Capital structure decisions

A case study on high growth SMEs listed on NGM Equity in Sweden

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ACKNOWLEDGEMENTS

We would hereby like to thank several people who strongly supported and added great value to this study.

First of all we would like to thank our supervisor Barbara Cornelius who has constantly given us advice on solutions and who has strongly motivated us through the whole process. We are grateful for the knowledge we have gained through discussions on the topic of capital structure.

We would also like to thank the representatives of the companies listed on the NGM Equity stock market who despite their busy schedule managed to participate in the survey which resulted in a very high response rate while doing this case study of the whole population. We also appreciate their time spent during the follow up discussions of answers on survey questions.

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SUMMARY
Small and medium sized enterprises (SMEs) stand for 99.8 percent of businesses in Europe and are therefore a vital part of every country’s economic growth. The maintenance of an optimal capital structure is considered as an area where decision makers can influence the company as company value and risk depends, at least in part, on its capital structure. Of particular interest when studying capital structures among SMEs are high growth firms which are assumed to be more capital intense due to the need to finance their extraordinary growth. There seems to be a knowledge gap regarding research on the capital structure employed by firms listed in Sweden and there is therefore an opening for a study of this kind.

Theories discussed in this paper are the pecking order theory and trade off theory which have been supplemented with information asymmetry theory and agency theory to build up a solid theoretical framework. These theories are also commonly used when capital structure issues are discussed. Pecking order theory describes how firms raise capital according to a ladder of preferences where internally generated funds are preferred to external funds and where debt is preferred to equity. Looking at the empirics on the pecking order there appear to be contradictions in the literature where some previous research findings suggest a reversion of the pecking order with regard to external funds, i.e. that external equity is preferred to external debt.

Three factors that are extensively mentioned in the seminal work are financial flexibility, ownership control and the tax advantage of debt interest deductibility. These seem to have an influence on capital structure decisions. Therefore we also look at the relative importance of these factors. The research question of this study is thus: “What influences the capital structure and the pecking order among high growth, listed SMEs in Sweden?”. The practical implication of this study is to increase knowledge on what factors companies value with regard to capital structure decisions.

A quantitative case study of the total population of high growth SMEs listed on the NGM Equity in Sweden was conducted. A deductive approach was used. A web based questionnaire was sent out to all 26 companies listed on NGM Equity during April 2010.

The result is presented in an aggregated form using descriptive statistics and shows no evidence for a specific pecking order with regard to external funds. This suggests that the theory therefore needs revision. Equity and debt appear to be close to equally preferred and the overall finding suggests that there is a lack of financial strategy among SMEs listed on NGM Equity. Financial flexibility appears to have the most impact on influencing the financial structure followed by ownership control. The advantage of debt interest deductibility on tax appears to be of less importance.

We believe that this study has contributed to knowledge about capital structure decisions and is good groundwork for future research. Future researchers are suggested to increase the studied population and separate companies according to industry and size and in order to get statistically significant results applicable on other similar groups in other countries.
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1. INTRODUCTION

The following chapter introduces the topic of this study, its actuality and importance. Further on, practical implications are presented showing why and how this study might be of interest to people concerned with capital structure decisions. The problem background leads to a research question followed by a section where the purpose of the study is described. The chapter ends with several definitions that are widely used in the study, but may not be well-known to a broad public readership.

1.1 Choice of Topic

People tend to classify countries into various groupings based, at least in part, on their economic status. Whether the country is “third world” or “first”, economic growth is important for its population’s quality of life. In order to maintain high levels of economic growth countries have united and formed partnerships (e.g. European Union) where both people and businesses gain advantages from the cooperation between nations (Europa.eu, 2010).

A major factor influencing economic growth in a country is the existence of companies that provide employment for the country’s population. The dominant companies providing this service in Europe are small and medium sized enterprises (SMEs). SMEs stand for 99.8 percent of all companies in Europe and employ nearly 85 million people (Svenskt Näringsliv, 2010).

