

**FIRM CHARACTERISTICS AND FUTURE STOCK RETURNS: EVIDENCE
FROM TAIWAN'S ELECTRICAL AND CABLE INDUSTRY**

SZU-HSIEN LIN

Department of Accounting and Information Systems,
Asia University, Taichung, Taiwan

CHIEN-CHUNG TU

Taiwan Instrument Research Institute,
National Applied Research Laboratories, Hsinchu, Taiwan

HUEI-HWA LAI*

*Department of Business Administration,
Chaoyang University of Technology, Taichung, Taiwan

SHAO-CHUN CHIU

Department of Accounting and Information Systems,
Asia University, Taichung, Taiwan

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ABSTRACT

This study examines whether firm characteristics explain one-quarter-ahead stock returns in Taiwan's listed electrical and cable industry. Using 507 firm-quarter observations from the Taiwan Economic Journal (TEJ), this study investigates the effects of firm size (SIZE), leverage (LEV), return on assets (ROA), and earnings per share (EPS) on future stock returns. The empirical analysis employs ordinary least squares regression with year fixed effects and HC3 robust standard errors. The results show that firm size is significantly and negatively associated with one-quarter-ahead stock returns, whereas leverage, ROA, and EPS are insignificant. Robustness tests based on nested model specifications confirm the stability of the size effect. These findings suggest that firm size provides more useful information for predicting short-term stock returns than conventional accounting performance measures in Taiwan's electrical and cable industry.

KEYWORDS: - Future stock returns; Firm size; Leverage; ROA; EPS; Electrical and cable industry.

1.0 INTRODUCTION

Forecasting future stock returns remains one of the most important topics in finance because it directly influences investment decisions, portfolio allocation, and corporate valuation. Despite the development of sophisticated asset-pricing models, researchers continue to investigate whether firm-specific characteristics provide useful information for explaining differences in subsequent stock returns. Identifying reliable predictors of future returns is valuable not only for academic research but also for investors seeking to improve investment performance.

Previous studies have documented that firm characteristics, including firm size, leverage, profitability, and earnings performance, are associated with stock returns. Firm size has been recognized as one of the most influential determinants of expected returns since the size effect was first documented in the finance literature. Likewise, accounting-based indicators, such as return on assets (ROA) and earnings per share (EPS), are widely used to evaluate firms' operating performance and financial health, while leverage reflects financing decisions and financial risk. However, empirical evidence remains mixed regarding whether these characteristics retain predictive power for future stock returns after publicly available financial information has been incorporated into market prices.

Taiwan's electrical and cable industry provides a particularly suitable setting for examining this issue. The industry forms an essential component of electricity transmission, infrastructure construction, manufacturing, and industrial development. Compared with many technology-intensive industries, electrical and cable manufacturers operate in a relatively mature and capital-intensive environment, requiring substantial investment in production facilities, equipment, and inventories. Their operating performance is therefore closely related to financing decisions, production efficiency, and long-term capital investment. These industrial characteristics may influence how investors evaluate firm information and consequently affect future stock returns.

Although numerous studies have examined the determinants of stock returns, most focus on broad market samples or firms from multiple industries. Such approaches provide general evidence but may overlook industry-specific characteristics that influence investor behavior and firm performance. Relatively limited research has investigated whether commonly used firm characteristics remain informative within Taiwan's electrical and cable industry, where firms operate under similar production technologies, capital requirements, and competitive environments. Furthermore, previous studies have primarily examined contemporaneous firm performance rather than one-quarter-ahead stock returns, leaving the predictive ability of accounting-based characteristics insufficiently explored in this industrial context.

Accordingly, this study investigates whether firm characteristics explain one-quarter-ahead stock returns in Taiwan's listed electrical and cable industry. Specifically, this study examines the effects of firm size, leverage, and return on assets, and earnings per share on subsequent stock returns using quarterly firm-level data. Ordinary least squares regression with year fixed effects and HC3 heteroskedasticity-robust standard error is employed to provide reliable statistical inference.

