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

John R. Graham\textsuperscript{a}, Campbell R. Harvey\textsuperscript{a,b,*}

\textsuperscript{a}Fuqua School of Business, Duke University, Durham, NC 27708, USA
\textsuperscript{b}National Bureau of Economic Research, Cambridge, MA 02912, USA

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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

\textsuperscript{*}Corresponding author. Fuqua School of Business, Duke University, Durham, NC 27708, USA. Tel.: +1-919-660-7768; fax: +1-919-660-7971.

E-mail address: cam.harvey@duke.edu (C.R. Harvey).
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.

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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. 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.

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