Companies strive to optimize their activities in order to increase value, which in the European model is more extensively defined as value to stakeholders whereas the Anglo-Saxon model emphasizes value to shareholders (Thorsell, Cornelius, 2009, p. 109). The maintenance of an optimal capital structure is considered as one area where decision makers can influence the company as company value and risk depends, at least in part, on its capital structure. If we presume, along with Milken (2009, p. A21) that it is important to maintain optimum levels of debt and equity in that capital structure, decision makers must constantly be in control of capital structure determinants. These are described, by Milken as monitoring management and industry, the capital markets and macroeconomic regulation as well as watching trends as they develop.

The practical implications of investigating capital structures and the strength of capital structure determinants on listed SMEs in Sweden is to increase understanding of what factors companies value most with regard to capital structure decisions. This in turn, has the potential of partly explaining the performance of companies in Sweden. Moreover, the performance of companies listed in Sweden might reflect capital structure and company performance in a broader sense since Sweden, in some aspects, is described as a pioneer with regard to business life and corporate structures. Thorsell and Cornelius (2009) state that the corporate
governance models employed in Sweden are a mixture between the Anglo-Saxon shareholder model that emphasizes shareholder wealth maximization and the European model emphasizing stakeholder value. Being a country highly dependent on the outside world with an integrated financial market (Riksbanken, 2009), the structure of companies in Sweden, including capital structure, is of great interest since Sweden and Swedish authorities have managed the crisis of 2008 and 2009 reasonably successfully (Johansson, 2009). Sweden is also ranked as one of the European countries that have survived the financial crisis best as determined by a survey of international business people (Servcorp International Business Confidence Survey, 2009). Taking into consideration Sweden’s position as a pioneer with regard to corporate structure and Sweden’s performance in the recent economic downturn, this indicates that the results have greater applicability than to Sweden only.

The application of these results regarding companies’ capital structures should therefore be of interest to stakeholders active in markets worldwide. This is of interest, because the Swedish environment described by Thorsell and Cornelius (2009) as a leading one become the norm in countries around the world. This practical implication will therefore, even though one cannot generalize the results to groups other than the studied population, give an indication to countries and companies other than ones listed in Sweden.

1.2 Problem Background

A firm will be profitable if the yield on an asset exceeds the interest paid for financing the asset. An asset is thus worth acquiring if it adds more value than the cost of acquiring it. (Modigliani, Miller, 1958) Hence, in order to assess this equation the concept of cost of capital must be taken into consideration. Since a firm can choose from a range of sources of finance the cost of capital will be dependent on the financial instruments and the source employed. This fundamental concept has been of interest for three major classes of economists; corporation specialists seeking financing techniques to secure survival and growth, corporation managers working with capital budgeting, and economists seeking to explain investment behaviors (Modigliani, Miller, 1958).

Considering the portion of debt and the portion of equity that is used in the firm, one can derive its weighted average cost of capital. The weighted average cost of capital should further reflect current financial costs associated with the mix of debt and equity that is chosen and not be based on historical averages. Similarly, the weighted average cost of capital should reflect an investor’s internal rate of return on future cash flows for a particular investment taking the source of financing used into consideration (Bruner et al., 1998). In essence, if an investment is financed entirely by equity the cost of capital benchmark should be based on the cost of equity, and similarly if debt is used the cost of capital should reflect the cost of debt. However, since it might be difficult to estimate what source of funds is being used for a specific investment the cost of capital estimation is often based on a firm’s target capital structure. When estimating the cost of capital it should also be noted that if a certain source of funds is used for a particular investment this source might still not represent the “true” cost of capital, i.e. if an investment is financed by pure debt, equity capital might be needed as
collateral for that portion of debt being used. In order to reflect a more realistic picture, many companies therefore use a weighted average when calculating their cost of capital. Bruner et al. (1998) state that the cost used when estimating the cost of capital should be the after tax cost, taking into consideration the debt interest deductibility on tax.