This study contributes to the literature in three respects. First, it extends the stock return literature by providing industry-specific evidence from Taiwan's electrical and cable industry, a traditional manufacturing sector that has received relatively limited attention. Second, it evaluates whether conventional accounting-based firm characteristics continue to provide incremental explanatory power for predicting one-quarter-ahead stock returns after controlling for firm size and year-specific effects. Finally, the findings enhance the understanding of stock return determinants within a relatively homogeneous industrial setting and provide practical implications for investors evaluating firms in traditional manufacturing industries.

2.0 LITERATURE REVIEW

2.1 Firm Characteristics and Future Stock Returns

Predicting future stock returns has been one of the fundamental issues in finance because accurate return prediction contributes to investment decisions, portfolio management, and corporate valuation. According to the Efficient Market Hypothesis (EMH; Fama, 1970), publicly available information is rapidly incorporated into stock prices, implying that consistently predicting future returns is difficult. Nevertheless, subsequent studies have shown that firm-specific characteristics contain incremental information beyond market risk and help explain cross-sectional differences in stock returns. Previous studies suggest that firm characteristics provide useful information for explaining cross-sectional differences in future stock returns. Variables such as firm size, profitability, and investment have been shown to capture important dimensions of expected returns (Fama & French, 1992, 2015; Hou et al., 2015).

Fama and French (1992) showed that firm size and book-to-market equity capture much of the cross-sectional variation in average stock returns beyond market beta. Their later five-factor model further incorporated profitability and investment as important determinants of expected returns (Fama & French, 2015). Similarly, Hou et al. (2015) proposed the q-factor model, emphasizing that firm investment and profitability capture important dimensions of expected stock returns. These studies suggest that firm characteristics remain one of the most important approaches for understanding future stock return behavior.

Although extensive evidence exists, previous findings remain inconsistent regarding which firm characteristics retain predictive power after controlling for other financial information. Accounting variables may contain useful information regarding firms' operating conditions; however, financial statements are publicly available, and investors may rapidly incorporate such information into stock prices. Consequently, whether accounting-based characteristics continue to explain subsequent stock returns remains an empirical issue.

Accordingly, this study examines whether commonly used firm characteristics, including firm size, leverage, profitability, and earnings performance, are associated with one-quarter-ahead stock returns in Taiwan's electrical and cable industry.

2.2 Firm Size and Future Stock Returns

Firm size is among the most extensively studied firm characteristics in the asset-pricing literature. Banz (1981) first documented that firms with relatively small market capitalization earn higher average stock returns than larger firms, a phenomenon commonly referred to as the size effect. Subsequent studies by Fama and French (1992, 2015) further established firm size as an important component of multifactor explanations of cross-sectional stock returns.

Several explanations have been proposed for the size effect. Smaller firms generally face greater information asymmetry, lower stock liquidity, and higher operational uncertainty than larger firms. Because investors require compensation for bearing these additional risks, smaller firms are expected to generate higher future returns. In addition, smaller firms often possess greater growth opportunities and operational flexibility, allowing them to respond more quickly to changes in market demand.

Recent studies continue to report that firm size remains economically important, although the magnitude of the size premium varies across industries and market conditions. Hou et al. (2015) also demonstrate that firm size continues to play an important role in explaining stock return differences after incorporating investment and profitability factors.

These arguments may be particularly relevant to Taiwan's electrical and cable industry. As a traditional capital-intensive manufacturing industry, firms require substantial investments in production facilities and inventories. Large firms generally enjoy more stable operations and lower business risk, whereas smaller firms may exhibit greater growth potential and stronger market reactions to new infrastructure projects and industrial investment. Consequently, firm size is expected to remain an important determinant of future stock returns.

H1. Firm size is negatively associated with one-quarter-ahead stock returns.

2.3 Financial Characteristics and Future Stock Returns

Besides firm size, financial characteristics are widely employed to evaluate firms' operating conditions and financial performance. Among these characteristics, leverage, profitability, and earnings performance have received considerable attention because they reflect firms' financing decisions, operational efficiency, and value creation ability. Previous studies suggest that these variables may influence stock returns through different economic mechanisms, although the empirical evidence remains inconclusive across markets and industries.

