Financial theories

Running Head: Financial Theories Financial Theories [Institute’s . Financial Theories Efficiency Theory Efficiency theory applies to the range of statistical and non-statistical way of production estimates and cost frontiers. It underlines the relationship between operations research and economic theory. Significant attributes of this theory are: (1) assimilate the industry equilibrium and firm efficiency, (2) integrating ambiguity of prices and market demand. Adidas is one the examples, which incorporate this theory.

Theory of Investment

Theory of Investment includes the substitute between risk and return, it also explain the meaning of investor risk which significantly depends upon fluctuation. This theory applied to establish the expected rate of return on investments to pricing models of modern assets. Some of the attributes include the support of what information can be supportive for strategic investment (Shankman, 1999).

Agency Cost Theory

Agency theory aimed at the ever-present relationship of agency, in which delegation of work takes place from one person to another, usually the principal and agent. The agency theory deals with the agency clashes, between principals and agents (Bamberg & Spremann, 1987). This theory has certain attributes which includes: (1) ambiguity in routine conclusions, (2) unfavorable choice, and (3) nature of work performed (Bamberg & Spremann, 1987).

Agency Costs of Free Cash Flow Theory

Agency Costs of free-cash-flow occur between stockholders and managers’ conflict. These conflict arises where a firms with large cash flows than positive investment forecast. The attributes are: (1) agency costs of free cash flow’s reduction benefit in debts and (2) substitution of debt against dividends (Bowie & Freeman, 1992).

Pecking-order Theory of Capital Structure

Theory of Capital Structure provides the companies to organize their financial sources from internal to equity financing. Capital raising sources includes equity or debt, to equity is treated as less preferred means of raising capital. Firms usually, large firms raise their debts to support the dividend’s payment while small firms cut their debts to disburse dividend (Myers & Nicholas, 1984).

Economic Value Added Theory

“ Economic Value Added Theory” (EVA) is a technique of financial performance to compute the profit of a firm. Coca-Cola and General Motors are good examples of this theory. The attributes of this theory includes: (1) maximization of the wealth of shareholders, and (2) investors expectation of company’s growth in future profits against the cost of capital (Hayne, 1998).

Weighted Average Cost of Capital

“ Weighted average cost of Capital is the rate of return, sometimes called discount rate” (Shankman, 1999). This applied in assessing weather the project is viable or not in the net present value (NPV) analysis, or in evaluating the asset’s worth (Jensen & Meckling, 1976). Example includes Microsoft’s WACC. Key attributes includes: (1) support in shaping capital leveraging cost, (2) allows other, including share holders to conclude the financial position (Shankman, 1999).

Break-Even Analysis

Break-Even is the point at which your revenues and the amount of costs which related to earn that revenue are equal. This analysis determines the exceeding amount of revenues to the break-even point, sometimes known as margin of safety (Bowie & Freeman, 1992).

Time Value of Money (TVM)

Time Value of Money is the concept that money available to you at present changes its value in the near future, because of its possible holding capacity. Most of the companies invest their unused capital in bank and onto which they will earn interest (Bamberg & Spremann, 1987).

Discounted Cash Flow (DCF)

Discounted Cash Flow (DCF) means that someone's wanted to pay right at the moment and in turn, obtain the probable cash flow in future years. It indicates that today's money is being converted into future earnings (Fama & Jensen, 1983).

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