Moreover, when distinguishing between the two sources of finance it should be noted that debt is based on a contractual relationship whereas equity is based on a residual relationship (Hamberg, 2001, p. 192). Being based on a legal contract the debt holder has certain legal rights and the arrangement is therefore viewed as less risky from an investor’s point of view. This in turn allows the investor to require a lower rate of return and debt is therefore, from a firm standpoint, viewed as the cheaper source of capital. The equity holder, on the other hand, does not have the same legal rights or guarantees of a certain return as the debt holder has and only once all contractual relationships are fulfilled can the equity holder receive the residual value of the firm (Hamberg, 2001, p. 192).

Leverage is connected to profitability and the cost of capital. The topic has been discussed in various textbooks on finance and is commonly divided into operational and financial leverage. Operational leverage deals with the volatility of earnings before interest and tax (EBIT) and how an increase in revenue can result in a levered increase in EBIT depending on the movement of variable costs. The concept is similar to that of economies of scale. Of particular interest when discussing the topic of capital structure is the concept of financial leverage which deals with the volatility of earnings after tax (EAT) and how the debt interest deductibility on tax increases value to shareholders. As noted above, debt is thought of as the cheaper source of capital and by adding the tax shield advantage the after tax cost of debt will be even lower. As opposed to leveraging the firm in order to gain the advantages associated with debt, firms may also keep modest debt levels in order to remain financially flexible. Financial flexibility is, in this paper, defined as unused debt levels which allow the firm to keep interest rates low in case of a downturn in the economy (Graham, Harvey, 2001) and thus remain flexible and able to react to opportunities and threats that confront the firm.

The risks associated with debt financing, e.g. costs of financial distress must also be considered when it is proposed that a firm can find an optimal capital structure (Kraus, Litzenberg, 1973). This balance between the advantages and risks of using debt is referred to as the trade off theory of capital structure and was presented by Modigliani and Miller in 1958. Frank and Goyal (2009) made a study on American firms during a period of years 1950-2003 to investigate the relative importance of various factors influencing capital structure decisions. They concluded that versions of the trade off theory were supported by empirical evidence. Similarly, Fama and French (2002) stated that they found support for many of the predictions made by the trade off theory in their study testing that and the major alternative theory, pecking order, which will be described below.

In contrast to finding the optimal point in the mix of liabilities, e.g. debt and equity, researchers have tried to explain financing patterns among firms according to firm preferences. Donaldson (1961) proposed that internally generated funds were preferred to
external financing. His proposal was later developed by Myers (1984) who proposed a hierarchic preference order where the first resort of firms seeking capital is internal funds (retained earnings), followed by external funds where debt is preferred over equity.

![Figure 1.2.1. Pecking order as presented in theory.](image)

As will be discussed later on in this paper, it is disputed whether firms do follow the pecking order or not. However, Hutchinson (1995) found evidence of SMEs following the pecking order and he further stated that it is their typical behavior since equity issues are much costlier than debt issues. Fama and French (2002) also note that many pecking order theory predictions they tested in their study were supported.

Connected to the pecking order theory as one of the most important determinants of capital structure, is information asymmetry theory (Fama, French, 2002). The theory describes risk uncertainty among investors, i.e. where they perceive investments as riskier they demand a higher premium (Watson, Wilson, 2002) which, from a firm’s point of view, results in a preference for external debt over external equity. Another theory that is closely connected to the pecking order theory and often brought up when discussing the topic of capital structure is agency theory. The theory refers to the agency relationship between firm owners and managers, where it is stated that it is virtually impossible for the owner to ensure that the agent acts according to the objectives of the owner at zero cost (Jensen, Meckling, 1976). Moreover, Romano et al. (2000) state that costs connected to monitoring and control are critical issues in the relationship between owners and suppliers of external financing. These problems are used similarly to the problems of information asymmetry to explain the apparent preference for external debt over external equity.

