

Managerial Perspectives on Corporate Finance Decisions[‡]

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Managerial Perspectives on Corporate Finance Decisions

Abstract

This article uses the extended case method (Burawoy, 1998) to explore the drivers and objectives of senior executives in making corporate finance decisions. We sequentially survey relevant literature to identify core concepts and theories; compile empirical data to test these concepts and theories, which we achieve using an instrument similar to that of Graham & Harvey (2001) to survey Australian finance executives (N=76); and then fill in gaps and resolve puzzles by detailed investigation, conducted here through face-to-face interviews with eight CFOs or similar of listed Australian firms.

Our stimulus is to explain the puzzle of why educated and well-paid executives apparently destroy value every time they approach markets, whether it be with an IPO, acquisition or hedging strategy). We find that managers generally have a sophisticated approach to financial decisions that is displayed in logical, defensible rationales. Thus we resolve the puzzle in favor of the executives and conclude that a balanced interpretation of the evidence shows they are superior to markets in evaluating the medium-term value of investments.

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1. Introduction

Most analyses of decisions in corporate finance use data revealed by decisions, typically as large databases of transactions. Thus the econometrician with access to hundreds or thousands of decisions knows more about them than the decision makers. These last invariably emerge badly from such analyses. Typical examples of their inadequate decision making include the systematic underpricing of initial public offerings (Ritter, 1998), over-payment for acquisitions (Andrade, Mitchell and Stafford, 2001); poor hedging judgments (Tufano, 1998); and under-investment (Froot and Stein, 1998). It can seem that every time managers go near markets they destroy value (Jensen, 2001).

Our study is prompted by the puzzle of why finance managers who are experienced, highly educated and paid well seem to make poor decisions. The puzzle is compounded by the fact that many executives have studied under the very academics who are so scathing of their subsequent performance.

Our empirical evidence is obtained in two steps. The first is to survey practicing finance executives using an instrument similar to that of Graham and Harvey (2001); this was conducted in conjunction with a major professional finance association and elicited 76 responses. Results were similar to those from North America, but left many questions – and our major puzzle – unanswered. This led to the second step, which was to interview senior finance managers – most of them chief finance officers (CFOs) and Treasurers of major listed companies – to probe the rationales and strategies of their decisions. We deliberately sought the granularity of face-to-face interviews to unravel the puzzle of apparently poor managerial decision-making. The technique of personal interviews is common in the management discipline (where it yields excellent case studies), anthropology and elsewhere but less so in finance research; we commend the methodology to readers.

Our study follows the extended case method (Burawoy, 1998) and is the first to build an integrated picture of how senior executives make their firms' major finance decisions. Responses from Australian executives in the survey proved similar to their American counterparts, with extensive use of NPV for project evaluation, and more frequent use of sophisticated analytical approaches by large, growth firms with rated debt. Cash flow volatility was the most important influence on debt levels, but firms also responded opportunistically, particularly to secure financial flexibility.

The most surprising finding from the interviews was that qualitative criteria dominated executives' financial strategies. They also sought real options in investments, although few managers attributed any significant value to future flexibility, and were skeptical of 'strategic investments'.

Moral hazard repeatedly featured in executives' finance decisions, by shaping choices so they send favorable signals, meet the needs of clienteles, and satisfy rating agencies. Executives were respectful towards Boards, but none could give an example of where they had added value. Risk management proved important in all firms, largely with its management sense of avoiding loss or poor outcome, and was

seen as directly linked to returns. Most firms had explicit ethics policies and executives expect issues related to sustainability will become more intense and pervasive.

The balance of the article proceeds as follows. The next section discusses the foundations and limitations of our research techniques. The following section presents the major findings as themes identified in the research classified within standard corporate finance categories; and we close with a brief discussion.

2. Methodology

2.1. Previous Survey Studies

Many articles have reported the results of large scale ($N > 70$) mail or electronic surveys that use self-reports by finance executives to investigate how decisions are actually made in the field. Significant recent contributions have been made by Brau and Fawcett (2006), Block (1999), Fraser (2004), and Graham and Harvey (2001).

As an extension of this technique, a number of authors have followed up the surveys with interviews of a smaller group (typically $N = 10-20$) to provide additional explanation of factors that drive finance decisions. Pioneering contributions in this area were by Lintner (1956); Donaldson (1961, 1969); Donaldson and Lorsch (1983); Duhaime and Grant (1984); and March and Shapira (1987). More recent studies include those of Brav, Graham, Harvey and Michaely (2005); Graham, Harvey and Rajgopal (2005); and Hodge, Rajgopal and Shevlin (2006).

Our study extends this literature in several important directions. The first is to conduct a survey in Australia using instruments similar to those reported for United States executives. Whilst responses to any survey will be affected by the setting in which it is administered and the way it is framed or presented to participants, use of a similar survey in a geographically remote country provides an interesting test of the influences of national differences. Specifically, we are able to determine the impact on managerial decision-making of alternative market mechanisms such as different taxation and regulatory regimes. The second innovation in this survey is to specifically probe the importance to finance decisions of non-financial factors such as governance, risk (in the general sense used by executives as the possibility of loss) and the growing subject of corporate sustainability. Finally we are interested in solving the puzzle of managers' apparent lack of financial competence that is prevalent in the literature.

2.2. Survey Design and Distribution

The first part of the study is a survey of finance executives using an instrument similar to that employed by Graham and Harvey (2001). The latter focused on capital budgeting, cost of capital and capital structure and was designed with significant input from prominent academics, survey research experts and the Financial Executives Institute (FEI).

Our survey incorporates two important differences to that of Graham and Harvey, largely as a result of incorporating local advice from finance academics, researchers with survey-based experience, and the Finance and Treasury Association (FTA)¹. The first change has been to account for specific Australian market characteristics such as sales revenue figures and industry sectors. Secondly, the study was extended to include questions relating to firms' payout decisions. Our final survey consisted of 145 questions spread out over 21 topics concerning capital budgeting practices, cost of capital calculation, capital structure decisions, the formation of payout policy and key characteristics of the firm. Respondents were asked to provide answers on a five-point Likert scale where 0='Never'; and 4='Always'.

The Survey was sent out to the chief financial officers of 1,373 Australian firms identified via the FTA proprietary database, with a covering letter encouraging participation in the project. The survey was mailed at the beginning of March 2005 with a reply-paid envelope and instructions that it was to be returned by the end of the month.

2.3. Characteristics of Survey Respondents

We received 76 usable responses to give a response rate of just above five percent. Whilst lower than Graham and Harvey's response rate of approximately eight and half percent, this is not surprising as our survey included an extra section dealing with payout policy which required 24 additional responses.

Figure 1 provides summary information about the characteristics of respondents' firms.

[Insert Figure 1 here]

It is apparent that we have a diverse spread of firms in terms of size as measured by sales revenue. In order to ascertain the impact of size upon firm decisions we will subsequently separate the full sample into large and small firms on the basis of whether their annual sales revenue exceeds \$500 million. We also find an even spread of industry representation, with all 10 of the Standard and Poor's Global Industry Classification Standard (GICS) sectors represented. The industrials sector is the most heavily represented, with this sector contributing 24% to the final sample.

47% of the respondents reported a P/E ratio with a mean (median) value of 14.53 (13.0). 13% of the firms that did not report a P/E ratio recorded their reason for doing so as being that they were an unlisted entity whilst the remaining 40% of respondent firms provided no reason for their omission. Following Graham and Harvey (2001) we classify the subsample of P/E reporting firms as high growth (low growth) firms if their P/E ratio is greater (less than or equal to) than 14. This classification criterion results in an almost even split of firms between the two P/E categories.

With regards to adopting a target debt ratio, we find a similar pattern of reported behaviour as that documented in Graham and Harvey (2001). Specifically, we find that most respondents have a flexible target debt ratio with the most infrequent

¹ The FTA is the pre-eminent professional body for corporate treasurers in Australia.

response being that firms adopt a strict debt ratio. In contrast to previous reported results from overseas studies, we find that our sample firms more frequently adopt a “no-target” debt policy rather than one described as “somewhat tight” which is not surprising given that the tax attractiveness of debt, and hence the motivation for higher leverage levels, in the Australian context is reduced by the operation of the imputation tax system. Almost half of our sample firms do not report having any foreign sales while only 17% of the sample reports deriving the majority of its sales revenue from overseas sources.

2.4. Interview Design and Conduct

The second part of the study involved interviews with senior finance executives, which had two objectives. The first was to amplify anomalous results obtained from the surveys, whilst the second objective was to explore in detail the way that senior finance executives actually make decisions. In short the interviews were designed to test a number of propositions centered around the decision making competences of managers. We intended them to constitute the prime data sources in this study.

