capitalization in 2001; Market capitalization measured against sales; Market value added and economic value added; Ways to increase shareholder value of companies.

Banerjee, Ashok (2003) According to the authors valuing a research-driven firm is a challenging task. The static discounted cash flow (DC.) model fails to capture the value of R&D options. Pharmaceutical companies are, by their very nature, dependent on research products. These companies face an uncertain business environment. Roughly, one out of 10,000 explored chemicals becomes a prescription drug and only 30 per cent of drugs succeed in recovering their costs. Since the future of current R&D investments is
uncertain, the traditional cash flow method may return a negative value of the future growth plan. Various studies have shown that the concept of real options can be applied to capture the value of R&D investments. Options give their owner the right (and not the obligation) to buy or sell assets at a pre-determined price (called the exercise or strike price) on or before an agreed expiry date. The underlying asset for which the option contract is made can be financial instruments (e.g., shares) or investment projects (e.g., expansion or acquisition or R&D investments). If the underlying assets are shares, such options are called stock options. On the other hand, options on investment projects are known as real options. This study shows how we can value a pharmaceutical company with potential research products in the pipeline. The traditional DC method could hardly explain around 39 per cent of the market capitalization of the company. This is because the market price has already factored in the growth options the possible growth from drug discovery initiatives, growth from joint venture initiatives, etc. The cash flow model fails to capture these future values. Real options model to value research products has significantly improved the valuation. We show that the underlying value of R&D investments is best recognized in option pricing model.

With Indian patent laws following the footsteps of the WTO prescriptions (from 2005), Indian pharmaceutical companies cannot avoid making significant investments in R&D. The study reveals that unless the compounds under research have potential to be breakthrough drugs, it may be difficult to recover R&D investments. Therefore, attaining a reasonable global market share is critical for Indian pharmaceutical companies to exercise options. The Indian market for any high-investment research drug is comparatively small. Given the huge R&D costs of new drug discovery, it is impossible for a domestic manufacturer to recover the R&D costs from domestic sales. Capturing export market is vital to the success of any new drug. So far, not a single new drug has been fully developed in India (right from discovery to successful completion of all trials). Indian companies have acquired generic products, discovered alternative process of manufacturing a patented drug, and licensed out the compounds to multinational companies for clinical trials and commercialization. They have not taken the risk of completing the entire
process of drug discovery on their own. But, things are changing now. Indian
companies have realized the importance of having a strong R&D base and we
may see some blockbuster drugs being manufactured in India. This, we hope,
will further popularize the real options model of valuing R&D investments.

Deloof, Marc1 (2003) The relation between working capital management and
corporate profitability is investigated for a sample of 1,009 large Belgian non-
financial firms for the 1992-1996 period. Trade credit policy and inventory
policy are measured by number of days accounts receivable, accounts
payable and inventories, and the cash conversion cycle is used as a
comprehensive measure of working capital management. The results suggest
that managers can increase corporate profitability by reducing the number of
days accounts receivable and inventories. Less profitable firms wait longer to
pay their bills.

Evans, John P.1, Evans, Robert T.2, Gentry, James A.3 (2003) The paper
examines the changes in the cash flow position of companies embarking on a
share repurchase strategy. Reasons for initiating a share repurchase
program; Relative investment flow; Net working capital flows.

Kumar, Manoj, Bhole, L. M., Saudagar, Shahrokh M. (2003) This paper
studies firm-level financial data of foreign listed Indian firms to see whether
the 'improved access to external capital markets' is an important consideration
for Indian firms listing on the foreign markets. The results of the study can be
interpreted in terms of informational disclosure requirements of the foreign
markets (in our case the Global Depositary Receipts—GDR markets) where
sample Indian firms have listed their securities. The firms listed on the US
exchanges have to necessarily follow US GAAP in casting of their accounts
and disclose more. Hence, US listing acts as a signal about the firm's level of
transparency and disclosures which, in turn, reduces informational asymmetry
between managers and external investors. Thus, listing of emerging markets'
firms on the US exchanges improves their access to the external capital
markets and hence reduces their investment-to-cash flow sensitivity. Also, till
recently, two-way fungibility in the Indian DRs was not allowed. Foreign institutional investors (FIIs), investing in the Indian GDRs, are restricted from owning and trading in Indian shares listed on the Indian stock exchanges. Besides, Indian citizens were prohibited from owning and trading in Indian DRs listed on the foreign markets. These factors impede the free flow of information between the G DR markets and Indian markets. Thus, GDR listings by the Indian firms are rendered ineffective in removing the information asymmetry about the listing firms and in improving Indian firms' access to the external markets.

