HARVARD | BUSINESS | SCHOOL

FACULTY & RESEARCH

Working Paper | HBS Working Paper Series | 2013

FIN Around the World: The Contribution of Financing Activity to Profitability

by Russell Lundholm, George Serafeim and Gwen Yu

Abstract

We study how the availability of domestic credit influences the contribution that financing activities make to a firm's return on equity (ROE). Using a sample of 51,866 firms from 69 countries, we find that financing activities contribute more to a firm's ROE in countries with higher domestic credit. However, the path from available credit to firm profitability varies significantly between small firms and large firms. More domestic credit allows small firms to increase their leverage ratio but has no effect on the leverage ratio of large firms, presumably because the smaller firms are the marginal borrowers. However, large firms still benefit more from domestic credit because they have higher leverage ratios to begin with, and countries with more available domestic credit have lower borrowing costs. Finally, we show that large increases in domestic credit are followed by significant increases in the financing contribution to ROE in the subsequent year. This is not true for large decreases in domestic credit suggesting that firms are able to access credit in other countries during a financial crisis.

Keywords: Domestic Credit; Return of Equity; Corporate performance; financial statement analysis; Financial Statements; Valuation; Cost of Capital; Asset Pricing; Economic Growth;

Language: English Format: Print 50 pages SSRN

Citation:

Lundholm, Russell, George Serafeim, and Gwen Yu. "FIN Around the World: The Contribution of Financing Activity to Profitability." Harvard Business School Working Paper, No. 13-011, July 2012. (Revised March 2014.)

Export Citation

Related Work

WORKING PAPER | HBS WORKING PAPER SERIES | 2013

FIN Around the World: The Contribution of Financing Activity to Profitability

Russell Lundholm, George Serafeim and Gwen Yu

We study how the availability of domestic credit influences the contribution that financing activities make to a firm's return on equity (ROE). Using a sample of 51,866 firms from 69 countries, we find that financing activities contribute more to a firm's ROE in countries with higher domestic credit. However, the path from available credit to firm profitability varies significantly between small firms and

large firms. More domestic credit allows small firms to increase their leverage ratio but has no effect on the leverage ratio of large firms, presumably because the smaller firms are the marginal borrowers. However, large firms still benefit more from domestic credit because they have higher leverage ratios to begin with, and countries with more available domestic credit have lower borrowing costs. Finally, we show that large increases in domestic credit are followed by significant increases in the financing contribution to ROE in the subsequent year. This is not true for large decreases in domestic credit suggesting that firms are able to access credit in other countries during a financial crisis.

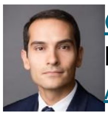
Keywords: Domestic Credit; Return of Equity; Corporate performance; financial statement analysis; Financial Statements; Valuation; Cost of Capital; Asset Pricing; Economic Growth;

Citation:

Lundholm, Russell, George Serafeim, and Gwen Yu. "FIN Around the World: The Contribution of Financing Activity to Profitability." Harvard Business School Working Paper, No. 13-011, July 2012. (Revised March 2014.) View Details

CITE SSRN RELATED

About the Author



George Serafeim
Professor of Business Administration
Accounting and Management

View Profile »
View Publications »