

# Contents

*Preface* 11

*Chapter 1. Introduction* 13

- 1.1 Background and purpose 13
- 1.2 An outline of the study 14

*Chapter 2. The size, profitability, growth, and value of the firm* 16

- 2.1 Elements of a dynamic theory of the firm 16
  - 2.1.1 The internal conditions of production 17
  - 2.1.2 The external conditions of production 18
  - 2.1.3 Some functional relationships and identities 19
  - 2.1.4 The objectives of the firm 22
- 2.2 A growth model of the firm 22
  - 2.2.1 The assumptions 23
  - 2.2.2 The equation system 25
  - 2.2.3 The structure of the model 25
- 2.3 Earlier studies 26
  - 2.3.1 Theories of investment and production 27
  - 2.3.2 Theories of investment and finance 28
  - 2.3.3 The models of Gordon, Marris, and Vickers 29

*Chapter 3. Empirical analysis of the relationship between profitability and growth* 32

- 3.1 Theories of the influence of growth on profitability 33
  - 3.1.1 Growth costs 33
  - 3.1.2 Growth benefits 36
- 3.2 The empirical data and definition of variables 36
- 3.3 Regression model 39
- 3.4 The results 40
  - 3.4.1 Growth as the only explanatory variable 40
  - 3.4.2 Growth as one of several explanatory variables 41
  - 3.4.3 Growth costs and the firm's optimal rate of growth 43

*Chapter 4. The financial costs of the firm* 46

- 4.1 Introduction 46
- 4.2 The interest rate on borrowing 48

4.2.1	Hypotheses concerning the effect of debt finance on the interest rate	48
4.2.2	Regression model	50
4.2.3	Results	51
4.2.3.1	Regression estimates	51
4.2.3.2	Effects of an altered leverage ratio	53
4.3	The discount rate	55
4.3.1	Hypotheses concerning the influences of internal and external finance on the discount rate	55
4.3.2	Regression model	58
4.3.3	Results	60
4.3.3.1	Regression estimates	60
4.3.3.2	Effects of a changed pay-out ratio	63
<i>Chapter 5. The behavior of the firm: real and financial</i>		
5.1	Introduction	65
5.2	Optimal labor intensity, the leverage ratio and retention ratio	66
5.2.1	The optimality conditions	66
5.2.2	The explicit solutions	69
5.3	The influence of exogenous factors on the behavior of the firm	70
5.3.1	Changes of direction in the endogenous variables	70
5.3.2	Comments	71
5.4	Growth costs	74
5.4.1	The optimization	74
5.4.2	The influence of the exogenous factors	75
5.5	A diagrammatic illustration	76
<i>Chapter 6. The model applied to empirical data</i>		
6.1	Introduction	82
6.2	Tests of inequality relations and marginal conditions	82
6.2.1	The inequality relations	82
6.2.2	The marginal conditions	84
6.3	Tests of certain effects of exogenous changes	86
6.3.1	The leverage-ratio relationship	86
6.3.2	The relationship for the pay-out ratio	88
6.4	Sensitivity analysis	89
6.4.1	The influence of exogenous factors	90
6.4.2	Inoptimal financial behavior	93
<i>Chapter 7. Generalizations of the model</i>		
7.1	Finance through new share issues	96
7.1.1	Optimality conditions	96
7.1.2	The influence of exogenous factors	98

7.2	The discount rate as a positive function of the leverage ratio	98
7.2.1	Optimum conditions	99
7.2.2	The influence of exogenous factors	100
7.3	Autonomous price changes	101
7.4	Worker-controlled and management-controlled firms	103
7.4.1	The worker-controlled firm	103
7.4.2	The management-controlled firm	106
<i>Chapter 8. Summary and further issues</i>		108
8.1	Summary	108
8.1.1	The model	108
8.1.2	Empirical tests of some basic assumptions	110
8.1.3	The optimal decisions of the firm	111
8.1.4	Tests of certain results	114
8.1.5	Some generalizations of the model	115
8.2	Further issue	117
8.2.1	The objectives of firms	117
8.2.2	Unbalanced growth	118
8.2.3	Some macroeconomic implications	119
<i>Variable list</i>		122
<i>Appendix A. Some identities from chapter 2</i>		126
<i>Appendix B. Data, estimation methods and regression results for chapter 3</i>		129
<i>Appendix C. Data, estimation procedures, regression results, etc., for chapter 4</i>		142
<i>Appendix D. Derivatives and optimum conditions for chapter 5</i>		151
<i>Appendix E. Variable definitions, partial derivatives, simulation curves, etc., for chapter 6</i>		159
<i>Appendix F. Optimum conditions for chapter 7</i>		167
<i>References</i>		173
<i>Figures</i>		
1.	Flow chart of relations between certain central firm variables	20
2.	Optimal rates of growth in the presence of various growth-cost constraints	44
3.	The influence of the leverage ratio on the interest rate and on the rate of return on equity	55