Kumbhakar, Subal C.1, Sarkar, Subrata2 (2003) This paper analyzes the relationship between deregulation and total factor productivity (TFP) growth in the Indian banking industry using a generalized shadow cost function approach. TFP growth is decomposed into a technological change, a scale, and a miscellaneous component. A disaggregated panel data analysis, using the population of public and private banks over 1985-96 that covers both pre- and post-deregulation periods, indicates that a significant decline in regulatory distortions and the anticipated increase in TFP growth have not yet materialized following deregulation. While private sector banks have improved their performance mainly due to the freedom to expand output, public sector banks have not responded well to the deregulation measures.

Pandey, I. M., Nair, Rajesh, Awasthi, Dinesh et.al (2003) Entrepreneurship is the driver of growth. It helps creating innovative enterprises which provide foundation for building a nation's competitiveness. Enterprise creation needs risk capital. Venture capitalists provide risk capital and facilitate the development of entrepreneurship. There are several issues relating to entrepreneurship development and venture capital that deserve serious discussion. To put these issues into perspective, the Centre for Innovation, Incubation, and Entrepreneurship and Entre Club at IIMA organized a panel discussion which was coordinated by I M Pandey, Professor at Indian Institute of Management, Ahmedabad. Some of the key questions that the panel has addressed to are: What is the contribution of entrepreneurship in the
economic development of India? What factors have facilitated or hindered the
development of entrepreneurship in India? What role has venture capital
played in fostering the growth of entrepreneurship in India? What do
entrepreneurs look for from venture capitalists other than the capital in the
growth of their enterprises? What are the experiences of venture capitalists
and entrepreneurs vis-a-vis the interface between venture capital and
entrepreneurship? The following are some important points that emerged from
the panel discussion: There is a direct link between entrepreneurship and the
economic growth. There is some evidence that entrepreneurship has made
contribution to India’s growth. Factors responsible for the slow growth of
entrepreneurship and lack of innovative spirit included the faulty education
system, absence of proper incentives and environment to innovate, lack of
proactive and favourable government policies, non-availability of risk capital,
and the Indian mindset favouring comfortable.

Ravitz, Leslie C., Bova, Anthony, Stanley, Morgan(2003) This paper provides
insights into the economic value added trends in the chemical industry in the
U.S. Cost of capital based on the amount of equity and debt in a company’s
capital structure; Creation of shareholder value among diversified chemical
companies; Tool in analyzing net operating profit after taxes.

Sarkar, Mitali (2003) The paper features summary of articles published in
Indian and international journals with special emphasis on India and other
emerging markets. 'Reforming Venture Capital in India: Creating the Enabling
Environment for Information Technology,' by Rafiq Dossani; 'Why Good
Accountants do Bad Audits,' by Max H. Bazerman, George Loewenstein and
Don Moore; 'Market Microstructure: A Practitioner’s Guide,' by Ananth
Madhavan.

desire for simplicity combined with Wall Street’s reliance on earnings and
book value has resulted in a numbing array of equity styles that have little
direct relationship to wealth creation. There are large-cap stocks, and there
are small-cap stocks. There are growth stocks and value stocks, along with
several cross-combinations that fill out the equity style box. Given style limitations, it is time portfolio managers took stock of the economic profit revolution that now joins the fields of corporate finance and investment management. In this discussion, the authors use a well-known measure of economic profit called economic value added (EVA). They call this approach to company and equity analysis the EVA style of investing because it emphasizes the fundamental ability of a company to create wealth through the generation of economic earnings rather than accounting earnings. The authors look at the pioneering role of economic profit in identifying wealth-creating and wealth-destroying companies. They expand the EVA style foundation in the context of best practice EVA models, offering some practical insights from the portfolio manager's corner.