While agency theory and information asymmetry theory are connected to the pecking order theory in a very straightforward manner, the connection between trade off theory and pecking order theory is not as obvious. While trade off theory advocates the use of debt up to a certain level to maximize the gains from debt interest deductibility on tax, the pecking order theory explains the hierarchic steps used when raising capital where debt is preferred over equity according to the law of least effort. However, there is a connection where the trade off theory implicitly supports the pecking order theory with regard to external funds. De Jong and Verwijmeren (2010) state that larger firms tend to follow a target debt ratio while smaller firms tend to follow a preference order due to higher levels of information asymmetry. They
also state that trade off and pecking order theories are not mutually exclusive, but overlap to some extent.

Although theoretical explanations have supported the contention that firms use a hierarchic preference order, there seem to be some empirical contradictions to the theory as well. When looking at SMEs there are reasons to believe that the pecking order is not being followed. Researchers, relying on empirical evidence, describe firms that issue equity before they issue debt, suggesting a reversed order in regard to external funding (Helwege et al., 1996, Hogan, 2005, Ni, Yu, 2008). The results list a reversal of steps two and three in the preference order.

![Pecking order as found in previous research.](image)

In a study of Swedish listed firms by Ekeroth and Wahlberg (2006) no support for the pecking order theory is found. Moreover, they state that companies in Sweden do not seem to have target debt levels and thus they are not striving to optimize their capital structure. Capital structures and capital structure decisions among listed firms in Sweden, however, have received only limited attention to date.

Taking into consideration the limited amount of information on companies listed in Sweden as well as the contradictions between theory and empirics found in theoretical discussions, there is an opening for a study focusing on capital structure and the factors influencing capital structure decisions among companies listed in Sweden.

### 1.3 Research Question
What influences the capital structure and the pecking order among high growth, listed SMEs in Sweden?

### 1.4 Purpose
The main purpose with this research study is to investigate if there are contradictions between theory and empirics on capital structure and the pecking order among SMEs. We aim to study whether the basic theory is applicable on complex situations that an SME might find itself in in real life. We further aim to verify the impact strength and the relative importance of
financial flexibility on capital structure preferences as well as the impact of the tax shield advantage and the role of ownership and control.

As mentioned above the practical implication of this study is to increase the knowledge on how strong specific factors are valued by companies with regard to capital structure decisions. According to Thorsell and Cornelius (2009) Sweden could be viewed as a pioneer when it comes to business life and corporate structure. Combining the Anglo-Saxon shareholder model and the European stakeholder model the results from a study on companies listed in Sweden might be of interest to a broader audience than Sweden only due to Sweden’s prominent position as described above as well as Sweden’s performance in the recent financial crisis.

1.5 Delimitations
Delimitation consists of studying firms listed in Sweden. Additionally the study is limited to the Nordic Growth Market and companies listed on that market. As the market name suggests the study will be delimited to high growth companies. NGM Equity stock market defines companies listed there as small and medium sized enterprises - SMEs (NGM Equity, 2009). The choice of NGM Equity market is motivated by the constant variation in capital structures of high growth firms and their constant need for capital to finance extraordinary growth. There are only 26 companies listed on the NGM Equity market and further separation according to industries will not be done since we would encounter statistical problems with such a limited number of companies within each group.

Theoretically this study is limited to existing theories that are connected to and describe capital structure. These theories are pecking order theory, trade off theory, agency theory and information asymmetry theory.

1.6 Definition of Concepts
**High growth firms** – companies with financial growth above average. Specifically the growth rate can be measured by either company’s turnover or number of employees (IQube.se, 2010). Companies included in this study are listed on the Nordic Growth Market and are assumed to be high growth companies per definition.

