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**Is it feasible for companies to form financial slack? The investigation**

**into investment motive**

Many contemporary studies stipulate that there is a strong trend towards the increase in the amount of financial slack in companies of different countries, including Russia. At the end of the first half of 2021 the amount of cash and cash equivalents (including bank deposits) of some Russian public companies exceeded 200 billion RUB. At the same time, as empirical studies show, the market value of financial slack goes up, which indicates the positive reaction of investors to the existence of stock of liquid assets in companies [Bates, Chang, Chi, 2018; Chung, Jung, Park, 2020].

 Value of financial slack depends on the reason why it is created: whether it is for investing into business development (investment motive) or to lower the bankruptcy risk (precautionary motive). The value of slack is caused by flexibility that financial slack ensures for decision-making. This forms the reason to regard financial slack as a real option and, consequently, to apply methods of valuation of options to this asset.

 We focus on the investment motive for forming and using financial slack assuming that investments are long-term value drivers for a company. By investing cash into different projects, a company expects to create additional value for shareholders.

 Large stream of prior research papers testifies to this: for example, Xiao et al. (2021) show that financial slack can mitigate the issue of inefficient investments. Financial slack lowers overinvestment, but at the same time intensifies underinvestment. In [Ashwin et al., 2016; Zhang et al., 2021] the direct relationship between financial slack and corporate R&D investments was revealed.

 We built a single-period theoretical model that may enable to make a conclusion about the feasibility of financial slack for a company by assessing new opportunities provided by financial slack to a firm. The underlying assumption for the model is that the existence of financial slack can be considered as a unique asset that creates the real option to wait for a company. In addition to this, the model rests on the following assumptions. First, the reason for creating and using financial slack is an investment motive, because investments of slack resources may enable a company to generate additional profit that contributes to value growth. Second, the agency problem is assumed to be absent, i.e. the situations when managers may use slack in order to obtain private benefits of control are not considered. Third, capital structure is conservative, i.e. a company never attracts external financing and does not have accounts payable, which means that assets are fully financed by equity. Fourth, a company is fairly valued by the market.

 Based on the theoretical model, we received the expression that allows to find the value of financial slack (relative to value of a company’s manufacturing assets) depending on current market value of manufacturing assets for companies with different level of riskiness of business:

е = *k∙(1+a) / a∙(1+k)*,

where *a* = *MV*0 / *BV* is current market value of a company's manufacturing assets; *MV*0 and *BV* are market and book values respectively; *k* characterizes riskiness of business.

Using the assumption that the value of financial slack should be reflected in stock prices of a company, we empirically tested the theoretical model using the following regression model (1):

$q\_{it }=β\_{0}+β\_{1}∙STL\_{it}+β\_{2}∙TD\_{it}+β\_{3}∙Size\_{it}+β\_{4}∙M\_{it-1}+β\_{5}∙R\_{it}+β\_{6}M\_{it-1}R\_{it}+ε\_{ti}$ (1)

$t=t\_{0},…,T$; $i=1,…,N$

 Description of variables of model (1) is presented in the Table below.

**Table. Description of variables of Model (1)**

|  |  |
| --- | --- |
| Variable | Description |
| ***Dependent variable*** |
| $$q\_{it }$$ | $$q\_{it}=\frac{MV\_{it}}{TA\_{it}} ,$$where$MV\_{it}$ $— $market value of assets of company *i*; $TA\_{it}$ $—$book value of total assets at the end of year *t* |
| ***Independent variables***  |
| $$STL\_{i,t}$$ | Ratio of current liabilities of company *i* to total assets at the end of year t |
| $$TD\_{it}$$ | Ratio of total debt of company *i* to total assets at the end of year t |
| $$Size\_{it}$$ | Proxy variable for a company’s size measured as natural logarithm of total assets of a company *i* at the end of year t |
| $$M\_{it-1}$$ | Binary variable that measures the feasibility of having financial slack for company *i* in year *t* on the basis of year (*t* – 1). $M\_{it-1}$ is 1 if it is feasible for a company to have financial slack in year *t* and 0 if it is not feasible for a company to have financial slack in year *t*. |
| $$R\_{it}$$ | Binary variable that measures the existence of financial slack. $R\_{it}$ is 1 if a company has financial slack and 0 if a company does not have financial slack. |

The sample of the study comprised 180 Russian public companies whose stocks were traded in 2012-2019. The overall amount of observations was 1440. The data were obtained from *Reuters Eikon.* The period from 2012 till 2016 was used in order to assess the parameters of theoretical model, while the estimation of parameters of model (1) was conducted on the data from 2017 till 2019 using 540 observations.

 The results of the study show that the value of qt of the next period *t* will be larger for those companies that have financial slack and for whom at the same time it is feasible to use financial slack in the next period according to the theoretical model, compared to those companies for whom this is not feasible. The economic effect from the existence of slack is larger for those companies that are prescribed to have financial slack according to the model.

 The model for assessing the feasibility of financial slack for a company is not universal and has certain limitations. For example, the main motive for the usage of slack that is considered is the motive of business expansion. However, there can be different motives that may be present at the same time.

**References:**

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