Baum Charles L, Sarver Lee Strickland and Thomas (2004) The aim of this study is to analyze the relationship between a company's performance, measured by Economic Value Added (EVA) and/or Market Value Added (MVA), and the compensation of its chief executive officer. The study also considers whether any relationship between compensation and performance might vary by industry. The results show MVA to be more closely related to executive compensation than is EVA, having a positive and significant association with each component of compensation.

Betts, Mitch(2004)The article discusses a new IT benchmarking metric, ROIT (Return on IT), that was used by Alinean LLC in its corporate rankings. Alinean LLC's new metric is intended to show ITs relationship to shareholder value, as measured by Economic Value Added (EVA), a widely used measure of corporate financial performance. When Alinean LLC came out with corporate rankings based on its new IT benchmarking metric, the top companies were Fannie Mae and Pioneer Natural Resources Co. But Wal-Mart Stores Inc., often considered a huge IT success story, was nowhere near the top. ROIT is calculated by dividing the company's EVA by its IT spending, which yields an ROIT percentage. Fannie Mae's ROIT was a whopping 4.248%. Wal-Mart's was 42%. Wal-Mart scored lower because, as the biggest company in the world, its revenue growth has slowed and it isn't as profitable
as it could be because it passes on its savings to consumers. ROI is just a snapshot, says Alinean LLC President Bill Johnston adds. For example, Lowe's Companies Inc. currently has a higher ROI than rival Home Depot Inc. But Johnston says Home Depot is making big IT investments to catch up after years of IT neglect, and he predicts that Home Depot Inc. will see dividends from those investments and a higher ROI in the next few years.

Bhalla, V. K (2004) Rewarded by knockout results, managers and investors are peering into the heart of what makes businesses valuable by using a tool called Economic Value Added (EVA). EVA focuses managers on the question, "For any given investment, will the company generates return above the cost of capital?" Most companies overly complicate financial management. The standard financial model uses cash flow analysis for capital budgeting reviews, turn to earnings, EBITDA, and return measures for performance reporting and investor relations, interjects yet another scorecard of metrics for planning and managing purposes, and generally ties bonus awards to beating budgets. Although each element in it is a simple and well established, the system as a whole is a complex jumble of metrics, methods and messages that managers find very difficult to understand. EVA is the measure of the management's ability to add value to tangible assets by creating and leveraging intangible assets. By integrating the business philosophy based on EVA, the companies that embrace EVA have bonus compensation schemes that reward or punish managers for adding value to or subtracting value from the company. The best companies keep it lean and linked to value. In other words, EVA reflects and implicitly values all forms of innovations and differentiation. It is the value of mind over matter.

Fairchild, Richard1 (2004) This study analyzes manager and venture capitalist bargaining over the financial contract in the face of double-sided moral hazard problems. The allocation of cash flows depends on the combined effects of value-added services, reputation seeking, and bargaining power. Welfare is maximized when the venture capitalist has high value-adding capabilities, the market for reputation is informationally efficient, and the manager has bargaining power. Furthermore, the study considers the effect of exit
strategies on the financial agreement. The study also considers bidding between venture capitalists of differing abilities. Generally, the superior venture capitalist wins with a lower bid, but in some cases the inferior venture capitalist can win.

Freeman Neal (2004) This article provides tips on determining the financial performance of various firms. Awareness on the returns on investment; Computation on the total costs of capital; Quantification of both after-tax return and the cost of the investment

Frederik P. Schlingemann (2004) In this paper the authors analyze the relation between bidder gains and the source of financing funds available. They document that after controlling for the form of payment, financing decisions during the year before a takeover play an important role in explaining the cross section of bidder gains. Bidder announcement period abnormal returns are positively and significantly related to the amount of ex ante equity financing. This relation is particularly strong for high q firms. The authors further report a negative and significant relation between bidder gains and free cash flow. This relation is particularly strong for firms classified as having poor investment opportunities. The amount of debt financing before a takeover announcement is not significantly related to bidder gains. Together, they take these findings as supportive of the pecking-order theory of financing and the free cash flow hypothesis.