**SME** – an abbreviation referring to small and medium sized enterprises. Companies should fulfill certain criterion in order to classify as an SME. The number of employees must be ≤250, as well as a yearly turnover of ≤50 million EURO or a balance sheet total of ≤43 million EURO. (European Commission, 2010)

**NGM Equity** – Nordic Growth Market Equity. An authorized stock market listing small and medium sized Nordic and specifically high growth companies in Sweden. Nordic Growth Market AB operates the market and has its headquarters in Stockholm, Sweden.
2. SCIENTIFIC PERSPECTIVE

The following Chapter describes the points of view taken in this study as well as preconceptions that we had before the study was conducted. The reasons for selecting an objectivistic standpoint are presented and justified. Further on, the scientific approach is described and the steps of a deductive approach are brought up in order to give a good picture of the overall scientific perspective taken in this study. The Chapter ends with a discussion of how the search for literature and criticism of secondary sources has been done in order to show that the literature included must be found correctly and reviewed critically.

2.1 Preconceptions

Authors’ preconceptions are important for the interpretation of information and therefore also a study’s outcome (Patel, Tebelius, 1987, p. 34). Montgomery and Qvarsell (2001, p. 152 ff) also show that preconceptions are something a person gets through their surroundings and not something they are born with. Knowledge obtained from a variety of sources will influence our future interpretation of results and the conclusions that are to be made in this study.

Our preconceptions mainly consist of theoretical knowledge that we have gained throughout our studies at Umeå School of Business. We have studied finance on an advanced level with courses such as Financial Management Practices, Financial Statement Analysis and Financial Valuation. A deeper knowledge when it comes to basic theories used in this study was gained by extensive reading of seminal work, scientific articles and previous research within the topic of capital structure.

When it comes to the practical preconceptions within the area of investment decisions and preferences of either taking on debt or equity in practice the preconceptions are insignificant. We do not have previous experience of practical decision making with regard to capital structure management of a company. According to us this will only increase the level of objectivity of this quantitative study where we gather data that we then analyze without preconceived expectations. An objective analysis of the quantitative data gathered is an important part of a researcher’s work according to Patel and Tebelius (1987, p. 45).

2.2 Ontology

The ontological point of view presented in this study can be described as objectivistic. The objectivistic standpoint occurs when the social reality cannot be influenced by a researcher’s intellect and consciousness (Bryman, Bell, 2005, p. 33). Bryman and Bell (2005) mean that any organization may be viewed as an entity with standardized rules and guidelines of how people should act and behave. In this study the objectivistic standpoint consists of gathering the quantitative data and further interpretation of it.
Patel and Tebelius suggest that a researcher is influenced by personal values and previous experiences and at some point in the research process he or she will have to take a standpoint on a specific question. Because of the nature of a quantitative study researchers have to analyze gathered data trying to minimize their subjectivity in the research (Patel, Tebelius, 1987, p. 44 ff). Johansson (2000, p. 150) says that all mental states are subjective. We do not accept this solipsistic world view and, while recognizing that some researchers claim that subjectivity cannot be over-ridden and that a researcher’s own ontological perspective influences their outcomes, we believe that we can claim a relatively objective standpoint in our research. We have no predetermined expectation about what ought to influence the capital structure of firms listed in Sweden and are simply gathering and analyzing information to determine what is done by companies in Sweden. We have no preconceived notions about their choices, this justifying our objectivistic standpoint.

2.3 Scientific Approach
In this study a deductive approach is used. The deductive process describes the relationship between theory and practice. The process consists of theory, hypothesis building, data gathering, analysis of results after which a proposition is supported or rejected and as a last step the theory is revised (Bryman, Bell, 2005, p. 23 ff). Patel and Tebelius (1987, p. 17) state that when a researcher draws a conclusion about existing phenomena based on theory the work is described as deductive. In our case assumptions are made based on relevant theories within the field of finance and capital structure and are then tested by gathering data. Assumptions are then formulated into propositions. Applying this approach also enables us to follow a procedure commonly used in our field of study. We will be able to follow standardized steps of a deductive process and support or reject our propositions as well as communicate our results clearly and easily to other financial researchers. Theories to be examined and potentially revised will be presented more thoroughly in Chapter 3 of this study.