Leverage

Leverage represents the extent to which firms rely on debt financing. According to the Modigliani and Miller (1958) theorem, capital structure is irrelevant under perfect market assumptions; however, when taxes, bankruptcy costs, and agency conflicts are considered, financing decisions may influence firm value. Jensen and Meckling (1976) further show that financing choices create agency conflicts among managers, shareholders, and creditors, implying that leverage may affect firm value through its associated agency costs. Empirical evidence further indicates that firms' leverage decisions depend on firm-specific characteristics and prevailing market conditions (Frank & Goyal, 2009).

In capital-intensive manufacturing industries such as electrical and cable production, debt financing is often necessary to support production facilities, inventories, and working capital. Consequently, leverage may reflect normal operating requirements rather than excessive financial risk. Whether leverage provides incremental information for predicting future stock returns therefore remains an empirical question.

H2. Leverage is associated with one-quarter-ahead stock returns.

Profitability (ROA)

Profitability reflects a firm's ability to generate earnings from its operating assets and is commonly viewed as an indicator of operating efficiency and competitive advantage. Novy-Marx (2013) documents that gross profitability is a significant predictor of expected stock returns, while Fama and French (2015) incorporate profitability into their five-factor asset pricing model. Likewise, Hou et al. (2015) show that profitability contributes significantly to explaining cross-sectional stock returns within the q-factor framework.

Although profitable firms generally possess stronger operating performance and greater financial flexibility, the predictive ability of historical profitability remains uncertain. Since profitability information is publicly available through financial statements, investors may rapidly incorporate

this information into stock prices, thereby reducing its incremental explanatory power for subsequent returns.

For firms in Taiwan's electrical and cable industry, ROA reflects how efficiently substantial production assets are utilized to generate earnings. Firms with higher ROA are expected to demonstrate superior operating efficiency and stronger future market performance.

H3. Return on assets is positively associated with one-quarter-ahead stock returns.

Earnings Performance (EPS)

Earnings per share (EPS) are one of the most widely followed accounting indicators because it measures earnings attributable to each common share and directly reflects shareholder profitability. Ball and Brown (1968) demonstrate that accounting earnings contain important information for capital markets, while Beaver (1968) shows that earnings announcements substantially affect investor behavior. Ohlson (1995) further establishes the theoretical linkage between accounting information and firm valuation.

Despite the importance of earnings information, previous studies also suggest that financial markets react rapidly to publicly disclosed earnings. Consequently, reported EPS may contain limited incremental information for explaining future stock returns once earnings information has been incorporated into market prices. Nevertheless, because EPS directly represents shareholder profitability, it remains one of the most frequently used indicators in equity valuation.

Although ROA and EPS both measure profitability, they capture different dimensions of firm performance. ROA evaluates operating efficiency relative to total assets, whereas EPS measures earnings attributable to shareholders. Examining both variables simultaneously enables this study to evaluate whether either accounting measure provides additional explanatory power for one-quarter-ahead stock returns.

H4. Earnings per share are positively associated with one-quarter-ahead stock returns.

2.4 Research Gap

Although numerous studies have investigated the determinants of stock returns, three research gaps remain. First, most previous studies employ broad market samples or cross-industry datasets, potentially masking industry-specific characteristics. Second, relatively limited evidence is available for Taiwan's electrical and cable industry, despite its importance as a traditional manufacturing sector supporting infrastructure development, energy transmission, and

industrial investment. Third, previous studies have primarily examined contemporaneous market performance, whereas relatively fewer studies investigate one-quarter-ahead stock returns using firm-specific accounting characteristics.

To address these gaps, this study focuses on listed firms in Taiwan's electrical and cable industry and examines whether firm size, leverage, return on assets, and earnings per share explain one-quarter-ahead stock returns. By concentrating on a relatively homogeneous industry, this study reduces cross-industry heterogeneity and provides industry-specific evidence regarding the determinants of future stock returns.