Griffith, John M.1(2004) Stern Stewart & Company (SSC) developed the measure, Economic Value Added (EVA®), to reward employees for maximizing shareholder wealth. Financial analysts also use EVA to measure firm performance. This study assesses the performance of companies that have implemented the EVA-based compensation system, and questions whether analysts should use EVA performance to forecast stock performance. Investors in EVA adopters or in firms for which EVA has been used to forecast stock performance would have suffered significant losses.
John S. Howe and Hongbok Lee (2004) The study examines three corporate governance characteristics of preferred stock issuers relative to non-issuers: managerial equity ownership, board size, and block shareholder ownership. This study finds that the preferred issuers have significantly lower managerial equity ownership than their controls. The finding is consistent with our expectation that the use of preferred stock and managerial equity ownership both serve to reduce agency costs and thus, preferred issuers tend to have little incentive to resort to higher managerial ownership to lessen agency costs. Significantly larger board size for preferred issuers is evident, but the study finds no difference in block shareholder ownership.

Rao, Kala Marshall, Julian (2004) This paper deals with the popularity of Indian foreign currency convertible bonds (FCCB) among foreign investors in 2004. Several Indian FCCB issued early this year are trading at a discount in the secondary market. A 100 million dollar convertible offering by Indian pharmaceutical company Wockhardt received a healthy response from European and offshore U.S. hedge fund investors in mid-September. The five-year Wockhardt bonds were priced with a coupon/yield to maturity of 5.25 percent and a conversion premium of around 50 percent to the company's share price in the local market. Last year's spectacular rise in Indian equity prices, the Indian government's decision to ease restrictions on foreign currency borrowing by Indian companies in January and a Moody's upgrade to investment grade for Indian foreign currency debt has led to record issuance of convertibles by Indian companies. They have raised 1.56 billion dollars so far this year. But equity prices have railed once again since July. Bankers claim it is also no surprise that the present issuers are from fast-growing sectors such as pharmaceuticals. Probir Rao of JPMorgan remarked that money is coming back into India and even though credit spreads have tightened, there is a demand for quality stocks from India.

Savangikar, V A Baskaran, Uma (2004) This article reports that India's local drug companies have long benefited from a relaxed patent regime. As a result of the Bill, India will, from January 1, 2005, have a fully TRIPs-compliant patent system. The domestic drug industry meets about 70% of India's
demand for bulk drugs, drug intermediates, chemicals, pharmaceutical formulations in the form of tablets, capsules and orals. India expects more patent filing in light of the new product patent regime. The industry realized that the new product patent regime will cement India's position as a global pharmaceutical outsourcing hub and off-shore location for R&D, the manufacture and export of domestically produced generics and other support services including strategic services in patenting and related matters. The new patent system will encourage R&D activities and India has a very bright future especially in herbal/Ayurvedic products, as well as in pharmaceuticals.

Sinha, Gunjan(2004) The article discusses how the Mumbai-based D&O Clinical Research Organization has been manufacturing precursor drug compounds for foreign pharmaceutical companies for more than a decade. Just this year, however, D&O expanded its services to include support for clinical trials, specifically, coordinating the studies and managing data. The expansion is intended to corral more clients as India's business climate heats up. As part of a World Trade Organization agreement that India signed in 1995, starting next year the country will honor product patents. Although pharmaceutical giants such as Novartis, Pfizer and Eli Lilly have commissioned Indian firms to manufacture compounds for years, all R&D work -- drug design and preclinical testing -- has been done elsewhere. The intellectual-property law change will also jump-start growth in the market for the clinical trials. But as foreign companies set up shop in India, expertise will grow. Take Mumbai-based SIRO Clinpharm, one of India's first contract research organizations. It has been performing clinical trial services for the past seven years. Drug outsourcing's biggest plus is cost savings. Pharmaceutical companies spend as much as 20 percent of their sales on research and development. Indian drugmakers spend a quarter as much or less. Certainly India isn't the only country to which pharmaceutical companies can take their business.

Worthington, Andrew C.1, West, Tracey1(2004) Pooled time-series, cross-sectional data on 110 Australian companies over the period 1992-1998 is employed to examine whether the trademarked variant of residual income
known as economic value-added (EVA) is more highly associated with stock returns than other commonly-used accounting-based measures. These other measures of internal and external performance include earnings, net cash flow and residual income. Three alternative formulations for pooling data are also employed in the analysis, namely, the common-effects, fixed-effects and random-effects models, with the fixed-effects approach found to be the most empirically appropriate. Relative information content tests reveal returns to be more closely associated with EVA than residual income, earnings and net cash flow, respectively. An analysis of the components of EVA confirms that the GAAP-related adjustments most closely associated with EVA are significant at the margin in explaining stock returns.