4. The influence of the pay-out ratio on the discount rate, the growth of dividends and the valuation ratio 64
  5. Determination of the firm's production, finance and investment decisions 77
  6. Influence of external changes on the firm's production, finance and investment decisions 79
  7. Simulated relationship between the leverage ratio and the valuation ratio 94
  8. Simulated relationship between the pay-out ratio and the valuation ratio 94
  9. Optimization of the capital value of the firm with respect to the leverage ratio 99
- E: 1. Simulated relationships between the exogenously given rate of return on total capital and the endogenous variables 164
- E: 2. Simulated relationships between the exogenously given interest rate and the endogenous variables 165
- E: 3. Simulated relationships between the exogenously given discount rate and the endogenous variables 166

#### *Tables*

1. Regression estimates for the influence of the growth of sales on the rate of profit on working capital and total capital 41
2. Regression estimates for the influence of growth of sales, rate of product diversification, etc., on the rate of profit on working capital 42
3. Estimated regressions of the interest rate on the leverage ratio, the share of long-term debt, and the size of the firm. Linear specifications 52
4. Estimated regressions of the interest rate on the leverage ratio, the share of long-term debt, and the size of the firm. Linear-multiplicative specifications 53
5. Estimated regressions of the discount rate on the pay-out ratio, the new issue ratio and the leverage ratio. Linear specifications 60
6. Estimated regressions of the discount rate on the pay-out ratio, the new issue ratio and the leverage ratio. Linear-multiplicative specifications 61
7. Changes in the optimal values of the endogenous variables associated with increases in the exogenous factors when no growth costs exist 72
8. Changes in the optimal values of certain endogenous variables associated with increases in the exogenous factors when growth costs exist 76
9. Firms satisfying the financing inequalities 83
10. Calculated normalized deviations from the marginal conditions 85
11. Regression estimates for the leverage ratio with the exogenous values of the interest rate and total profitability as explanatory variables 88

12. Regression estimates for the pay-out ratio with exogenous values of the interest rate, total profitability and the discount rate as explanatory variables 89
  13. Simulated changes in the optimal values of the endogenous variables following from changes in exogenous factors 92
- 
- B: 1. Regressions showing the impact of the actual growth rate on the rate of return on working capital and on total capital 136
  - B: 2. Regressions showing the impact of the calculated growth rate on the rate of return on working capital and on total capital 136
  - B: 3. Regressions showing the impact of the growth rate on the rate of return on working capital and on total capital. Five groups of firms with different growth rates 137
  - B: 4. Regressions showing the impact of the growth rate on the rate of return on working capital. Firms with negative growth rates 137
  - B: 5. Regressions showing the impact of the growth rate on the rate of return on working capital. Firms with positive growth rates 138
  - B: 6. Regressions showing the impact of the growth rate on the rate of return on total capital. Firms with positive growth rates. Linear specifications 138
  - B: 7. Regressions showing the impact of the growth rate on the rate of return on working capital. Firms with negative growth rates 139
  - B: 8. Regressions showing the impact of the growth rate on the rate of return on working capital. Firms with positive growth rates 139
  - B: 9. Regressions showing the impact of the growth rate on the rate of return on total capital. Firms with positive growth rates 140
  - C: 1. Regressions for the interest rate as a function of the leverage ratio 150
  - C: 2. Regression estimates for the discount rate as a function of the pay-out ratio 150