Research note

Cross-balance sheet interdependencies of restaurant firms: a canonical correlation analysis

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Abstract

Using canonical correlation analysis, this study examined the interdependencies in investing and financing decisions of restaurant firms. The results indicated that the similar four cross-balance sheet interdependencies exist in the restaurant industry as identified by previous studies for different industries and companies in various countries: (1) maturity matching structure of assets and liabilities, (2) use of long-term assets as collateral for long-term debt, (3) use of accounts payable to finance operational assets (e.g., inventories and other current assets), and (4) concurrent use of cash and stockholders’ equity to manage risk. Additionally, this study discovered the unique financing features of the restaurant industry: (1) restaurant firms did not relate account receivables to short-term liabilities, and (2) they financed their operational assets with stockholders’ equity in addition to account payable. The findings are expected to contribute to the understanding of restaurant financing behavior as related to assets structures. This study also demonstrated the usefulness of canonical correlation analysis in extracting information related to financial management strategy.

Keywords: Restaurant firms; Financing behavior; Financial management strategy; Balance sheet; Canonical correlation analysis

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1. Introduction

Tobin’s (1958) separation theorem and Modigliani and Miller’s (1958) classic theory for capital structure provided foundations for modern finance theories. In developing their theories, they assumed that a company’s investing and financing decisions are independently made. This assumption suggests independence between the asset and liability/equity proportions of a balance sheet, which is known as ‘separation’ and it contributes to simplifying corporate financial conditions and easier understanding of financial decision-making.

However, the actual empirical studies have presented interdependencies between the two sides of a balance sheet (Carter and Van Auken, 1990; Helleloid and Sheikholeslami, 1996; Simonson et al., 1983; Stowe et al., 1980; Van Auken et al., 1993). In a study of large industrial firms, Stowe et al. (1980) revealed cross-balance sheet interdependencies in four ways: (1) hedging through the maturity matching of assets and liabilities, (2) use of assets as collateral for loans, (3) use of accounts payable to finance inventories, and (4) risk management by using less leverage and/or by maintaining greater liquidity. Simonson et al. (1983) also reported evidence of the existence of asset/liability hedging to manage interest rate risk in the US banking industry. Based on the Stowe et al. (1980), Carter and Van Auken (1990) attempted to identify dependencies between investing and financing decisions in small firms, as compared to large companies. Reflecting their unique business environments, small firms tended to manage risk through the simultaneous use of cash and debt. It might be due to their greater difficulty of obtaining capital from equity markets. In addition, small firms rely heavily on accounts payable instead of short-term debt to finance current assets. In another study conducted by Van Auken et al. (1993), the cross-balance sheet interdependencies were also identified for Korean firms in comparison to US firms. All four relationships between the two sides of the balance sheet were detected in Van Auken et al.’s study (1993). One unique finding was that Korean firms depend heavily on the use of current debt to finance not only current assets but also long-term assets, which is different from the findings of other studies (maturity matching behavior). Similarly, Helleloid and Sheikholeslami (1996) undertook a study for US multinationals to examine the differences of cross-balance sheet relationships and found a couple of unique findings: (1) long-term assets are financed by a combination of short-term and long-term debt, and (2) current assets (accounts receivable, inventories, and other current assets) are financed by stockholders’ capital. The researchers explained that those unique behaviors might be attributed to local factors within the host countries including political risks, currency risks, and regulatory conditions.

The empirical results of the aforementioned studies generally suggest that the separation theorem is not an appropriate picture of corporate finance reality. The studies have also demonstrated that financial strategies of firms are influenced by economic and political conditions, cultural elements, and financial market situations, which implies that the interdependency behaviors between investing and financing decision may vary by country and/or by industry. In this regard, it is necessary to investigate the investing and financing relationships of the hospitality industry since...
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