Reliance on interviews was motivated by successful results reported across many disciplines, including finance management. These one-on-one studies enable researchers to ask qualitative questions, elicit motivation and rationale for actions, and explore questions in terms familiar to the executives. This overcomes a number of well-recognized shortcomings of surveys, especially their inflexibility, tendency to elicit answers based on theory or belief rather than actual practice, and difficulty in deriving an explanatory model that matches all responses.

A total of eight CFOs or Treasurers of listed Australian companies agreed to participate. Interviewees were aged between 40 and 55 years, with between four and 20 years experience with their current employer. The firms were headquartered on the Australian east coast (in Brisbane, Melbourne and Sydney), involved in the construction, finance, manufacturing and mining sectors and are in the top 100 by market capitalization of firms listed on the ASX.

Interviews were conducted face-to-face in each interviewee’s office by both of the first two authors. Each was assured of confidentiality. We began with an open-ended question asking how the firm decided what to do with its expected cash flow, given the alternatives of investment, adjusting debt and returning equity. The balance of the interview was designed to cover each of the questions in table 1. Interviewers were alert, however, to the opportunity to probe answers and only loosely followed ‘the script’. Interviewees were encouraged to give examples to illustrate their answers, and the process generally followed the framework advocated by Strauss (1987). Interviews were recorded (and subsequently transcribed by a commercial service) and took between 55 and 90 minutes. The authors verified each transcription and lightly edited them to ensure that the written comments flowed.

[Insert table 1 here]

An obvious limitation of the study is the number of executives interviewed. However, as is typically found with interviews, a point of diminishing returns is reached relatively quickly (e.g. Danneels, 2007). After transcribing and editing the interviews,

we found that over a quarter of the material was relevant and directly illuminating of our research questions. However, even after further harsh paring, for reasons of space we have only been able to include (in the section below) about a third of this relevant material.

In summary, we have followed what Burawoy (1991) termed the ‘extended case method’. This involves sequentially surveying relevant literature (in this case decisions in corporate finance) to identify core concepts and theories; compiling empirical data to test these concepts and theories (which we achieve through a survey); and then filling in gaps and resolving puzzles by detailed investigation (through the interviews). The last, interview stage involves multiple iterations as actual practice is identified, tested for conformance to theory, and – as necessary - examined further in subsequent interviews.

This process is reflexive in that there is extensive interaction between we analysts and the subjects of our study. Unlike databases and surveys that strictly separate analysts from their subjects, we sought productive interaction with our subjects. Although the study is grounded in theory, the subjects of our interviews were experienced executives who – almost as a consequence of accepting academics’ invitation to provide real-world data – had well-formed views about finance theory and practice. As interviews are not bound by the strictures of databases that can only report quantifiable transaction data and surveys that generally prejudge acceptable responses, they have the very real advantage of enabling researchers to understand not just what firms do, but to probe *why* they do it.

3. Findings: Survey and interview results

3.1. Capital Budgets and Investment

Figure 2 and table 3 report results from the Survey questions on techniques used to evaluate investment opportunities, and how discount rates are derived.

[Insert figure 2 and table 2 here]

The results above are very consistent with that reported by Graham and Harvey (2001). Firstly, the discounted cash flow techniques clearly dominate other methods of project evaluation with very similar results being reported for the NPV and IRR approaches. Furthermore, we also find that larger firms and firms with rated debt are more likely to employ the discounted cash flow techniques when compared to smaller firms or those without rated debt. A firm’s growth prospects had no noticeable impact on the likelihood of it employing any of the techniques, except for an earnings multiple approach with non-growth firms using this technique more often than growth firms.

One possible explanation for this result may be that in the successful utilization of an earnings multiple approach is aided by the presence of a predictable earnings stream, which is more likely to be observed in low-growth firms. Finally, the ranking of the first six project evaluation techniques (as measured by the percentage of respondents who ‘Always’ or ‘Almost always’ used a technique) is identical to that

reported by Graham and Harvey (2001). Also of note, is the lack of support for some of the more contemporary project evaluation techniques such as real options and VaR analysis. We explicitly follow up these latter findings during the interview stage of the project.

Given the importance of discounted cash flow measures, the question of how the firm comes to decide which discount rate is employed is of obvious interest. Survey results are shown in table 3.

[Insert table 3 here]

Once again the responses to this question are very similar to those reported in Graham and Harvey (2001). Contrary to the message delivered in almost every introductory finance class, the evidence suggests that new projects tend to be evaluated using a company-wide discount rate rather than a rate that specifically reflects the risk-profile of the project being evaluated. Of course, this is not necessarily a significant issue where the project being assessed is 'typical' and reflects the average risk of the firm's existing portfolio of projects.

We also asked firms whether they estimated the cost of equity capital and, if so, what technique they employed to do so. In unreported results (available from the authors by request) we find that the over 70% of respondents always or almost always utilize the standard CAPM. This result closely matches the Graham and Harvey (2001) result as does the finding that just over 30% of those that estimate the cost of equity utilize some multi-factor version of the CAPM.

3.1.1. Capital budgeting

Most firms had a formal process for establishing capital budgets and allocating capital and/or approving individual investment projects.

It's a laborious process that takes several months. This may sound ridiculous; and sometimes it feels like it is. [CFO manufacturing firm]

Operations talk about the strategies they want to pursue as a separate dialogue with management and the board. It's a separate dialogue, because the strategic business plan is about the left hand side of the balance sheet. Strategic financing is about the right hand side of the balance sheet. We consider how is our EPS behaving, that's number one. Number two is our return on funds invested [ROFI], that's before funding, before equity and debt. And then what is our gearing and our ratios as determined by the rating agencies, because that impacts the availability of funding and the pricing of funding. And we perceive that as being very important. So you're working within what can we do on EPS, what can we do on ROFI, what can we do within our funding constraints that we've agreed with the board. [CFO manufacturing firm]

The process is centered on the reporting year end (June) with top-down objectives set by senior management and bottom-up submission of proposals from business units.

We do an annual exercise. It's a religious sort of thing, with a big planning meeting ... There are ratios that are set by the Board: this dividend payout, this return on assets and turnover. They are put in the business plan and set out priorities over the next two years. A lot of those ratios are historical, but they're the ones people are comfortable with. [Treasurer construction firm]

We consider what is required to maintain and grow the base business and then identify strategic options on top of that. This takes in what our investors are looking for, what our competitors' investors have been receiving. We then marry financial demands with the business projection to arrive at a constrained plan. [CFO manufacturing firm]

Apart from projected returns, a number of other factors shape decisions on allocation of capital. An important link is prior capital expenditure.

We say to the business units [BUs]: 'Capex-wise you can only have something like 80 percent of your depreciation charge, so rank your projects.' That means there's 20 percent of the depreciation charge left in a corporate pool. BUs have to compete to get a hold on that, because we at the corporate centre want to be able to favour our strategic position assessment ... Funds go to businesses with a history of delivering on their capex proposals. [CFO manufacturing firm]

Several firms displayed a strong home country bias in capital allocation.

Even though my boss would have me for saying this, intuitively and practically we accept a lower rate of return in Australia. It's a well-established economy, it's going to generate positive returns for many years. [CFO manufacturing firm]

3.1.2. Investment criteria

Most firms reported that their investment decision making relied on strategic benefits and rules-of-thumb rather than detailed calculations of rates of return.

We have quite a clear and disciplined strategy about what we will invest in and what we won't. It's not driven so much by IRRs or anything like that. It's a commitment to specific commodities and regions where we have a competitive advantage, both geologically and also understanding how to do business in those parts of the world. We are focussed on our region, we're focussed on our metals ... If you've got good grade, good metallurgical process, you're in the right metal, you've got the right size orebody, the IRR will look after itself. [CFO mining company]

A few years ago, we had a long hard look at what our strategy should be going forward. Our targets are where we could get a good position in the industry and negotiate good prices. This focus has determined what geological provinces around the world we look in. [Treasurer mining company]

We further probed this qualitative, strategic rationale to understand the role in investment of quantitative assessments and traditional finance measures such as rate of return.

Investing is risky business. You can have all the maths you like out there, all the projections, all the analysis. But judgement comes into play. Maths is the easy bit. The difficult part is the strategic judgements that you make about what markets you want to be in, what customers, what places. [CFO manufacturing firm]

Pushed to explain 'How you get the strategic decisions right?', managers talked about simplicity and focus.

We focus on keeping it simple and understanding what are the really fundamental things you've got to get right. [CFO mining company]

Even though investment strategy was at least as much qualitative as quantitative, financial performance was a *sine qua non* and investments are universally required to add to earnings per share and provide a minimum return across a mix of assets, equity and sales.