3.0 DATA AND METHODOLOGY

3.1 Sample Selection and Data Sources

The sample consists of all publicly listed companies classified in the electrical and cable industry by the Taiwan Stock Exchange (TWSE) and the Taipei Exchange (TPEX). Quarterly firm-level financial and market data are obtained from the Taiwan Economic Journal (TEJ), a widely used database for empirical research on Taiwan's capital market.

The sample period spans from 2015Q1 to 2024Q4. Financial institutions and firms with incomplete financial information are excluded. Observations with missing values for the dependent or independent variables are removed. After data screening, the final sample comprises 507 firm-quarter observations.

To investigate subsequent market performance, the dependent variable is measured as the one-quarter-ahead return (ROI_{t+1}). Specifically, each firm's quarterly stock return is matched with firm characteristics observed in the preceding quarter, thereby reducing potential simultaneity between explanatory variables and subsequent stock performance.

3.2 Variable Definitions

Dependent Variable

The dependent variable is one-quarter-ahead stock return (ROI_{t+1}). The one-quarter-ahead stock return is constructed by shifting each firm's observed quarterly stock return forward by one quarter, ensuring that firm characteristics at quarter t are used to explain stock returns in quarter $t + 1$. This design mitigates potential reverse causality and better reflects the predictive ability of firm characteristics.

Independent Variables

Firm size (SIZE) is measured as the natural logarithm of total assets. Larger firms generally possess lower information asymmetry and more stable operating performance but may exhibit lower expected returns because of lower perceived risk.

Leverage (LEV) is measured as the ratio of total liabilities to total assets. This variable reflects firms' financing structure and financial risk.

Return on assets (ROA) is calculated as net income divided by total assets. ROA measures operating efficiency and overall profitability.

Earnings per share (EPS) represent earnings attributable to each outstanding common share and capture shareholder-oriented accounting performance.

3.3 Empirical Model

To examine the relationship between firm characteristics and future stock returns, this study estimates the following regression model:

Model (1)

$$ROI_{i,t+1} = \beta_0 + \beta_1 SIZE_{i,t} + \beta_2 LEV_{i,t} + \beta_3 ROA_{i,t} + \beta_4 EPS_{i,t} + YearFE_t + \varepsilon_{i,t}$$

Where $ROI_{i,t+1}$ denotes the one-quarter-ahead stock return of firm i , $SIZE$ represents firm size, LEV denotes leverage, ROA measures return on assets, and EPS represents earnings per share. Year fixed effects are included to control for macroeconomic conditions and market-wide shocks that may affect stock returns over time.

3.4 Estimation Method

The empirical analysis is conducted using ordinary least squares (OLS) regression. Because heteroskedasticity may bias conventional standard errors, this study reports HC3 heteroskedasticity-robust standard errors, which have been shown to perform well in finite samples and provide more reliable statistical inference than conventional OLS standard errors.

Prior to the regression analysis, descriptive statistics and Pearson correlation coefficients are reported to summarize the characteristics of the sample and examine the relationships among variables. Variance inflation factors (VIFs) are further calculated to assess potential multicollinearity among the explanatory variables. The maximum VIF is below the commonly accepted threshold of 5, indicating that multicollinearity is not a serious concern in this study.

To evaluate the robustness of the empirical findings, nested model specifications are estimated by sequentially introducing the explanatory variables while maintaining year fixed effects and HC3 robust standard errors. Consistent results across these specifications provide additional support for the stability of the estimated relationships.

4.0 EMPIRICAL RESULTS

4.1 Descriptive Statistics

Table 1 reports the descriptive statistics of the variables. The mean one-quarter-ahead stock return (ROI_{t+1}) is 1.201%, with a standard deviation of 8.413%, indicating substantial variation in future stock performance across firm-quarter observations. Firm size (SIZE) has a mean value of 16.024, while the average leverage ratio (LEV) is 36.356%. The mean return on assets (ROA) is 2.533%, and the average earnings per share (EPS) is 0.751. The relatively wide ranges of ROI_{t+1} , ROA, and EPS suggest considerable heterogeneity in both market and accounting performance among Taiwanese electrical and cable firms.