Yook Ken C (2004) This study reexamines post-acquisition performance of acquiring firms using EVA. Investigation of the largest 75 acquisitions occurring during 1989 to 1993 reveals that acquiring firms experience significantly deteriorating raw EVA after the completion of acquisitions. When industry-adjusted EVA is examined, however, the difference is almost indiscernible. These results indicate that the sharp decline in raw EVA is mostly accounted for by industry effects. If EVA is calculated assuming that no premium was paid to target firms, i.e., the premium is excluded from the acquiring firm's capital in the post-acquisition period, industry-adjusted EVA shows an insignificant improvement. These results suggest that acquiring firms tend to experience slightly improved performance relative to their industry counterparts after completion of the acquisition. But the improved operating performance is wiped out by capital costs of the large premiums paid to the target firm, creating no real economic gains to acquiring firm's shareholders.

Barraclough, Emma1(2005) The article reports that the Indian government has made last minute changes to its patent laws to bring them in line with WTO rules, but has come under fire from both multinational pharmaceutical companies and left-wing politicians who say the new rules fail to meet their demands. The government issued an Ordinance on December 26, 2004 to ensure India met a WTO-imposed deadline of January 1, 2005 to introduce a
product patent regime for drugs and chemicals. Since 1970 only process patents have been available for pharmaceuticals, allowing India's generics industry to flourish by reverse engineering branded drugs.

De, Ahibhusan, Baskaran, Uma (2005) This article reports that India's latest amendment to its Patent Act revolutionized the country's IP regime by introducing a product patent for pharmaceutical. The rise of India's pharmaceutical industry has been attributed in part to the process patent regime, and has been presented as the chief reason by old guards for opposing change to a product patent regime. Under the old patent regime, drugs patented in other countries could be analyzed and manufactured in India by a different process without paying royalty to the patent holder. Under the new product patent regime, the patent term is 20 years from the date of filing in India. Indian companies that are now producing generic versions of drugs for which patent applications were filed between January 1, 1995 and January 1, 2005 will be allowed to continue doing so only if they pay a "reasonable" royalty to the patent holder.

de Klerk, Vic (2005) Reports on impact of increasing rate of petrol price in the marketing industry in South Africa. Suggestions to the government with regard to tax rate and value added tax to beat imminent petrol price; Effect of expensive petrol and diesel on the operation of market forces; Disadvantages of the economic trend in the transportation industry.

Dobbs, Richard, Rehm, Werner (2005) This article discusses the value of share buy-backs. Many market participants and executives believe that since a repurchase reduces the number of outstanding shares, thus increasing EPS, it also raises a company's share price. The company's earnings fall as a result of losing the interest income, but its EPS rises because the number of shares has fallen more than earnings have. The share price increase from a buy-back in theory results purely from the tax benefits of a company's new capital structure rather than from any underlying operational improvement. The market responds to announcements of buy-backs because they offer new information, often called a signal, about a company's future and hence its
share price. When companies buy back their own stock, they can usually expect the capital markets to reward them with an increase in their share price. Share buy-backs are often most valuable not for their effect on EPS, but for the messages they send to the markets. Any mechanical increase in earnings per share will likely be offset by a reduction in the company's price-to-earnings ratio.

Ferguson, Robert, Rentzler, Joel, Yu, Susana(2005) This article uses event study methodology to investigate whether firms adopt Stern Stewart's EVA system due to poor stock performance (i.e., poor profitability) and whether adopting EVA leads to better stock performance (i.e., greater profitability). There is insufficient evidence to conclude that poor stock performance leads firms to adopt EVA or that adopting EVA improves stock performance. Firms that adopt EVA appear to have above average profitability Relative to their peers both before and after the adoption of EVA; further, There is some evidence that EVA adopters experience increased profitability relative to their peers following adoption.

