

Understanding the Effect of Operating and Financial Leverage to Absorb Macroeconomic Shocks

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Abstract. We examine the mechanisms that allow companies to transform a short-term negative shock generated by a recession in a long-term gain in market value. We claim that firms should build optimum levels of operating and financial leverage to permanently expand their market value during and in the aftermath of a recession. However, this decision is nontrivial, given the multiple contrasting effects relating leverage with firm value, particularly in moments of excess capacity. Empirical results from various industries in the US during the period 1982-2015 allow us to shed light on the relationship between operating and financial leverage with firms' value during and in the aftermath of recessions.

Keywords: Operating Leverage, Financial Leverage, Recessions, Firm Value.