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ON THE THEORETICAL RELATIONSHIP BETWEEN SYSTEMATIC RISK AND PRICE ELASTICITY OF DEMAND

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Abstract

The linkage between financial valuation and the product and factor markets faced by the firm is an area that is rapidly developing in the literature. The purpose of this paper is to demonstrate the theoretical bridge between systematic risk and price elasticity of demand for a firm's output. The primary theoretical result indicates that price elasticity of demand, the certainty equivalents of the random demand parameter and variable cost, and their respective covariances with the cash flow of the market portfolio are key determinants of systematic risk and thus a firms's cost of capital.

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