Every time we build a project we're almost betting the company so it does mean that we're reasonably conservative and very disciplined about our investment decisions. [CFO mining company]

3.1.3. Real options

The concept of real options – in the sense of placing a value on future flexibility in a decision – was familiar and important to most managers. Whilst they were aware of techniques to price real options, most believed that the market did not place full value on them. Even so, they sought strategies with inbuilt flexibility and regarded this as a very tangible additional benefit. Real options proved important in strategy development, but are seen as separate to the formal investment process.

We look at the base business, how do we maintain or sustain and grow the base business and then what are strategic options on top of that. Do we go and formally calculate that optionality, the value of that? No, it's more of a business awareness, a commercial awareness rather than an explicit calculation. [CFO manufacturing firm]

Interviews probed the extent to which uncertain future opportunities – which are effectively real options – are priced into project evaluations. Few managers would justify an investment on "strategic grounds".

Something may offer intangible opportunities down the track, but these are not valued except in a roundabout fashion as a footnote which acknowledges the unknowns. [CFO mining company]

It would be quite extraordinary if we did invest for strategic reasons because there's sufficient scepticism around the review table about the very word strategic. Faced with a 'strategic investment', we sort of go: 'Sorry, what does that mean?' There's a cynicism that's now developed: so, unless an investment can be demonstrated in terms of its economic worth, it's not appropriate to spend that money. [CFO manufacturing firm]

Several managers did, though, display a greater appetite for taking strategic risk with small projects. This reflected a seed capital approach in which small amounts of money may fund a strategic project.

If it was a relatively small investment and ... it gave you a strategic interest in something, then yeah it could get up on those grounds alone. But ultimately it would need to stack up on economic terms. [Treasurer mining company]

3.1.4. Acquisitions and private equity

Of the many explanations for the weak post-acquisition performance of acquiring firms, we found most evidence in support of agency problems (e.g. Roll, 1986). Managers recognised that the market took a conservative approach to real options in acquisitions, and was prepared to price in low-risk cost savings but not less certain revenue synergies and growth opportunities. Inevitably, then, the only way for acquirers to justify paying the premium required by target shareholders is to build in some blue sky.

Investors don't put a value on revenue synergies until you start delivering. But we went to a pretty high percentage number of cost savings that we paid away as a premium. The reason why the board got comfortable about paying away so much is because of the quantum of revenue synergies they believed could be extracted in the future. [GM Strategy finance firm].

Managers are also aware of the winner's curse when bidding for projects.

The worst thing is going in and making a bid and nobody making a counter bid, because you then know you have paid too much. [Treasurer mining company]

Interviewees were each alert to the possibility of being taken over, especially by private equity, but largely treated it as a background issue. Some had formal contingency strategies in place to respond, whilst others somewhat blithely believed that good managerial performance is the best defence. Most companies maintain an up to date valuation model.

We internally value our company every half year, so when private equity comes knocking - if it comes knocking, I didn't say it did - we actually have a

very good idea as to what our view of value is versus their view of value. [CFO manufacturing firm]

None of the interviewees seemed worried or pre-occupied with being taken over.

A [hostile takeover] could happen any day. If it happens it happens ... Our best defence is a strong share price. [CFO mining company]

In fact one manager who had previously worked for an unlisted firm welcomed a takeover by a private equity group as possibly leading to better decision making.

In a lot of ways I liked not being tied into discussing short-term objectives and painting pictures for analysts out there and the guy in the street ... In fact, what does next quarter mean, *per se*? It is just a quarter's results. I would say perhaps some better quality decisions would come as a result of a takeover. [CFO manufacturing firm]

3.1.5. Constraints

Theoretically a firm adds value by investing in all projects whose incremental risk-adjusted expected return exceeds the marginal cost of capital. However, as many as 70 percent of firms stop well short of this limit (Zhang, 1997), frequently because of practical barriers including difficulties in identifying sufficient suitable investments and an inability to execute investments due to a shortage of non-financial resources, particularly skilled labor and management time (Richardson, 1964).

All managers reported constraints on their investment strategy, but these were rarely financial.

Three things have constrained us are: inappropriate use of capital and working capital; the fact that we weren't bringing talent along as quickly as we should; and we weren't getting the right prices in the market place. [CFO manufacturing firm]

Investment comes down to what is available. The issue with the mining industry is where you find the resources ... Factors that constrain us are that it's an extremely competitive industry. [Treasurer mining company]

At the time of interviews unemployment was at a long term low and the finance, mining and construction sectors (where most interviewees worked) were experiencing strong growth in demand. A shortage of skilled staff was a chronic problem that had become acute.

The constraint we talk about now is people ... The company hasn't been constrained by a lack of cash. [Treasurer construction firm]

3.2. Capital Structure Decisions

Table 4 reports results from the Survey question on debt levels.

[Insert table 4 here]

The traditional trade-off theory of capital structure suggests that optimal decisions about debt levels are reached by balancing out the advantages to the firm (and its shareholders) associated with the tax-deductibility of interest payments versus the additional costs of financial distress that accompany higher debt levels. Our findings provide some support for the theory in that managers seem keenly aware of the constraints imposed on debt levels by volatile earnings and cash flows. Managers are also keen to maintain some financial flexibility in terms of leveraging up the firm and also seem aware of the impact on credit ratings of their debt decisions. These findings are broadly in line with Graham and Harvey (2001).

One departure from prior survey evidence on the topic is the fact that the managers surveyed attach very little importance to the tax advantage provided by debt. This is not surprising given that under the Australian system of taxation, corporate tax is merely a prepayment of personal tax. Consequently, any savings in corporate tax that a firm is able to achieve only provides a small benefit to shareholders in that shareholders would have received a tax credit for that corporate tax already paid.

An alternative theory of capital structure is the pecking order theory which suggests that firms will first use retained earnings and then debt and only after the firm has utilized all of its debt capacity will it issue equity. The explanation for this is that retained earnings are a relatively low-cost (and hassle free) source of funds relative to debt, while an issue of equity may be interpreted by the market as a strong signal of overvaluation. The survey results support this decision-making approach in that the third most important factor cited in making the decision to raise additional debt is the availability of internal funds.

3.2.1. Financing policy

The best supported explanation of capital structure is the pecking order theory (Lemmon and Zender, 2002) in which firms do not have any specific gearing target, but move sequentially from retaining earnings, lifting debt to capacity, and finally raising new equity. Given that managers have monopoly information about their firm's investments, debt can signal that they do not fear financial distress and so establish a positive relationship between firm value and gearing (Ross, 1977). Firms also take into account more transient factors including credit rating, interest rate cycles, tax effects, competitors and potential acquirors (Graham and Harvey, 2001). Interviews provided support for each of these influences on financing policy.

Funding is looked at in aggregate at the group level. So in that sense we're not interested, we're not worried about if we buy this or build that, whether it's debt or equity. [CFO manufacturing firm]

When we looked at our long-term capital structure, we did the classical analysis but the problem is that it's all sensitive to commodity prices. We turned it around and said 'Well what do we do if commodity prices tank?' We know what we could take out of the business in terms of costs, so what could

we use to service debt? It was quite frankly no more sophisticated. And that's how we came up with a number for our debt-to-equity limit. [Treasurer mining company]

Financial strategies were generally fairly vanilla, with not much time spent on the funding decision. Facilitating business operations is the priority because managers see that is where value is created, not through financing.

Our general debt funding is built up from the business plan: this is what we're looking at, how best can we service that debt? And we don't try and get sexy, you keep it pretty simple. I think that's been the nature of the balance sheet and what you see in the group at the moment. Don't get too fancy about anything. [Treasurer construction firm]

Once you know you've got a project, the funding is not a big worry ... I'm not a fan of getting too smart or overly complicated with big structures. With new projects we put in place a pretty basic bank debt deal. I take the view that I just want the money, don't want to buggerise around. It's not the main game, it's not what creates value - not in the mining business. What creates the value is what's in the ground. I don't want to hold the project up while messing around to get some smart structure in place. Just get the money and get the thing built. Commissioning takes out a lot of the risk and we can re-look at financing after that. ... We make sure we've got good banking relationships in place, banks that we know and trust and are going to support us. [CFO mining company]

By separating investment decisions from finance, the main drivers of finance strategy become tax and (as we discuss later) natural hedges. To minimise funding risk, firms establish and maintain strong alliances with trusted banks and seek diversification of funding sources.

When we push down our funding structures into different entities and different jurisdictions, that is typically driven by tax. Sorry shouldn't have said that ... We make sure we pay the right amount of tax, which means that we try and minimise the overall tax burden. So the capital structures underneath the consolidated total are absolutely micro driven. We have high levels of debt in high tax jurisdictions so as to minimise the foreign tax take. [CFO manufacturing firm]

Tax wouldn't really be a big issue for our capital structure. We're more focused on making sure we keep the company going forward, and long term that really comes back to the nature of our operations and the nature of our cash flows. Our debt decisions are more driven by our assets and the lives of those assets. [CFO mining company]

As CFO my number one rule has been availability of funds; pricing is of second order. It's been burned into me by experience and in other organisations going through bank work outs ... When you go to the market - perhaps for a major acquisition - the first thing you're looking at is diversity of funding. You don't want to be locked into having to go to one particular sector

of the market, so it's all about diversification, giving choice to investors. [CFO manufacturing firm]

Despite a low risk approach to financing, managers were aware of many options in terms of financing strategies, but rarely see merit for their specific circumstances.

