MANAGERIAL DECISIONS, CONTROL INFLUENCES AND CORPORATE FINANCE: SURVEY EVIDENCE

By

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Abstract

We surveyed senior (C-level) executives in a variety of privately-owned and publicly-traded organizations to examine their corporate goals, the factors that affect the ability of their managers to make decisions to achieve these goals, the control influences on managerial decisions exerted by various stakeholders, the factors that affect firms’ capital-raising, M&A and dividend policy decisions, and how firms make their capital structure decisions. The main findings are as follows. While managers seek to maximize shareholder value, achieving long-term growth and stability for all stakeholders and increasing market share growth are also important, even for public firms. A key impediment perceived by managers in the attainment of their goals is lack of endorsement of their decisions by key stakeholders, caused by fundamental disagreement. Managers thus attempt to make decisions that they believe their key employees, boards of directors and major investors will endorse. The choice of which security to issue to raise external capital is driven most significantly by the firm’s overall corporate strategy and whether the chosen security will facilitate management’s flexibility (increase decision endorsement) to execute that strategy. Agency and asymmetric information matter in some corporate decisions, but agency costs have no impact on financial policy. Tests of specific hypotheses reveal that firms that value managerial decision-making autonomy (which is adversely affected by fundamental disagreement) more choose lower dividend-payout ratios and lower leverage ratios, whereas firms that face larger asymmetric information have lower leverage ratios.
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EXECUTIVE SUMMARY

This study, sponsored by the Olin Business School Center for Finance and Accounting Research, was undertaken to benchmark best practices in the governance and financial policies of firms, within the context of the research in Finance over the past fifty years. The questions the study sought to address were:

- What are the goals of managerial decision-making?
- What factors affect the manager’s ability (autonomy) to make decisions that achieve these goals?
- Whose endorsement of managerial decisions is critical?
- When managerial decisions are not endorsed, which factors are the most important contributors to the lack of endorsement?
- What do managers do to facilitate endorsement of their decisions by key stakeholders?
- Which factors are more important in enabling firms to raise capital?
- Which factors are most important for firms in acquisitions?
- Which factors affect dividend policy the most?
- Do firms have target debt-equity ratios? Are these ratios in market value or book value terms? Are they adjusted when the firms’ stock prices change?

To address these questions, we designed a survey questionnaire that was sent out to senior executives (CEO, CFO, Board Member, Chairman, Controller, Director, Founder, General Manager, Managing Director, Owner, Partner, President, Senior Vice President and Vice President) at 2,081 companies. The survey was sent out June 3, 2008 and respondents were
asked to respond by July 3, 2008. We received 528 responses, for a response rate of 15.4%. After deleting incompletely-filled out surveys, government employees and so on, as well as consolidating multiple respondents from the same organization, we ended up with 321 distinct firms whose executives responded.

The main results we found are listed below:

1. For both public and private firms, the top goal is ensuring growth and stability for all stakeholders. Shareholder value maximization is the second-most important goal.

2. Factors that contribute to the manager’s decision-making autonomy are considered important in affecting the firm’s ability to cope with environmental changes and achieve its goals. Having the Board of Directors share management’s vision and hence not disagree with management is considered an important factor. More surprisingly, managers also attach a great deal of importance to key employees sharing management’s vision. That is, *internal governance* is considered important.

For public firms, the most important stakeholders for decision endorsement are the Board, key employees, major shareholders/investors, customers, and finally security analysts. Private firms are similar, except that instead of security analysts, they view banks as a key stakeholder for decision endorsement.

3. For both public and private firms, their past financial performance, their competitive position and on-balance-sheet cash are viewed as factors that increase the manager’s decision-making autonomy, whereas the presence of high on-balance-sheet debt, the use of debt for financing new projects, and large shareholders are viewed as reducing managerial decision-making autonomy. Thus, managers who wish to retain the most decision-making flexibility maintain consistent financial
performance, a strong competitive position, low levels of debt, and high levels of cash.

4. Managers actively undertake actions to reduce potential disagreement with key stakeholders. These include achieving consistent financial performance, developing the confidence of key stakeholders, laying the groundwork with the Board to get agreement, clearly communicating the firm’s strategy, and having transparency.

5. About 80% of all public firms and 35% of private firms seriously considered raising external capital. Many factors were considered important in the security issuance decision. The most striking factor for both private and public firms was corporate strategy and whether the security under consideration would facilitate or impede managerial decision-making autonomy to implement the strategy. Another important factor, which shows up only for public firms, is EPS dilution.

6. For both private and public firms, one of the factors considered important in acquisitions is the cultural compatibility of the target with the acquirer. Another factor, related to managerial decision-making autonomy, is the endorsement of the Board of Directors.

7. Public firms predicate their dividend policies on factors such as the anticipated reaction of investors and analysts, current and past stock price, and the dividend policies of peer group firms. Managers who value their decision-making autonomy/flexibility choose to pay lower dividends. Private firms take into account the personal tax consequences of dividends for their shareholders and paying lower dividends now to have the higher internal financing in the future.

8. Managers who value their decision-making autonomy more choose lower dividend payout and leverage ratios.
9. Only 58% of public firms and 38% of private firms mentioned that they had target debt-equity ratios. A surprising 34% of public firms and 32% of private firms said their target ratio was related to the debt-equity ratios adopted by their peers. Of the public firms, 45% stated that they set their target debt-equity ratio in book-value terms, and 69% said that they did not adjust their ratio to movements in their stock prices. Thus, even among public firms that set their target debt-equity ratios in market-value terms, many firms make no proactive capital structure adjustments in response to stock price changes.

This paper provides the description of the research methodology, the data and the details underlying the findings. While the study is based on data that were collected prior to the current financial crisis reaching its depths, the best practices identified here seem to apply quite broadly to normal times as well as times of stress. We hope you enjoy reading it.

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