We have chosen to do a case study analyzing results gathered from the whole population of high growth SMEs listed on the NGM Equity stock market in Sweden. The exact definition of the total population is vital (Kent, 2007, p. 227 ff) and is well motivated throughout the whole study. Due to the relatively low number of represented companies on the NGM Equity stock market that make up the total population studied we are trying to do a census study. A census study is described as a quantitative study where researchers try to study the total, relatively small, population for scientifically motivated reasons (Kent, 2007, p. 228). This is in line with the type of study we are undertaking.

2.4 Perspective
Any perspective taken and any interpretation of reality in research influences the results less than do the questions that are being asked. A choice of a perspective is, however, vital
according to Halvorsen (1992, p. 38) and the perspective taken herein is that of traditional capital structure theoreticians. As far as the research question: “What influences the capital structure and the pecking order among high growth, listed SMEs in Sweden?” we believe that the key to answering this question lies in examining what is done by companies. Any knowledge gained, as presented in the purpose of this study, is interesting not solely to theoreticians, but for any stakeholder, as they might increase the degree of their understanding regarding preferred capital structures and the reasons corporate officers make these decisions.

2.5 Literature Search
In the process of our literature search it was important for us to use seminal work when it comes to theories within the area of capital structure. We were constantly aware of interconnecting theoretical basics with previous research studies in order to show the relevance of the topic. In order to find relevant studies we used databases for scientific articles. These databases were Business Source Premier and Emerald Fulltext which were available through Umeå School of Business library database system. All the material used was derived from published articles and books except for one study by Ekeroth and Wahlberg that was included due to the lack of research about Swedish companies. This increased the level of trustworthiness of the literature used, which of course can and will be discussed in part 2.6 Criticism of Secondary Sources. Besides being published in peer reviewed journals, we have noticed that most of the articles are often quoted by other researchers, a probable reflection of their scientific validity. We have been inspired by several scientific articles and used the material that was referred to for further reading. Johansson-Lindfors (1993, p. 88) says that it is important to control the sources’ authenticity and origin and use up to date literature. We believe that we have done all this and fulfilled all important criteria while searching for literature.

Practically the literature search was done by using the following keywords: capital structure, pecking order theory, financing decisions, debt, equity, preferences, internal funding, external funding, trade off theory, financial flexibility, tax advantages, ownership control, agency theory, ownership structure.

2.6 Criticism of Secondary Sources
Secondary sources have been used both with regard to capital structure theory and when deciding upon our selected scientific approach and design.

Searching for relevant and reliable sources of information regarding the topic of capital structure is something we have devoted a significant amount of time to from the very start. Since capital structure has been a heavily debated topic for several decades, both older seminal articles and recent up to date articles have been used. The two main theories, pecking order theory and trade off theory were first promulgated respectively in 1958 and 1984 and are still used as a basis for capital structure decisions among companies (Modigliani, Miller, 1958, Myers, 1984, Hamberg, 2001). With regard to empirical findings in the area we have
relied upon more recent studies since the results presented, even though they apply well accepted theories, reflect recent developments and practices within the area. The possible shortcomings of using such sources are the risk of missing new ideas and challenges that exist among less tested positions. However, the seminal work included in the study still make up the foundation for theory within the area and hence we do not perceive this as a major problem.
3. LITERATURE REVIEW

In the following Chapter major theories within the area of capital structure are introduced. Theoretical basics are described and applied to the topic of capital structure bringing up seminal work and relevant previous research. All theories are introduced both separately as well as interconnected in the Theory Discussion section. Financial flexibility has been discussed as one of the possible main reasons that companies maintain a certain capital structure. The theoretical section together with the literature review have resulted in propositions that are to be tested, supported or rejected, after which theories are to be reviewed.