We have looked at off balance sheet structures for longer term initiatives, but they do not add EPS in the short term. [GM Strategy finance firm]

It's rare, very rare in my experience, that you get a finance-driven strategy ... The strategic business plan is all about the left hand side of the balance sheet. [CFO manufacturing firm]

3.2.2. Asset-liability management

As noted above, funding is rarely linked to investments, except possibly for major acquisitions. Despite that, companies explicitly integrated their balance sheets in order to manage liabilities in light of assets, particularly as a technique to optimise risk. Several managers actually used the term 'asset-liability management'.

Because we take the view that shareholders are paying for our exposure to commodity prices, we don't want to hedge at all. Therefore you've got volatile cash flows with assets that have a finite life, and that means that you need to have shorter life debt facilities and a more conservative gearing ratio. [CFO mining company]

The risk from our no-hedge policy manifested itself in the balance sheet structure with little impact on operational strategy. We needed a very low geared balance sheet to manage the risk from being unhedged. [Treasurer mining company]

Debt was also used as a natural hedge to manage country risk.

The [country omitted] funding is just secured against the assets that are located there ... If the government decides it doesn't like Australia and you can't mine up there anymore, well they have got to take a bit of a hit. So that has saved us political risk insurance. [Treasurer industry omitted]

3.3. Payout Policy

Table 5 and 6 report results from the Survey questions on payout policy.

[Insert tables 5 and 6 here]

Consistent with the pecking order theory, and the importance of the signal sent to the market via the dividend decision, the two most important factors considered by firms when making are the necessity to be able to maintain the dividend amount into the future (and not be forced to decrease the amount if market conditions deteriorate) whilst ensuring that the dividend declared at least matches that historically paid. Of

lesser importance in deciding the optimal level for ordinary dividends is their use in returning free cash flows and tax credits to shareholders².

When asked about share buybacks, the most important factor in making that decision is the presence of free cash flows. Respondents also recognized the importance of the positive signal conveyed by the buyback announcement, which can be seen as analogous to the negative signal conveyed by the announcement of an equity issue as per the pecking order theory.

3.3.1. Payout ratio

Since Lintner (1956) it has been assumed that dividends can be explained in terms of reported earnings and historical payout ratios, and dividends are used by managers to signal confidence in future cash flows (Allen and Michaely, 2003). In jurisdictions such as Australia where taxation of capital gains differs to that of income and different shareholder groups have different marginal tax rates, a clientele effect can emerge and payout policies respond – or *cater* - to investor demand (Baker and Wurgler, 2004). Interviews provided support for each of these theories.

Our dividend payout ratio is pretty much the same over time... We target a constant dividend payout ratio. [Treasurer construction firm]

Dividends were seen as valuable signals to the market.

One reason for paying out dividends is because it sends a very strong message to the market. It has a positive impact on your share price in a number of senses. One is to signal that you've got the cash available. Dividends broaden the number of shareholders that are interested in buying the stock: the pensioners and the mums and dads, if you like, particularly if that yield is fully franked, or it's got some franking on it. Secondly, it sends a very strong signal to the market that you can fund your growth pipeline so you're not going to come back to them and ask for equity with a rights issue or something like that. So there's no perceived overhang on your stock in the marketplace. [CFO mining company]

3.3.2. Clientele effect

Firms saw the need to cater to the expectations and requirements of their shareholders, but neither was very clear. One of the principal sources of divergence between firms was in how they identified and served various clienteles, particularly in the balance between different expectations of retail and institutional investors. Most managers complained good naturedly that investors prove fickle.

² In contrast, when participants were asked what factors were important when deciding to make a special dividend payment, the two most important factors were the presence of free cash flows and the ability to use the special dividend scheme to return tax credits to shareholders. These results are available from the authors by request.

We've become trapped by our dividend because of a history of paying out a certain level. There is a perception that we have a strong and loyal base there that relies upon the dividend yield ... In the end you are a function of what the business produces, you are also a function of your history if you have been locked in to a dividend regime like we have. [CFO manufacturing firm]

We have got a lot more retail investors on our register than we had when we floated. They have obviously been attracted by the dividend yield, which is unfortunate, because it is a volatile stock ... Quite frankly if and when the stock price drops, they are going to be most unhappy. [Treasurer mining company]

Most firms have a formal process of collating information on shareholder requirements, but the correct balance can be hard to strike between clienteles

There is a regular program of engagement with brokers and analysts and major investors. But our investors have different views on what is important ... When we go to different institutional holders we get different stories. We walk out of one meeting and it's different to the previous meeting, so you can't actually please them all. [CFO manufacturing firm]

Institutional shareholders are much more demanding than retail shareholders. They in essence want to have time with our CEOs and CFOs and then want to have a chat about the strategies and want to have a chat about the actual expectation for everything going forward, because that's a key part of them trying to understand whether to invest more or to reduce their investment in the group. [GM Strategy finance firm]

It was clear that most firms felt that shareholders imposed a number of strong requirements on them.

The recent share buyback was a straight tax decision. [Treasurer mining company]

The presence of a large number of retail investors on the registry is a major consideration and it's probably one of the reasons why we've actually chosen special dividends as opposed to buybacks. [GM Strategy finance firm]

One manager with a majority shareholder noted dryly:

"That's a big constraint." The shareholder is unwilling to inject additional equity, but he can't afford to go below 50 percent equity because he wants to consolidate our numbers... We would love to raise additional capital but we can't. So we put in place a hybrid that the banks see as capital but we count as debt because it has a coupon and repayment date. [Treasurer industry omitted]

Although the clientele effect can be hard to break, given the downside of a dividend clientele and retail investors, especially in what might prove a volatile stock, several companies were actively trying to shape and diversify their investor base.

We'd like to broaden our shareholding base by growing the institutional part of it and increase the regions where shareholders come from. Particularly we'd like to grow our US shareholding because we see that there's a lot of money there, and historically there has been stronger multiples paid for earnings out of the US, and other markets, than out of Australia. [CFO mining company]

3.4. Risk Management

Companies established broad-based criteria for their risk appetite, either allocating capital between countries and business lines, or setting individual hurdle performance criteria, including earnings and rates of return on assets, equity or revenue. Most companies roughly follow Australian Standard 4360 on Risk Management, which covers strategic, operational and financial risks. Risk management is generally not within a centralised function, but embedded in processes and approvals.

We have a high level approach to risk ... making sure that we identify risks around our operations, particularly on the social, community and environmental side, and safety. We take safety incredibly seriously. [CFO mining company]

Our risk area has been strengthened over the last couple of years. Now there's a whole procedures manual on risk. So when you're making a decision, these are guidelines we expect you to comply to ... We are in the business of taking risk. If we didn't take a risk we wouldn't have a job. Risk management is all about trying to maximise those profits on jobs where you are taking risk. [Treasurer construction firm]

We are risk takers, but we're measured risk takers ... If we say we're going to do something then we are very focussed on making sure we do it. So we don't make promises that we don't know we can deliver. [CFO mining company]

3.4.1. Country risk

In addition to the home country bias noted earlier, operational and reputational risks were important determinants of countries in which investments are made. Part of the risk is political, largely a reflection of the difficulty in dealing with some host governments. Most country risk, though, appeared to relate to different standards, particularly in relation to operational safety.

In Indonesia and The Philippines, our perception is that the political risk there is a bit more than we are prepared to take ... I'm never going near Papua New Guinea again in my life. [Treasurer mining company]

If we set up a mine in Africa, we would certainly be seeking to apply Australian standards. [Treasurer mining company]

We're in Dubai because it has similar conditions to here or New Zealand or Hong Kong ... One of the main reasons we don't go into China is our strict rules on safety. If you kill 60 workers there you count it as six and don't worry about it. We can't afford to have a single death. It's all reported. We have our corporate governance processes that say: 'Sorry, fellas. You can't do that'. We won't go into China until such time as jobs are bid on the same standards as in our world. [Treasurer industry omitted]

3.4.2. Moral hazard

Despite the clientele effect, few executives reported moral hazard. When asked 'Have you been forced to take decisions or take risks by outside influences?' they invariably answered 'No'. Drilling down a bit further, however, revealed a number of contributors to moral hazard.