Hariharan, Malini, Viswanathan, Prem (2005) The article focuses on a 2005 report from PriceWaterhouseCoopers concerning chemical companies in India. It reports on the financial performance of around 65 companies across different segments during the periods 2000-02 to 2004-05. Firms were assessed across their peer group to identify those which consistently beat the benchmarks for revenue growth and shareholder value creation. It revealed that only a few companies satisfied the criteria for being identified as value generators.

Humphries, J.I(2005) The article presents information on important key measures of asset performance for industry. It provides guidelines for creating competitive advantage from asset performance improvement. Measures of asset performance levels include return on assets, return on invested capital and economic value added. The most common and effective approach toward gaining competitive superiority is to design and implement work process improvements that enable enhanced results and the desired financials. For
step-change improvements involving multiple measures of business results, a management team should charter and guide multiple focus teams.

Inamdar, Anita1(2005) The article presents information on the Indian pharmaceutical industry. In 1970, the Indian Patents Act came into existence and began to regulate process patents and ignored product patents. After initiation of the economic liberalization, Indian companies prepared to face the pharmaceutical trade globally. India is 2nd largest country that has source of active pharmaceutical Ingredients worldwide. Indian pharmaceutical industry started to recognize product patents when Trade-Related Intellectual Property Rights Agreement applied in 1994.

Krishnamurthy et al (2005) According to the authors, with the liberalization and entry of private companies in insurance, the Indian insurance sector has started showing signs of significant change. Within a short span of time, private insurance has acquired 13 per cent of the life insurance market and 14 per cent of non-life market. However, there is still a huge untapped demand for insurance. Insurance companies have a pivotal role in offering insurance products which meet the requirements of the people and, at the same time, are affordable. Some of the challenges faced by the insurance sector pertain to the demand conditions, competition in the sector, product innovations, delivery and distribution systems, use of technology, and regulation. To understand the growth and development and the future prospects of this sector, this colloquium addresses the following issues: * What will be the demand for insurance? What types of innovative strategies of insurance education and awareness will we require to encourage the Indian consumers? * With the changes following bank participation in insurance, will the nature of competition in this sector intensify? * What kind of competitive and risk pressures will the insurance businesses experience? What are their implications for profitability, margins, and efficiency? * The average size of the polices will continuously decline as the insurance companies increase the geographic coverage. As a result of this, the intermediation costs will go up. What are the implications of these on average costs? * What will be the product market scenario? * Has the insurance sector benefited from the
knowledge base of global companies? * To what extent have the technology gains in telecommunications, computer information, and data processing contributed to increased efficiency and productivity of insurance companies? The following key points emerged from the responses of the panelists: * The future in life insurance will be determined by the increase in pure protection products, a refreshing.

Sathye, Milind1,2 (2005) Enhancing efficiency and performance of public sector banks (PSBs) is a key objective of economic reforms in many countries including India. It is believed that private ownership helps improve efficiency and performance. Accordingly, the Indian government started diluting its equity in PSBs from early 1990s in a phased manner. Has the partial privatization of Indian banks really helped improve their efficiency and performance? International evidence on impact of privatization is mixed. Though the issue is important in the Indian context, no study to the author's knowledge has addressed it so far. The present study, thus, fills an important gap. The data required for the study were obtained from Performance Highlights of Banks, a publication of the Indian Banks' Association. The author could readily obtain publications for five years -- 1998-2002; his analysis is, thus, restricted to these five years. The financial performance of the banks was measured using the standard financial performance measures such as return on assets. The efficiency of banks was measured using accounting ratios, e.g., deposits per employee. Two main approaches are generally used to evaluate the impact of privatization on firm performance: * 'Synchronic' approach in which the performance of state-owned firms is compared with the firms that were privatized or with the firms that were already in private ownership. * 'Historical' approach, in which ex-ante and ex-post privatization performance of the same enterprise is compared. Given that the data are available for only five years, the author uses the synchronic approach. Since the dataset is not large enough to allow the use of more robust multivariate statistical procedures, he confines himself to the use of the difference of means test. This study reveals the following: * Financial performance of partially privatized banks (measured by return on
assets) and their efficiency (measured by three different ratios) were significantly higher.