4.2 Correlation Analysis

Table 2 presents the Pearson correlation matrix. Future stock returns exhibit a weak negative correlation with firm size ($r = -0.075$) and weak positive correlations with ROA ($r = 0.136$) and EPS ($r = 0.131$). Although ROA and EPS are highly correlated ($r = 0.824$), the variance inflation factors remain within acceptable levels. Specifically, the maximum VIF is 3.704 and the mean VIF is 2.420, both well below the commonly accepted threshold of 5. These results indicate that multicollinearity is not a serious concern and all explanatory variables are retained for subsequent regression analysis.

4.3 Regression Results

Table 3 reports the baseline regression results using year fixed effects and HC3 heteroskedasticity-robust standard errors. Firm size (SIZE) exhibits a significantly negative association with one-quarter-ahead stock returns ($\beta = -0.891$, $p < 0.05$), suggesting that relatively smaller firms generate higher subsequent stock returns than larger firms within the Taiwanese electrical and cable industry. This finding is consistent with the size effect documented in the asset pricing literature.

In contrast, leverage (LEV), return on assets (ROA), and earnings per share (EPS) do not have statistically significant effects on future stock returns after controlling for firm size and year-specific effects. These findings imply that traditional accounting performance indicators provide limited incremental explanatory power for predicting subsequent stock returns in this industry. The model explains approximately 13.6% of the variation in future stock returns ($R^2 = 0.136$; adjusted $R^2 = 0.113$).

4.4 Robustness Analysis

Table 4 reports the robustness analysis based on nested model specifications. The negative coefficient of firm size remains statistically significant across all model specifications, with coefficients ranging from -0.696 to -0.891 . This consistency demonstrates that the estimated size effect is robust to the sequential inclusion of leverage, ROA, and EPS.

Leverage remains statistically insignificant throughout all specifications. ROA is only marginally significant before EPS is included in the regression model, but its significance disappears after EPS is added. Similarly, EPS is insignificant in the full specification. The adjusted R^2 changes only slightly across models, indicating that the additional accounting variables contribute little incremental explanatory power beyond firm size. Overall, the robustness analysis confirms that firm size is the only variable consistently associated with subsequent stock returns in the sample firms.

5.0 DISCUSSION

The empirical findings indicate that firm size is the only variable consistently associated with subsequent stock returns in Taiwan's electrical and cable industry. Specifically, firm size exhibits a significantly negative relationship with one-quarter-ahead stock returns across all model specifications, suggesting that smaller firms tend to outperform larger firms in subsequent periods. The robustness analysis further confirms that this relationship remains stable after the sequential inclusion of leverage, ROA, and EPS.

The negative size effect is generally consistent with the size anomaly documented in the asset-pricing literature, where relatively smaller firms tend to earn higher average returns than larger firms. In the electrical and cable industry, smaller firms may also possess greater operational flexibility and stronger growth potential, making them more responsive to changes in market demand and industrial investment cycles. Consequently, investors may require higher expected returns when investing in these firms.

In contrast, leverage, profitability, and earnings per share do not exhibit significant explanatory power for future stock returns after controlling for firm size and year-specific effects. The insignificant coefficients suggest that accounting information may already be reflected in market prices before the subsequent quarter. Consequently, ROA and EPS provide limited incremental information for predicting one-quarter-ahead stock returns beyond that already incorporated by investors. The high correlation between ROA and EPS further suggests that both variables capture similar aspects of corporate performance, although the multicollinearity diagnostics indicate that the correlation is not severe enough to bias the regression estimates. Overall, the findings suggest that market participants place greater emphasis on firm characteristics related to

size than on conventional accounting performance measures when evaluating future stock returns in Taiwan's electrical and cable industry. These results imply that firm size remains an important determinant of future market performance, whereas traditional financial indicators contribute relatively little additional predictive information once firm size has been taken into account.