By far the biggest issue in investments is working out what the long-term price is going to be. And if the consensus starts to move up, then really you are forced to move with that consensus. But by the same token, you've got to be very careful not to get carried away. [Treasurer mining company]

They also recognise the need to respond to other firms in their supply chain.

When Marks & Spencer and companies like that talk about how they are going to be carbon neutral, they put that pressure back on us. [CFO manufacturing firm]

3.4.3. Hedging strategy

Although most companies are non-hedgers, this was based on a variety of views. The dominant explanation was that risk-taking is the primary role of the firm and shareholders would not value hedging.

We take the view that we don't want to hedge our commodity price exposures at all. The shareholders are paying us for our exposure to copper price, or gold price or commodity price ... We fundamentally have the view that we don't hedge. [CFO mining company]

At one company, hedging was seen as an agency issue whose prime benefit was to management rather than to shareholders.

The final decision has always been: 'Why should investors take a haircut just so we can lock in a minimum price?' It was very difficult to demonstrate a net benefit to investors from that form of insurance. The only people that benefited were management in having a slightly softer time. [Treasurer mining company]

The difficulty in getting hedging right was clear to most firms.

I think we moved away from hedging because it was just too bloody hard. Look we're in the business of making money and it would be nice if you could call hedging a profit all the time. But you can't and the experts are no help because they don't know. The dollar is at 90 cents today: who thought it was going to get there? Now some people are saying it'll be 94. The experts don't know. We as managers would like to be able to control the currency, but we can't, it's beyond our control. So we don't hedge: just take the hit or take the profit. [Treasurer construction firm]

The only firm that hedges uses it as a tool to smooth income.

It allows us a little bit of time to react in terms of pricing and communicating the message out to the field and our customer base. But it does necessarily put you on a different footing than some of your competition. [CFO manufacturing firm]

Despite the current unpopularity of hedging, perspectives may change.

If the dollar started to fall, companies' responses will depend on who the CFO is and how they view it. I think the answer is 'No. We would not start hedging'. But again, times do change and people do swing around. [Treasurer construction firm]

3.5. Corporate Strategy and Governance

3.5.1. Governance

Most managers portrayed their Boards as passive. Each was asked: 'Can you give an example of a decision in which the Board added value?' No response was more substantial than that directors asked questions and sometimes provided contacts.

Their value is probably questionable because they are looking at the financials that we're providing up to them, and also looking at the financing picture of the business. I would say there were very few times that we have gotten credible feedback on something. Value added is probably a bit questionable. [CFO manufacturing firm]

To summarise it's all about the experience they had previously that they can bring and which is relevant to what we're considering. And it's also basically the people that they know. [GM Strategy finance firm]

The Board would normally rely on what management is saying. [Treasurer construction firm]

Given the passivity of Boards, management saw its job as anticipating their needs.

We provide the Board with monthly information that's fairly detailed ... We never ask the Board for their opinion. You provide them with management's view and seek their endorsement. That's generally the way we tend to do things. [CFO mining company]

You never want to have an occasion as management where the board says 'But you never told us'. That would be death for a CFO ... The next sentence is 'We don't have confidence in you'. [CFO manufacturing firm]

Boards also merited respect.

My objective is about building credibility with the Board, making sure they trust you. So - when you do put things up - there's a comfort level that management's done their job and thought about all the aspects. It's not rubber stamping. If management has done their job properly then you shouldn't have situations that the board's knocking you back: if you don't know you're going to get it approved then don't put it up. [CFO mining company]

We like to put up the right strategy to the board so they say: 'Fellas, get on with it.' I don't think anybody wants to put up crap and get told 'No!'. [Treasurer construction firm]

The role and focus of most Boards changed following introduction of Sarbanes-Oxley and complementary changes in Australian corporate law and stock exchange rules.

They probably ask more questions now: they're more focused on issues of control and systems and those sorts of things, which is fine. It is more likely now for them to ask those questions, they want to see some presentations, that sort of material. But if you're aware that's the trend, then you shouldn't wait for the board to ask the question before you start making sure you've got the ducks in a row. [CFO mining company]

3.5.2. Monitoring financial performance

Not surprisingly, all companies spend considerable time evaluating performance.

We believe the return on funds measure is best because it's against the WACC, against the aspirational target and against the improvement we want to see. [CFO manufacturing firm]

Smoothing of income also occurs.

Our financial guys really try to bring profits so it looks like a steady stream. And often times you are putting a few bucks away. [Treasurer construction firm]

Most companies recognise the need for strong discipline over investment and operations.

We have post capex review processes which are conducted by the businesses and reviewed by internal audit and presented to the audit committee ... The audit committee meets regularly with each of the business leaders, and it's very powerful when they have the capex reviews. [CFO manufacturing firm]

On projects, we demand the return that the group wants overall. If guys in charge are not getting it, the CEO will probably find someone that can. [Treasurer construction firm]

3.5.3. Sustainability and values

Sustainability was a hot topic at the time of the interviews and all managers were aware of it and had experienced stakeholder pressures in regard to sustainability and related issues such as corporate social responsibility (CSR). However, it seemed to be a factor that had long been present in other guises because most firms recognise that sustainable operations have favourable economic consequences.

Key performance measures on our business are in fact all about sustainability. They are about energy usage, waste, health and safety measures, lost time injury frequency rates. In fact you can plot the lost time injury frequency rate over time: if it's going up, return on funds will be going up. It's amazing: safe, clean, efficient operations are profitable. It's typically about discipline ... I'm a little bit cynical: all this is now being branded as sustainability, but in fact this is all about economics, about smart ways of doing business. [CFO manufacturing firm]

We certainly want to play a part in creating a sustainable environment. We want to do it right. We don't want to be seen as just promoting sustainability to the market to appear more attractive to investors without really doing any work to promote sustainability. We want to well and truly develop our sustainable strategy, do the hard work and make it effective in our business and then announce it to the market. [GM Strategy finance firm]

Sustainability is not a fad for us: it's a key part of our core values ... In fact, I expect the financial report will start to become less important and the sustainability one more important. [CFO mining company]

Looking ahead, all firms expected the pressures towards sustainability and corporate social responsibility (would intensify. Partly this reflected an internal commitment because the strategies improve performance; but much was due to the expectation that it would be driven by key stakeholders, especially customers.

A lot of our stakeholders and banks we deal with read our CSR Report because most have environmental policies they've got to meet. Some of our shareholders, institutional advisers, advisers to our institutional shareholders would read it. A lot of the NGOs and key stakeholders around those sorts of things would read it, governments would read it. [CFO mining company]

Perhaps reflecting the fallout from a number of high profile cases involving ethics breaches extending to criminal acts, most firms had an explicit ethics policy that went well beyond compliance.

We have a set of core values that we use which resonate strongly. We talk about respect, action, performance and openness. Respect takes into account community, social, safety, environmental as well. [CFO mining company]

We have a values gateway at senior executive level where we score each other on how we behaved. Before you get a bonus of any kind you have to pass the values gateway. It demonstrates that values are critical. [CFO manufacturing firm]

A recurring influence on values was the firm's history, and several managers reported a strong inheritance from 'dark periods' in historical times.

Given where we came from [i.e. near bankruptcy], we have an absolute test on shareholder value. [Treasurer mining company]

The thing that the oldies talk about, guys that have retired, is that they went through some very hard times. They've got long memories and they haven't forgotten. They don't want to fall into those traps again, where they were beholden to the banks. We just have conservative management that's been built up over time. [Treasurer construction firm]

How do sustainability and values demonstrate a payoff?

Sustainability shows up in the fact that we have very little disputation with our staff. It shows up in the fact that we have never lost a day's work because of any political or community unrest ... It shows up in our environmental performance, in our safety record. [CFO mining company]

A personal view is that having a legitimate sustainability strategy that is going to effectively preserve the environment might well be a precursor to someone investing. Do they attribute any value to sustainability? Probably not. Their decision to invest and what they're prepared to pay reflects what sort of value they think they can create through investing in the business. [GM Strategy finance firm]

3.5.4. The future

In looking ahead at future issues of risk and opportunity, most executives thought in terms of economic and social changes requiring what one termed 'over the horizon thinking'. Not surprisingly, many 'talked up their own book'. Miners, for instance, foresaw a resurgence of industrialisation. All managers were acutely aware of environmental pressures, although not always in a negative way.

Our view is that we are in a generation of industrialisation that is going to go on for at least another couple of decades. [CFO mining company]

Yeah there seems to be a little bit more building at the moment, but look: infrastructure funding seems to be the popular flavour. [Treasurer construction firm]

Greenhouse gas will be the next thing. Reporting on your emissions and what you're going to do will just take off. Then you'll get the thing audited, and that becomes a report. In fact the financial report will start to become less important and the sustainability one much more important. [CFO mining company]

To be frank, global warming will mean that shipping routes are opening up around the Arctic so mining there actually becomes a viable proposition. [Treasurer mining company]

International operations remained a big part of future growth opportunities.

