Working Paper No. 562

Keep in mind

AUTHOR OR EDITOR

José Eduardo Gómez

Carlos Eduardo León Rincón

Leiton, Karen Juliet

AUTHORS AND/OR EDITORS

Leiton, Karen Juliet

Classic financial theory relies on the absolute perfection of capital markets, which results in one of the milestones of theoretical corporate finance: the firm's value is invariant to the choice of capital structure. As an extension to the aforementioned proposition by Modigliani and Miller (1958), corporate risk management is also futile. Nevertheless, it is clear that capital markets do not work with absolute perfection. There exist frictions which make risk management decisions essential for firm's value. Moreover, derivatives' market vast importance is a good proxy of the relevance of hedging decisions for corporate finance. There is a remarkable volume of literature which tests the effects of risk management and hedging decisions for the value of the firm, mainly for the US corporate market. However, there is little effort on this subject for markets which work even farther from absolute perfection. This document undertakes such task for the Colombian market. Focused on non-financial firms and the local's most liquid derivatives market, we find that for a panel of eight large Colombian corporations the growth rate of Tobin´s Q depends significantly on firm´s size and hedging. After controlling for relevant financial variables such as firm´s profitability and leverage, and other variables such as firm´s age, results suggest that an increase in hedging leads to a higher growth in firm´s value.