Lingnan University 嶺南大學 香港 Hong Kong

Faculty of Business 嶺南大學商學院

Department of Finance
Hong Kong Institute of Business Studies

Intermediate Input, Operating Profit, and Risk

Intermediate input price cyclicality, the extent to which an industry's input price comoves with economic conditions, is a key determinant of cash flow cyclicality and risk. Empirically, firms in industries with cyclical input price exhibit more stable operating profits and lower exposure to aggregate risk. A low-minus-high portfolio sorted by the cyclicality generates a 5.5% annualized return. A model featuring production network, Calvo pricing, and oligopoly can explain the empirical findings with cost pass-through and operating hedging channel. Using tariff changes as plausibly exogenous cost shock, I confirm additional predictions of the model: (i) pass-through to output prices occurs primarily when upstream suppliers are price-flexible and have low market power, and (ii) network-propagated input price increases reduce downstream operating profits.

Kane Bae is a Ph.D. candidate in Finance at University of Toronto, Rotman School of Management, specializing in macrofinance and asset pricing. His research investigates the role of inventory investment in firms' risk and studies the relationship between supply-chain network and asset pricing. His works have been presented at leading conferences including NFA, EFA, FMA, and SAIF.

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