India is another big market for us, if only everything there could come together. It's just all over the place in India, but there's huge potential and certainly the group is focusing in on it and on the Middle East at the moment. [Treasurer construction firm]

4. Discussion and Conclusion

This study is the first to apply the extended case method (Burawoy, 1998) to develop an integrated picture of how senior executives make their firms' major finance decisions across capital budgets and investments, sources of finance, returns to shareholders, risk management and governance.

In the first part of our study – a survey of 76 executives using an instrument similar to Graham and Harvey (2001) – we find that Australian executives provide similar answers to their American counterparts. Most respondents make extensive use of IRR and NPV for project evaluation, usually with a company-wide discount rate. Large, growth firms with rated debt have more sophisticated analytical approaches. Unwillingness to apply modern financial techniques – such as using project-specific discount rates, rather than the firm's discount rate – matches findings from America and suggests managers find limited merit in these approaches.

The most important influence on debt levels was cash flow volatility, indicating an awareness of financial distress. This proved particularly important to large, growth firms. Also important were opportunistic factors, particularly financial flexibility. Each is generally consistent with pecking order theory.

Payout policy caters to investor demand with a fixed, or slowly growing, dividend. Again this was more important to large, growth firms which are most likely to have strong clientele bases. Share buybacks are prompted by a temporary surplus of cash.

Like previous authors, we were reassured that finance executives seemed to be aware of modern financial techniques and reported applying them. We also confirmed differences in financial strategies and analytical techniques between large and small firms and between growth and value firms that could explain size and price-to-book valuation anomalies.

However, a number of puzzles emerged. The first was why executives make limited, relatively unsophisticated use of modern financial techniques. This was particularly pertinent given that Australian studies have demonstrated loss of value through IPOs (Lee, Taylor and Walter, 1996), acquisitions (da Silva Rosa and Walter, 2004) and other corporate finance decisions. A second research question was *how* the executives actually make decisions, and what – if any – role might be played by non-financial considerations such as constraints. Another question was how finance executives integrate their core decisions, and how they match them to corporate strategies: for instance do they manage liabilities in light of assets? Finally we were interested in the actual processes underpinning a number of important corporate practices that are hard to quantify, particularly, ethics, governance, risk management, and sustainability.

These puzzles and questions were largely resolved by face-to-face interviews with senior finance executives.

The most surprising finding was that qualitative criteria dominated financial strategies. With investments, for instance, executives understood CAPM and other sophisticated financial techniques, but believed that their application – what several termed ‘doing the maths’ - was easy in comparison to identifying opportunities, evaluating strategic factors such as markets and competition, and completing the investment. In arranging finance for projects, executives sought flexibility to quickly respond to business needs at low cost. Investments faced constraints from labour shortages and competitor activity, not finances.

Flexibility also emerged as a conscious drive to secure real options in investment. Few managers believed that investors placed any significant value on future flexibility, but they sought it themselves. Like markets, though, they were skeptical of value in ‘strategic investments’, except possibly for small scale seed ventures, and demanded tangible justification for all capital expenditures.

Moral hazard repeatedly featured in executives’ finance decisions, although in a variety of guises. These shaped choices so that they send favorable signals, meet the needs of several clienteles, and satisfy rating agencies.

The finance executives were respectful towards Boards, but none could give an example of where they had added value. They assumed that Boards which had confidence in management would endorse proposals put forward and structured their interaction to anticipate the Board’s needs.

Risk management is important in all firms, largely with its management sense of avoiding loss or a poor outcome (March Shapira, 1987). Managers follow each of the standard risk management techniques (Mehr and Hedges, 1963): avoidance, transfer

(through insurance, sharing or hedging), retention (through self-insurance and diversification), and reduction (through enterprise risk management). Many firms avoided countries with unreliable governments or poor workplace safety practices. They made extensive use of natural hedging, especially through debt; and actively diversified risks, especially funding. Each had strong, formal, usually embedded risk management programs to reduce operational and financial risks. Effective risk management – particularly a good safety record – was seen as directly linked to improved returns.

Although concepts such as ethics and sustainability are relatively recent additions to the academic literature, they tacitly underpin many longstanding business practices. Most firms had explicit ethics policies – including peer reviews – that go well beyond mere legislative compliance. Each executive expects that issues related to sustainability will become more intense and pervasive, perhaps making their annual Sustainability Reports more widely read and important than Financial Reports.

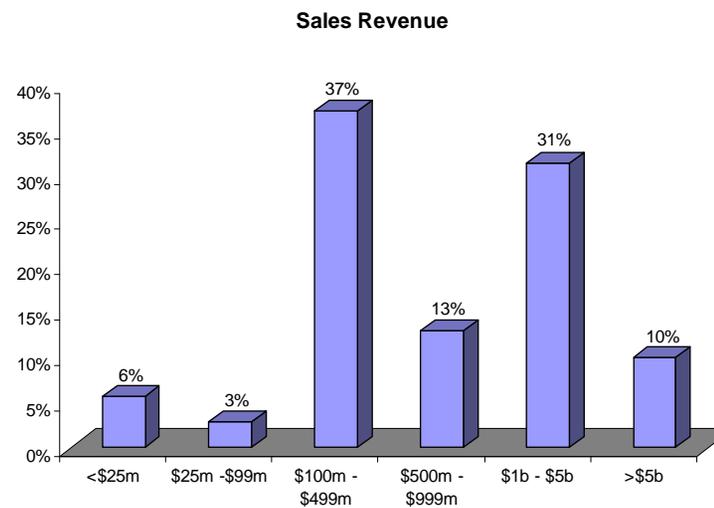
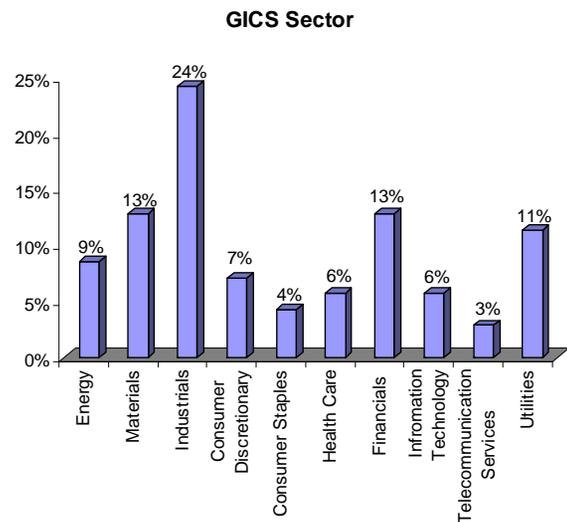
In conclusion, the style of field research inherent in the extended case method has proven illuminating. It enables interaction between analysts and subjects that is specifically excluded by studies using surveys and databases; it also enables iterations so theories from the literature can be validated through managers' observations and deviations from theory tested against other managers' behavior.

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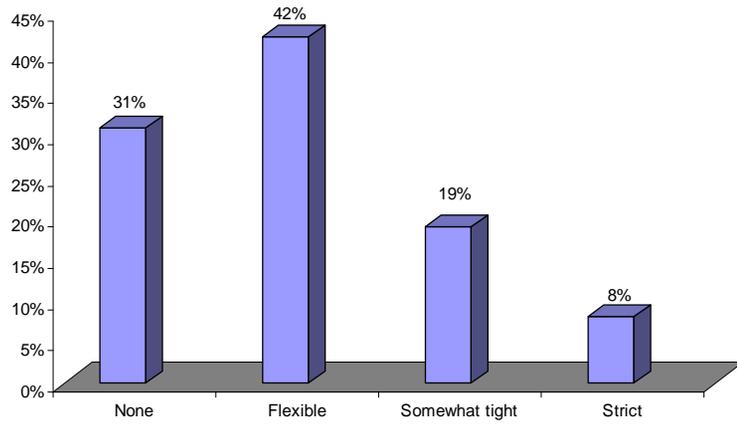
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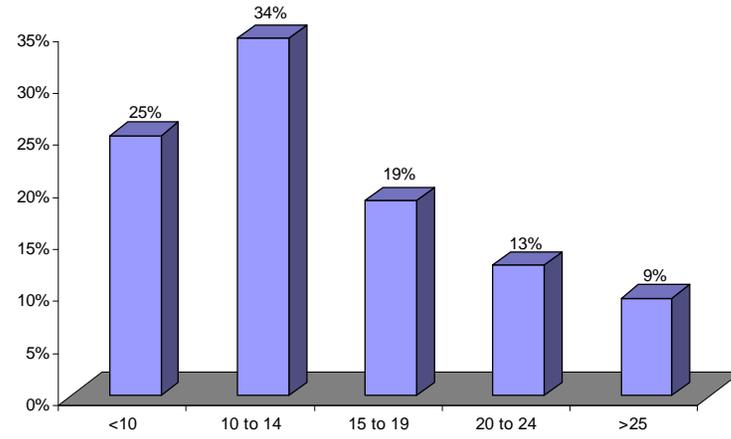
Figure One
Sample characteristics of respondent firms



Target debt ratio?