6.0 CONCLUSION

This study examines whether firm characteristics can explain subsequent stock returns in Taiwan's electrical and cable industry. Using quarterly firm-level data and ordinary least squares regression with year fixed effects and HC3 robust standard errors, this study investigates the effects of firm size, leverage, return on assets, and earnings per share on one-quarter-ahead stock returns.

The empirical results indicate that firm size is the only variable consistently associated with future stock returns. Specifically, firm size exhibits a significant negative relationship with one-quarter-ahead stock returns, suggesting that smaller firms tend to generate higher subsequent returns than larger firms. In contrast, leverage, return on assets, and earnings per share do not provide significant incremental explanatory power after controlling for firm size and year effects. The robustness analysis based on nested model specifications further confirms the stability of the negative size effect.

From a theoretical perspective, the findings support the continuing importance of the size effect in explaining cross-sectional differences in stock returns, even within a single traditional manufacturing industry. The results also suggest that conventional accounting performance measures may have limited ability to predict short-term future stock returns once publicly available information has been incorporated into stock prices, consistent with the implications of the Efficient Market Hypothesis (Fama, 1970).

From a practical perspective, investors may benefit from incorporating firm size into their stock selection process when evaluating firms in Taiwan's electrical and cable industry. Rather than relying solely on traditional accounting indicators such as ROA or EPS, investors should also consider firm characteristics that capture differences in market valuation and risk.

This study has several limitations. First, the sample is restricted to firms in Taiwan's electrical and cable industry, which may limit the generalizability of the findings to other industries or countries. Second, only one-quarter-ahead stock returns are examined, and future studies may investigate alternative forecasting horizons or additional market-based variables. Finally, although this study controls for year-specific effects, future research may consider alternative

empirical approaches or broader sets of firm characteristics to further improve the explanatory power of stock return prediction.

Future research may extend this analysis to different industries to examine whether the relationships between firm characteristics and one-quarter-ahead stock returns vary across industries with different business models, capital structures, and growth opportunities.

Table 1. Descriptive Statistics

Variable	N	Mean	Median	SD	Min	Max
ROI(t+1)	507	1.201	0.338	8.413	-22.081	69.846
SIZE	507	16.024	15.814	1.042	14.550	19.432
LEV	507	36.356	37.270	14.579	5.940	70.080
ROA	507	2.533	1.990	4.117	-13.850	38.970
EPS	507	0.751	0.500	1.053	-2.490	8.540

Table 2. Pearson Correlation Matrix

Variables	ROI(t+1)	SIZE	LEV	ROA	EPS
ROI(t+1)	1.000	-0.075	-0.021	0.136	0.131
SIZE	-0.075	1.000	0.341	0.065	0.262
LEV	-0.021	0.341	1.000	-0.109	0.062
ROA	0.136	0.065	-0.109	1.000	0.824
EPS	0.131	0.262	0.062	0.824	1.000

Note: Maximum VIF = 3.704; Mean VIF = 2.420, indicating no serious multicollinearity.

Table 3. Main Regression Results

Variables	Coefficient	Robust SE	t-statistic	p-value
Intercept	14.569	5.811	2.507	0.012
SIZE	-0.891	0.377	-2.364	0.019
LEV	0.007	0.028	0.267	0.790
ROA	0.035	0.175	0.199	0.842
EPS	0.669	0.759	0.881	0.379

Model Statistics	
Observations	507
R ²	0.136
Adjusted R ²	0.113
Year Fixed Effects	Yes
HC3 Robust SE	Yes

Table 4. Robustness Analysis (Nested Models)

Variables	Model 1	Model 2	Model 3	Model 4
SIZE	-0.696**	-0.719**	-0.773**	-0.891**
LEV		0.005	0.012	0.007
ROA			0.176*	0.035
EPS				0.669
Year FE	Yes	Yes	Yes	Yes
HC3 Robust SE	Yes	Yes	Yes	Yes
Observations	507	507	507	507
Adjusted R ²	0.111	0.109	0.113	0.113

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