Timothy R. Burch, Vikram Nanda and Vincent Warther (2005) The study examines underwriting fees for repeat issuers of new securities to determine the relation between loyalty to an underwriting bank and the fees charged. For a sample of offers over the 1975–2001 period, the study finds that loyalty is associated with lower fees for common stock offers, consistent with valuable relationship capital being built through loyalty. For debt offers, however, the authors find the opposite pattern, consistent with relationship capital not being as valuable. For both offer types, firms that graduate to higher-quality banks face lower fees. Firms that are more likely to be switching banks to improve analyst coverage face higher fees for common stock offers, but not for debt offers.

Nazir, Nazir A.1 na (2005) This paper makes an attempt to ascertain the relationship between socialization, person-culture fit, and employee commitment. In other words, it seeks to determine whether the organizations high on socialization scores will experience high value congruency/person-culture fit and also whether high value congruency leads to employee commitment. In the recent past, the concept of culture has gained wide acclaim as a subject of study and reflection. However, the parameters of culture are so intricate that they cannot be outlined or defined. While contemporary research fully endorses the view that culture is an internal variable and can be conceptualized in terms of widely shared and strongly held views, the researchers have not empirically investigated the relevance of social learning in permeating these values into the organizational members. This paper seeks to overcome this limitation and also deviates from the earlier research studies undertaken in this field in the Indian context by exploring whether the person-culture fit notion or the integration of organizational values and individual preferences for those values could predict employee commitment. This study was conducted on six banks including two public sector (banks 1 and 2), two private sector (banks 3 and 4), and two foreign
banks (banks 5 and 6) located in Delhi. It used three well-established scales -- organizational culture profile (OCP), organizational commitment scale (OCS), and socialization practices scale (SPS) -- to collect data from two separate groups of respondents through convenience sampling procedure. The first group consisted of 135 newly recruited employees who were asked to complete the OCP indicating their individual preferences on the given 54 value items and OCS for ascertaining their commitment. The second group comprised of 69 senior employees of the banks studied. An overall profile of the culture of each bank was developed by averaging the individual responses of this group.

Sikka, Harinder S(2005) Reprint the article "Fit in the paradigm change" by Harinder Sikka, which was printed earlier in the newspaper "Indian Express." Information on India's patent reforms; Implementation of the regulation on pharmaceutical manufacturing standards; Remarks on the product patent regime, value added tax and maximum retail price-based excise duty.

Anderson, Dwight (2006)The article discusses several tips in reducing the days sales outstanding. An analysis on the problem presents factors involving lapses from credit personnel that may have contributed to the delay of the payment process. Factors revealed include outdated pricing information, missing or incomplete delivery documentation, and the failure to provide updated billing.

Aoki, Reiko1,Kubo, Kensuke2 , Yamane, Hiroko3(2006)The article discusses on the implications of the World Trade Organization's Trade-Related Aspects of Intellectual Property Rights Agreement on the public health sector in developing countries. Under the product patent law, local pharmaceutical companies are restricted to copy manufactured drugs from other firms. The authors have examined the product patent law in Japan in 1976. They found out that the country's patent system is supported with basis for compulsory licensing, such as local working, working of dependent patents, and public interest.
Breton, Gary G. (2006) The article discusses the factors that small business owners in the U.S. should consider in seeking new or alternative financing, particularly in a rising-interest-rate market. As financing facilities bear interest that may be tied to different indexes, the author stresses the importance of evaluating available interest rate options and its impact to the company's cash flow and profitability.

Costanzo, Chris (2006) The article discusses several questions that community banks should consider when choosing a cash management solution and when faced with a tough third-party provider decision. The most basic cash management function is the ability to originate an automated clearinghouse transaction. Balance reporting and check management might be considered basic features. Many banks are responding to the broadening definition of cash management by offering two levels of services, one is the full-blown cash management and the other is Internet banking for businesses.