Price/Earnings ratio



Foreign Sales

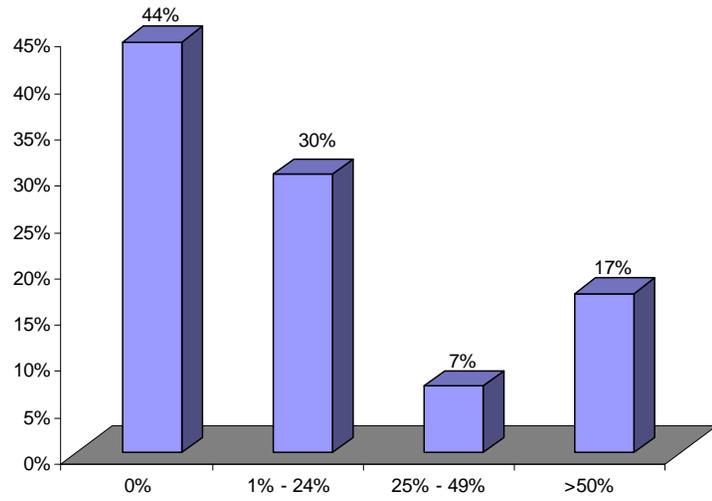


Figure Two

Survey evidence on the popularity of alternative project evaluation techniques

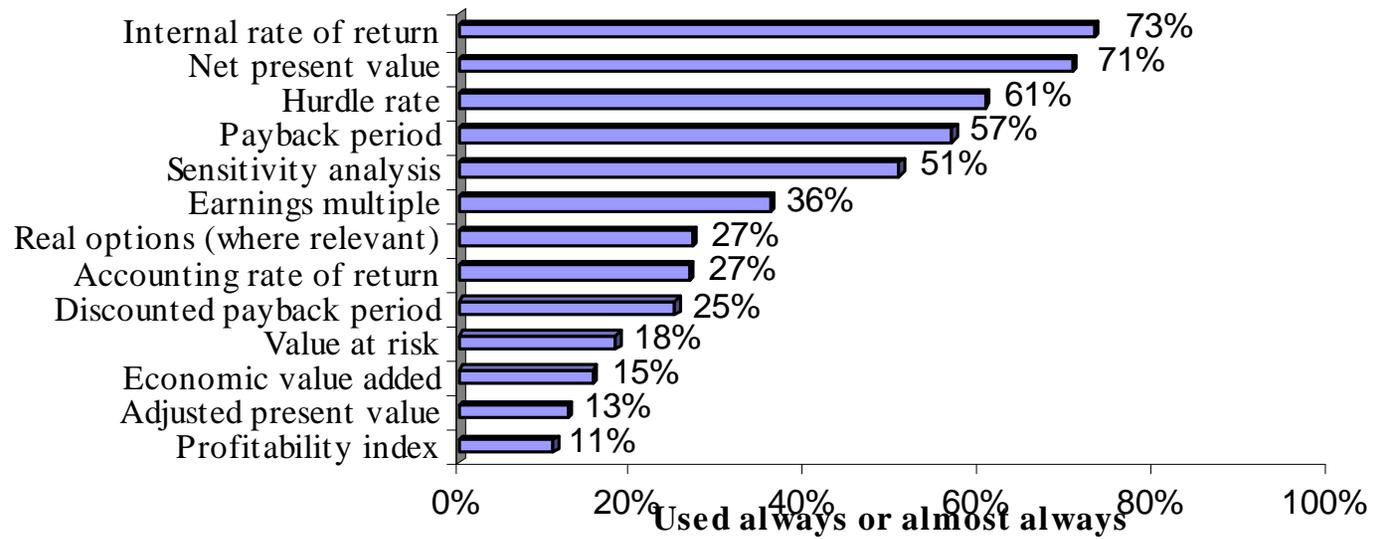


Table 1
Interview Protocol

Finance Decision	Questions
Capital Expenditure	<ol style="list-style-type: none"> 1. How are capital budgets set? What limits/constraints apply? Do they vary from year to year? 2. What procedures are used to develop and validate investment proposals? 3. What economic criteria are applied in investment decisions? 4. How is discount rate determined? How is project risk priced? 5. How are non-discretionary/non income producing projects approved? 6. Does financing play any role in investment decisions? 7. Are investments post audited? 8. Are acquisitions treated differently? What motivates them? 9. How are asset sales evaluated?
Financing	<ol style="list-style-type: none"> 10. What criteria are used in sourcing finance? 11. Does the firm have a target gearing level? Why? 12. When is external finance sought? 13. How is the choice made between debt and equity? 14. What is the preferred method of raising equity? 15. What is the preferred source of debt? 16. How is advice on funding strategies obtained? 17. What if any link is there to investing? 18. Is rating or market concerns an issue? 19. How is leasing evaluated?
Payout Policy	<ol style="list-style-type: none"> 20. How are dividends set? 21. Are stable dividends desirable? Is payout ratio fixed? 22. Are special dividends considered? 23. Can dividends be reinvested? Why/why not? 24. What decides on share buybacks?
Corporate Structure	<ol style="list-style-type: none"> 25. Does the firm have a target size? 26. What drives the business unit (BU) mix? 27. Are BUs integrated for financial decision making? 28. Do investor preferences drive decisions on structure?
Governance Systems	<ol style="list-style-type: none"> 29. How are managerial biases addressed?

	<p>30. What influences come from executive compensation?</p> <p>31. Does the Board operate efficiently?</p> <p>32. Does the Board add value to corporate finance decisions?</p>
Ethics and values	<p>33. Do ethics or values (CSR, SRI) impact corporate finance decisions?</p>
Risk Management	<p>34. How is insurance evaluated?</p> <p>35. Is self-insurance seen as an option? Where?</p> <p>36. What is your definition of risk?</p> <p>37. What is the firm's risk propensity?</p> <p>38. How is risk managed?</p>
General	<p>39. What is the principal objective behind corporate finance decisions? Profit, risk reduction?</p> <p>40. Are business or other cycles important?</p> <p>41. Are corporate finance decisions timed? How?</p> <p>42. What influence does stock price have on corporate finance decisions?</p> <p>43. What non-financial factors play a role in decisions? e.g. nature of income or expenditure; competitors; analysts</p> <p>44. What influence do clienteles - such as shareholders, especially institutions - have?</p>

Table 2[†]
How frequently does your firm use the following techniques when deciding which projects to pursue?

Technique	% Always or almost always	Mean	Size		P/E		Leverage		Rated debt		Pay dividends		Industry	
			Small	Large	Growth	Non-growth	High	Low	Yes	No	Yes	No	Energy, materials and IT	other
Internal rate of return	72.06	2.88	2.27	3.37***	2.84	3.00	2.90	3.21	3.29	2.68	3.10	2.32	3.26	2.73
Net present value	70.59	3.04	2.70	3.32**	3.18	2.68	3.29	3.00	3.64	2.78***	3.14	2.78	3.06	3.00
Hurdle rate	60.61	2.55	2.25	2.76	2.60	2.42	2.77	2.57	3.09	2.29**	2.75	2.00	2.57	2.53
Payback period	56.72	2.54	2.48	2.58	2.44	2.78	2.32	2.69	2.48	2.55	2.67	2.21	2.95	2.37
Sensitivity analysis	50.75	2.42	2.03	2.71	2.31	2.68	2.43	2.36	3.00	2.11**	2.53	2.11	2.89	2.23
Earnings multiple approach	35.94	1.81	1.59	1.97	1.46	2.72***	2.07	1.83	1.82	1.80	2.02	1.28	1.89	1.78
Accounting rate of return	26.15	1.42	1.39	1.43	1.28	1.78	1.57	1.33	1.65	1.25	1.55	1.05	1.67	1.32
Real options (when relevant)	26.56	1.41	1.48	1.35	1.40	1.41	1.57	0.92	1.52	1.26	1.28	1.72	1.67	1.30
Discounted payback period	25.00	1.25	0.78	1.59**	1.22	1.33	1.07	1.67	1.61	0.94	1.28	1.17	1.72	1.07
Economic Value Added (EVA)	15.38	1.05	0.68	1.32**	0.98	1.22	1.27	0.75	1.48	0.75**	0.93	1.33	0.94	1.09
VaR or other simulation analysis	17.91	1.07	1.03	1.11	1.08	1.05	1.20	1.23	1.32	0.92	1.06	1.11	1.47	0.92
Adjusted present value	12.50	0.73	0.52	0.89	0.74	0.72	0.62	0.92	0.87	0.60	0.83	0.50	0.72	0.74
Profitability index	10.94	0.70	0.70	0.70	0.63	0.89	0.97	0.67	0.74	0.60	0.76	0.55	1.00	0.59

[†] Respondents are asked to rate on a scale of 0 (never) to 4 (always).

