The signaling effect and the k-factors

Business

It is the prime interests of a corporation or business enterprise to maximize profits or rather attract more investors so as to increase the corporation's income. As a result, of this most companies come up with comprehensive, sufficient and sustainable methodologies of attracting possible investors. These methodologies aim at illustrating that a corporation is of sustainable capacity to provide a significant investing basis that will provide long-term benefits. This evaluative essay looks into one of the methodologies based on debt that attracts investors which is the signaling theory.

The signaling theory (ST) developed by Ross (1977) presents an approach whereby the increase in the amount of debt that a corporation offers signifies whether a corporation is expecting cash flows, which are effective in the future. This to investors is a ripe field for investments since if a corporation offers a positive signal then that the corporation is promising. This thus results to signaling effect, which has several implications in the corporation. The first implication entail the expansion of a corporation's business network because when a corporation is capable of attracting multiple investors, then the diversity of these new investors result to an enormous business dynasty. The second implication entails the increase of the customer base of a business because of the trust that the general public gains due to the ability of the company to lend massive amounts.

An increase in the customer base thus results to the increase in the corporation income generation. However, a corporation can send a negative signal if the signal does not get incorporated appropriately due to the presence of a signaling factor. A signaling factor entails the under-pricicing of equity. If equity is under-priced, then the corporation has a strong

managerial effect than investor’s effect. This leads to the downfall of a corporation trust and thus repelling possible investors.

The effect can however, be avoided if a corporation provides a comprehensive flawless system that illustrates open and accommodative management. The first implication that is evident in suchh occurrences is the fact that it will be exceptionally rigid for a corporation to convince investors that their investments in the corporation get secured in the near future. This thus makes the corporation an area of no investment interest. The subsequent implication is that due to the negative signal the corporation is at risk of oozing their customers and not attracting others. This results to a low customer basis which further causes generation of low income.

It is however, of much necessity to note that most of the corporations that offer a negative signal experiences immense losses. The next section analyses the effectiveness and comprehensiveness of the factor models relating the return on assets to several factors. The factor (s) of interest in this paper is the K-factors. However, the expected return (s) on these factors is not definite, but speculative. On these, the asset return is expected to increase relatively. In addition, the return on assets will be capable of even appropriating funds that maintain the assets and also facilitate the purchase of new ones.