A QUESTION OF VALUE – CASH FLOW AND CAPITAL STRUCTURE DETERMINANTS IN THE U.S. DEFENSE AND AEROSPACE INDUSTRIES

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ABSTRACT

Apart from the geopolitical implications inherent in the U.S. defense and aerospace industries, companies in these two industries are still required to continually increase firm value with a view to maximizing shareholder wealth. This study investigates whether cash flows and capital structure affect firm value in the U.S. defense and aerospace industries. Cash flows are operationalized by using cash flows from operations, while capital structure is operationalized by market capitalization and total debt-to-equity. Utilizing association inferential statistics, this study shows that in general, cash flow from operations, market capitalization, and total debt-to-equity have an effect on the firm value of companies in the U.S. defense and aerospace industries. In particular, the results of this study, show that cash flows from operations and market capitalization are statistically significant. Apart from adding to the extant literature, it is hoped that this study helps managers of companies in the U.S. defense and aerospace industries in their day-to-day management to increase firm value with the resultant maximization of shareholder wealth.

Keywords: *Firm value, cash flow from operations, market capitalization, debt-to-equity.*

1. INTRODUCTION

The U.S. defense and aerospace are technologically advanced industries that develop and manufacture defense components and aircraft for military and civilian customers. Generally speaking, these industries have impacted all, if not the majority of people's lives in terms of technology, travel, and overall safety. These two industries generate billions in revenue annually with 13 making the Fortune 500 list in 2019. Furthermore, these industries employ over 2 million workers and are projected to grow over the next decade. In 2022, the value of these industries was $416.63 billion, by 2030, their projected growth is estimated to be $550.78 billion (Mordor Intelligence, 2022).

The U.S. defense and aerospace industries exhibit idiosyncratic characteristics that vary with the ebb and flow of geopolitical events and national security concerns and the readiness to thwart any act of aggression against the U.S.

However, apart from the geopolitical implications in the two industries, there are business perspectives that must be addressed, and which ensure that companies continually increase firm value which in turn translates into maximizing shareholder wealth.

According to the shareholder theory, maximizing shareholder wealth is the number one objective for a firm (Friedman, 1962). One notable ratio to help understand a firm's value is Tobin's Q. This paper utilizes Tobin's Q to identify how firms can increase their value, which in return will increase shareholders' wealth. Since these industries have a high barrier to entry, stifling competition, and high costs associated with operations, companies in these industries need to continue to investigate and invest in opportunities for value growth. Following this introduction, a literature review is provided, followed by, a discussion of hypotheses, methodology, results, limitations, and conclusions and recommendations.