Dirk Brounen, Abe de Jong and Kees Koedijk (2006) In this paper the authors have presented the results of an international survey among 313 CFOs on capital structure choice. The paper documents several interesting insights on how theoretical concepts are being applied by professionals in the UK, the Netherlands, Germany, and France and they directly compare their results with previous findings from the US their results emphasize the presence of pecking-order behavior. At the same time this behavior is not driven by asymmetric information considerations. The static trade-off theory is confirmed by the importance of a target debt ratio in general, but also specifically by tax effects and bankruptcy costs. Overall, they found remarkably low disparities across countries, despite the presence of significant institutional differences. They found that private firms differ in many respects from publicly listed firms, e.g. listed firms use their stock price for the timing of new issues. Finally, they did not find substantial evidence that agency problems are important in capital structure choice.
Dummitt, Ken1 (2006) The article reports on the new solution for financial management that facilitates an integrated view of cash to unlock trapped value and reduce the risk AvantGard which is developed by SunGard. The solution provides collaborative tools that accelerate cash collection, improve payment cycle timing and enable the Chief Financial Officer optimize cash as a component of working capital. The collaboration with internal business partners, customers, vendors and banks are required for the cash flow.

Gundavelli, Veena (2006) The article provides tips that companies could consider to elevate working capital performance. The following seven steps serve as an effective roadmap for corporations looking for effective methods to free up cash locked in credit, receivables and payables by using business process improvements, technology and change management. Among the seven steps include concentrating on cash flow as a performance metric to drive the organization forward; integration of credit risk, receivables and payables management from a performance management, process automation and cross enterprise collaboration standpoint; and drive cost containment and standardization with finance shared services and outsourcing.


Khurana, Inder K.1, Pereira, Raynolde1, Martin, Xiumin1 (2006) Extant theoretical research posits that information asymmetry and agency issues affect the cost of external financing and hence impact the ability of firms to finance their growth opportunities. In contrast, the literature on disclosure policy posits that expanded and credible disclosure lowers the cost of external financing and improves a firm's ability to pursue potentially profitable projects. An empirical implication is that disclosure can help firms grow by relaxing external financing constraints, thereby allowing capital to flow to positive net present value projects. This paper empirically evaluates
this prediction using firm-level data over an 11-year period. As anticipated by theory, we find a positive relation between firm disclosure policy and the externally financed growth rate, after controlling for other influences.

Madden, Judy1 (2006) The article presents a study on the application of adenylate kinase technology by the leading personal care manufacturers in hastening microbial testing that will help in the reduction of the cost of quality and lead time. It is believed that the reduction in microbial testing would have tremendous value for manufacturers since it reduces working capital requirements and contamination risks. Thus, return on investment will be maximized.

Platt, Gordon (2006) The article comments on the initial public offering (IPO) of Lotte Shopping, the biggest chain of department stores in South Korea, in February 2006. The company raised a total of $3.5 billion during the IPO, which is inclusive of global depository receipts worth $2.8 billion. Background information on Lotte Shopping and its growth targets and strategies are also cited.

White, Joyce1 (2006) The article reports on the advantages of using asset-based loans among industries. There are several reasons why most companies use this financing tool including debt refinancing, capital expenditures, working capital, leverage buyouts and employee stock ownership programs. This loan is structured as a revolving line of credit and is supported by assets making it available to all companies regardless of financial status.

S. Abraham Ravid, Itzhak Venezia, Aharon Ofer, Vicente Pons and Shlomith Zuta (2007) This paper demonstrates that preferred stock may arise as an optimal security in a tax-induced equilibrium. This result is driven by graduated tax schedules and by uncertainty. In a more general sense, the results of the study can be interpreted as a template for including any security with a different tax treatment in a firm's capital structure. The first part of the paper demonstrates that the Miller equilibrium framework can accommodate
more than two securities if different investor classes are taxed differently on each security and the tax schedule for each investor group is upward sloping. The authors then simplify the tax schedule, but introduce uncertainty, which implies the possibility of bankruptcy and the possible loss of tax shelters. The interaction of tax rates and seniority now affects the contribution of each security to after-tax firm value, as in some states the firm may not be able to pay either interest (or dividends) or even principal to its various claimholders. It is shown why and how these features, i.e. the various tax rates and seniority, determine the financing equilibrium, which is obtained by equating the expected marginal tax benefit of all securities. They have demonstrated that non-profitable firms will tend to issue preferred shares whereas profitable firms will not find preferred stock advantageous in our framework. Comparative statics with respect to various tax rates are derived as well. These predictions are tested using a large sample of firms for the last 25 years. The empirical testing broadly confirms the theoretical predictions.