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Journal of Financial Economics 60 (2001) 187–243

JOURNAL OF
Financial
ECONOMICS

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The theory and practice of corporate finance: evidence from the field[☆]

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Received 2 August 1999; received in revised form 10 December 1999

Abstract

We survey 392 CFOs about the cost of capital, capital budgeting, and capital structure. Large firms rely heavily on present value techniques and the capital asset pricing model, while small firms are relatively likely to use the payback criterion. A surprising number of firms use firm risk rather than project risk in evaluating new investments. Firms are concerned about financial flexibility and credit ratings when issuing debt, and earnings

[☆]We thank Franklin Allen for his detailed comments on the survey instrument and the overall project. We appreciate the input of Chris Allen, J.B. Heaton, Craig Lewis, Cliff Smith, Jeremy Stein, Robert Taggart, and Sheridan Titman on the survey questions and design. We received expert survey advice from Lisa Abendroth, John Lynch, and Greg Stewart. We thank Carol Bass, Frank Ryan, and Fuqua MBA students for help in gathering the data, and Kathy Benton, Steve Fink, Anne Higgs, Ken Rona, and Ge Zhang for computer assistance. The paper has benefited from comments made by an anonymous referee, the editor (Bill Schwert), as well as Michael Bradley, Alon Brav, Susan Chaplinsky, Magnus Dahlquist, Gene Fama, Paul Gompers, Ravi Jagannathan, Tim Opler, Todd Pulvino, Nathalie Rossiensky, Rick Ruback, David Smith, René Stulz, and seminar participants at the Harvard Business School/Journal of Financial Economics Conference on the interplay between theoretical, empirical, and field research in finance, the 2000 Utah Winter Finance Conference, the University of Wisconsin and the 2001 American Finance Association Meetings. Finally, we thank the executives who took the time to fill out the survey. This research is partially sponsored by the Financial Executives Institute (FEI). The opinions expressed in the paper do not necessarily represent the views of FEI. Graham acknowledges financial support from the Alfred P. Sloan Research Foundation. Some supplementary research results are available at <http://www.duke.edu/~charvey/Research/indexr.htm>.

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per share dilution and recent stock price appreciation when issuing equity. We find some support for the pecking-order and trade-off capital structure hypotheses but little evidence that executives are concerned about asset substitution, asymmetric information, transactions costs, free cash flows, or personal taxes. © 2001 Published by Elsevier Science S.A.

JEL classification: G31; G32; G12

Keywords: Capital structure; Cost of capital; Cost of equity; Capital budgeting; Discount rates; Project valuation; Survey

1. Introduction

In this paper, we conduct a comprehensive survey that describes the current practice of corporate finance. Perhaps the best-known field study in this area is John Lintner's (1956) path-breaking analysis of dividend policy. The results of that study are still quoted today and have deeply affected the way that dividend policy research is conducted. In many respects, our goals are similar to Lintner's. We hope that researchers will use our results to develop new theories – and potentially modify or abandon existing views. We also hope that practitioners will learn from our analysis by noting how other firms operate and by identifying areas where academic recommendations have not been fully implemented.

Our survey differs from previous surveys in a number of dimensions.¹ First, the scope of our survey is broad. We examine capital budgeting, cost of capital, and capital structure. This allows us to link responses across areas. For example, we investigate whether firms that consider financial flexibility to be a capital structure priority are also likely to value real options in capital budgeting decisions. We explore each category in depth, asking more than 100 total questions.

Second, we sample a large cross-section of approximately 4,440 firms. In total, 392 chief financial officers responded to the survey, for a response rate of 9%. The next largest survey that we know of is Moore and Reichert (1983) who study 298 large firms. We investigate for possible nonresponse bias and conclude that our sample is representative of the population.

¹ See, for example, Lintner (1956), Gitman and Forrester (1977), Moore and Reichert (1983), Stanley and Block (1984), Baker et al. (1985), Pinegar and Wilbricht (1989), Wansley et al. (1989), Sangster (1993), Donaldson (1994), Epps and Mitchem (1994), Poterba and Summers (1995), Billingsley and Smith (1996), Shao and Shao (1996), Bodnar et al. (1998), Bruner et al. (1998) and Block (1999).

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