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Capital structure decisions: What Spanish CFOs think

Decisiones de Financiación: Lo que Piensan los Directores Financieros Españoles

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Abstract

Purpose – The way business practice adjusts to the models proposed by financial theory has been under moderate yet constant scrutiny from the academic world. The purpose of this paper is to contribute to this line of research by showing CFOs' perceptions of Spanish companies with regard to their capital structure decisions.
Design/Methodology – The empirical approach is examined using information gathered through a survey answered by 140 CFOs of Spanish companies during 2011. Results are obtained from mean difference tests and ordered probit estimations.
Findings – The results of the paper show that managers attach importance to establishing and monitoring a target debt ratio and the capacity to maintain additional debt in order to provide financial flexibility. In addition, CFOs prefer internal financing to external, using debt when internal funds do not allow investments to be funded.
Originality/Value – On the whole, the results of this research show that trade-off and pecking order theories are not alternative views of the same problem, but represent complementary approaches of how companies define their capital structures.

Keywords Capital structure, Debt maturity, Survey

Paper type Research paper

Resumen

Objetivo – El modo en que la práctica empresarial se ajusta a los modelos propuestos por la teoría financiera ha sido objeto de un tímido pero constante escrutinio por parte del mundo académico. En este trabajo, se contribuye a esta línea de investigación mediante la exploración de las percepciones que los directivos financieros de empresas españolas mantienen sobre sus decisiones de estructura de capital.
Diseño/Metodología – El análisis empírico explota las respuestas de 140 directores financieros de empresas españolas a una encuesta realizada en el año 2011. Los principales resultados son obtenidos de los tests de diferencias de medias y la estimación de modelos Probit ordenado.

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Resultados – Nuestros resultados muestran que los directivos financieros consideran importante el establecimiento y persecución de un objetivo de deuda objetivo y la flexibilidad financiera que otorga el mantenimiento de capacidad de endeudamiento adicional. Además los directores financieros prefieren utilizar los recursos generados internamente antes que la financiación externa, utilizando deuda cuando los fondos internos son insuficientes para financiar sus inversiones.
Originalidad/Valor – En conjunto, los resultados de nuestra investigación muestran que la teoría del *trade-off* y del *pecking-order* no son soluciones alternativas de un mismo problema, sino enfoques complementarios sobre las decisiones de estructura de capital adoptadas en la práctica.

Palabras clave Estructura de capital, Vencimiento de la deuda, Encuesta
Tipo de papel Trabajo de investigación

1. Introduction

A recurring issue in corporate finance is how companies determine their financing strategies. After the publication of hundreds of papers on the financing decision, one might be under the impression that we know everything we need to know on the topic. This is also the image projected by Brennan's (1995) assessment that "today's instructor is likely to feel that he has more to say about financial policy than about capital budgeting" and the fact that Brealey *et al.* (2011) had passed capital structure from the right to the left-hand side of the balance sheet of "what we do and do not know about finance". However, empirical research has continued to generate inconclusive results which suggest that quite the opposite is true.

In a comprehensive analysis of financial decisions made by the managers of American companies, Graham and Harvey (2001) described their research results on corporate finance practice as both "reassuring" and "disconcerting". Results were reassuring because respondents used CAPM or because NPV was the main tool for selecting investments, yet they were disconcerting because managers were far less likely to follow the precepts of capital structure theories. Academics and practitioners share their interest in finding new models for making better decisions, yet the "best" theoretical models are not the ones most widely used by managers (Graham and Harvey, 2001; Bancel and Mittoo, 2004) and decisions made by companies cannot be always explained by financial theories (Graham and Leary, 2011).

Most empirical research on this topic has been dominated by secondary data regression studies. However, this approach cannot grasp the heterogeneity in the managerial determinants of financing practices. Secondary database analysis reflects the output of the decision-making process but fails to identify its inputs. There are no databases on the criteria used by company managers when making financial decisions, and there is even less information about managers' motivations and preferences. The only alternative is to ask managers directly. Although survey-based analysis is not the standard academic approach in finance (Neuhauser, 2007) and is criticised in certain academic circles as being unscientific (Baker and Mukherjee, 2007), it can offer a richer understanding of practice (Beattie *et al.*, 2006; Andrés *et al.*, 2015) and provide a direct bridge between the academic and the managerial arena (Graham, 2004). As such, Norton (1990, 1991) proposes the use of surveys to observe the "inside" of the financing decision-making process in order to analyse the motivations, behaviours and beliefs that lead to capital structure decisions. Such evidence is not only interesting for researchers and practitioners but also proves valuable from an educational perspective, as claimed by Graham (2011) when describing surveys as a useful motivational tool for teaching corporate finance.

Results such as those reported by Stonehill *et al.* (1975), Pinegar and Wilbricht (1989), Fischer *et al.* (1989), Norton (1990, 1991), Graham and Harvey (2001), Fan and So (2004), Beattie *et al.* (2006), Brounen *et al.* (2006), de Jong and Verwijmeren (2010), Lindblom *et al.* (2011), Maquieira *et al.* (2012) and Nor *et al.* (2012), among others, are used to conclude the existence of a gap between the theory and practice of financing decisions for a broad range of firms worldwide. Although capital structure theories tend to be presented as competing explanations of the way in which companies make their financing decisions (Lindblom *et al.*,