***, **, * denotes a significant difference at the 1%, 5% and 10% level respectively.

Table 3[†]

How frequently would your company use the following discount rates when evaluating a new project in the Australian market?
To evaluate this project we would use...

	% Always or almost always	Mean	Size		P/E		Leverage		Rated debt		Pay dividends		Industry	
			Small	Large	Growth	Non-growth	High	Low	Yes	No	Yes	No	Energy, materials and IT	other
The discount rate for our entire company	63.07	2.62	2.21	2.94**	2.47	3.00	2.75	3.00	3.04	2.50	2.81	2.11	3.00	2.47
A risk-matched discount rate for this particular project	22.95	1.39	1.67	1.18	1.58	0.88*	1.64	1.00	1.45	1.21	1.26	1.72	1.76	1.29
The discount rate for the Australian market	21.88	1.38	1.33	1.41	1.35	1.44	1.58	0.70*	1.57	1.23	1.29	1.58	1.41	1.36
A divisional discount rate	13.11	0.80	0.56	1.00	0.76	0.94	0.93	1.00	1.00	0.61	0.98	0.39	1.12	1.68
A different discount rate for each component cash flow that has a different risk characteristic (e.g. depreciation vs. operating cash flows)	6.45	0.60	0.75	0.47	0.65	0.44	0.68	0.60	0.70	0.42	0.64	0.50	0.82	0.51

[†] Respondents are asked to rate on a scale of 0 (never) to 4 (always). ***, **, * denotes a significant difference at the 1%, 5% and 10% level respectively.

Table 4[†]
What factors affect how you choose the appropriate amount of debt for your firm?

	% Important or Very Important	Mean	Size		P/E		Leverage		Rated debt		Pay dividends		Industry	
			Small	Large	Growth	Non-growth	High	Low	Yes	No	Yes	No	Energy, materials and IT	other
The volatility of our earnings and cash flows	49.15	2.32	2.11	2.50	2.30	2.38	2.50	2.23	2.43	2.30	2.31	2.36	2.59	2.21
Financial flexibility (we restrict debt so we have enough internal funds available to pursue new projects when they come along)	47.46	2.24	2.15	2.30	2.33	2.00	2.33	1.92	2.35	2.10	2.11	2.64	2.47	2.14
We issue debt when our recent profits (internal funds) are not sufficient to fund our capital expenditures	35.09	1.77	1.62	1.90	1.98	1.25*	1.90	1.54	2.36	1.48**	1.70	2.00	2.35	1.53**
Our credit rating (as assigned by rating agencies)	32.20	1.59	0.85	2.22***	1.63	1.50	1.63	1.54	2.83	0.67	1.69	1.29	2.12	1.38
The transactions costs and fees for issuing debt	23.33	1.30	0.96	1.58	1.30	1.20	1.42	0.85	1.57	1.10	1.33	1.21	1.41	1.26
The tax advantage of interest deductibility	21.31	1.30	0.93	1.61**	1.32	1.24	1.52	1.14	1.39	1.22	1.45	0.79	1.71	1.14
We limit debt so our customers/suppliers are not worried about our firm going out of business	20.34	1.15	1.22	1.09	1.18	1.07	1.21	0.64	1.09	1.17	0.98	1.71	1.47	1.02
The potential costs of bankruptcy, near-bankruptcy, or financial distress	18.97	1.16	0.92	1.34	1.12	1.27	1.14	1.31	1.39	0.93	1.30	0.71	1.35	1.07
The debt levels of other firms in our industry	15.25	1.12	0.67	1.50***	1.09	1.19	1.30	1.15	1.39	1.00	1.31	0.50***	2.00	0.76***
We restrict our borrowing so that profits from	10.34	0.76	0.81	0.72	0.81	0.60	0.83	0.92	0.61	0.79	0.86	0.43	1.12	0.61

new/future projects can be captured fully by lenders														
We try to have enough debt that we are not an attractive takeover target	6.90	0.48	0.23	0.69**	0.35	0.87	0.45	0.62	0.52	0.48	0.55	0.29	0.88	0.32
The personal tax cost our investors face when they receive interest income	5.17	0.52	0.54	0.50	0.51	0.53	0.62	0.38	0.57	0.31	0.59	0.29	0.76	0.41
To ensure that upper management works hard and efficiently, we issue sufficient debt to make sure that a large portion of our cash flow is committed to interest payments	3.45	0.57	0.58	0.56	0.56	0.60	0.66	0.62	0.35	0.66	0.64	0.36	0.88	0.44
If we issue debt our competitors know that we are very unlikely to reduce our output	0	0.29	0.23	0.34	0.28	0.33	0.31	0.23	0.26	0.28	0.32	0.21	0.53	0.20
A higher debt ratio helps us bargain for concessions from our employees	0	0.21	0.31	0.13	0.23	0.13	0.17	0.15	0.04	0.17	0.16	0.36	0.35	0.15

[†] Respondents are asked to rate on a scale of 0 (Not important) to 4 (Very important). ***, **, * denotes a significant difference at the 1%, 5% and 10% level respectively.

Table 5[†]
 What factors influence your firm's decision about its dividend payout policy?

	% Important or Very Important	Mean	Size		P/E		Leverage		Rated debt		Pay dividends		Industry	
			Small	Large	Growth	Non-growth	High	Low	Yes	No	Yes	No	Energy, materials and IT	other
Ability of the firm to maintain the level of dividends paid out	50.00	2.19	1.45	2.69***	1.80	2.89***	2.37	2.38	2.55	2.21	2.40	0.50***	2.29	2.14
Level of dividends paid out by the firm previously	44.44	2.04	1.41	2.47**	1.66	2.74***	2.15	2.46	2.15	2.21	2.25	0.33***	2.41	1.86
Surplus of funds that cannot be currently invested in wealth-producing projects	41.82	1.80	1.70	1.88	1.64	2.11	1.93	2.23	2.19	1.72	1.84	1.50	2.24	1.61
Level of franking credits available to be paid out to shareholders	40.74	1.80	1.64	1.91	1.54	2.26	2.07	1.85	1.85	1.93	1.85	1.33	2.24	1.59
Market's response to the firm's announcement of the dividend	33.33	1.44	0.82	1.88***	1.09	2.11**	1.63	1.54	1.55	1.55	1.58	0.33**	1.82	1.27
Cost of replacing funds paid out as dividends	14.81	1.00	0.73	1.19	1.06	0.89	1.15	1.15	1.20	0.93	1.06	0.50	1.24	0.89

[†] Respondents are asked to rate on a scale of 0 (Not important) to 4 (Very important). ***, **, * denotes a significant difference at the 1%, 5% and 10% level respectively.

Table 6[†]

Has your firm ever considered conducting a share buyback? If 'yes', what factors affected your firm's decisions about conducting the buyback?

	% Important or Very Important	Mean	Size		P/E		Leverage		Rated debt		Industry	
			Small	Large	Growth	Non-growth	High	Low	Yes	No	Energy, materials and IT	other
Surplus of funds that cannot be currently invested in wealth-producing projects	77.27	3.05	2.71	3.20	3.10	3.00	3.13	3.33	3.22	2.92	3.38	2.86
Level of franking credits available to be paid out to shareholders	54.55	2.50	2.29	2.60	2.50	2.50	2.63	2.83	3.11	2.08	2.25	2.64
Market's response to the firm's announcement of the buyback	54.55	2.50	1.43	3.00**	2.80	2.25	3.13	2.00	3.44	1.85***	2.63	2.43
Positive impact on the firm's earnings per share	54.55	2.50	1.57	2.93**	2.60	2.42	2.88	1.83	3.22	2.00**	2.75	2.36
Buyback proceeds for shareholders relative to the receipt of ordinary dividend income	40.91	1.95	1.00	2.40**	2.30	1.67	2.25	1.83	3.22	1.08***	2.38	1.71
Cost of replacing funds paid out via the buyback	31.82	1.64	1.14	1.87	2.00	1.33	1.63	1.67	2.22	1.23*	2.25	1.29
Ability to conduct the buyback without creating an expectation that it will necessarily occur again	9.09	1.45	1.43	1.47	1.40	1.50	1.50	1.33	1.22	1.62	1.38	1.50

[†] Respondents are asked to rate on a scale of 0 (Not important) to 4 (Very important). ***, **, * denotes a significant difference at the 1%, 5% and 10% level respectively.