3.1 Theories

The review starts with the trade off theory, which was the first major theory on capital structure. It is followed by the pecking order theory. We then move on to a discussion of agency and information asymmetry theory which highlights important components of the two main theories just discussed. These sections will be followed by a discussion of how theory and our topic are connected in the present study. Theoretical perspectives that are not included in this study despite their relevance to capital structure are the modified pecking order perspective and signaling theory perspective. The reasons for these exclusions will follow the theory discussion.

Trade off theory and pecking order theory bring attention to important factors that have a great impact on capital structure decisions. As mentioned in the introductory section, the aim of this study is to investigate the underlying factors influencing capital structure decisions and we have therefore added a third component that, from our reading, we believe has a great impact on capital structure, but which is not a factor directly mentioned in the theories presented; financial flexibility.

3.1.1 Trade Off Theory

Researchers have proposed that the optimal capital structure involves a trade off between the advantages and disadvantages of leverage. Fama and French (2002) state that by weighting the benefits of debt, tax deductibility of interest, and the costs of bankruptcy and agency conflicts; the optimal balance of debt and equity can be identified.

As Modigliani and Miller (1958) explained in the M&M proposition, the investment behaviors and financing techniques used by firms are selected to ensure survival and growth. Based on the view that owner and management are rational decision makers who will strive to maximize the value of the firm they derive the two initial propositions, maximization of profits and maximization of market value. They state that profits will increase if the yield on an asset exceeds the interest paid, and that an asset is worth acquiring if it adds more value
than the cost of acquiring it. Under perfect market conditions and in a world without taxation, the Modigliani and Miller proposition states that the value of the firm is independent of its capital structure. Taking taxes and the advantage of the tax shield into consideration, a firm would benefit from maximizing the use of debt. However, adding the disadvantages associated with debt to the equation, bankruptcy costs and agency costs which will be discussed later in this Chapter, the advantage of cheaper debt will be offset as the risk of financial distress increases with levels of debt.

Other researchers also state that taxes as well as bankruptcy costs need to be taken into account when determining the optimal leverage level and the optimal debt level. Hence, the value of the levered firm will therefore equal the value of the unlevered firm, add the tax rate times the market value of a firm’s debt, and subtract the tax rate times costs associated with bankruptcy (Kraus, Litzenberger, 1973). As can be seen in Figure 3.1.1.1, the trade off theory suggests the use of debt up to a certain point where costs of financial distress offset the advantage of the interest tax shield.

![Figure 3.1.1.1 Trade off. (Myers, 1984, “The Capital Structure Puzzle. ”, p. 577)](image)

The Figure above shows that after the optimum point on the debt axis the present value of the tax shield goes down at the same time as the present value of costs for financial distress goes up. As time passes by the costs overweigh the benefits and a company might suffer economically ending up in bankruptcy.

Since the first major publications on trade off theory were released researchers have, to various degrees, failed to determine what the optimal leverage may be. Moreover, according to empirical findings and with regards to the trade off theory; companies do not appear to act entirely rationally in their capital structure decisions, which is why the area still remains puzzling. There is theoretical support for the trade off theory, but findings have led researchers to question whether firms actually strive to achieve an optimal balance in their capital structure.
Fama and French (2002) note that debt ratios tend to adjust to specific target levels. Additionally, Leary and Roberts (2005) state that firms respond to equity issuances and equity price shocks by appropriately rebalancing the actual leverage towards target leverage within two to four years. Furthermore, they state that persistent effects of shocks on leverage are due to optimizing strategies as opposed to indifference regarding their capital structure (Leary, Roberts, 2005). Beattie et al. (2006) performed a comprehensive survey in the UK among industrial and commercial, listed companies with the objective to increase understanding of the overall financing strategies employed by the average company. The overall result showed that current capital structure theory affects and contributes to the decision making practices of firms in general and that certain parts of theories are more useful while other parts are strongly refuted. A key finding closely connected to the trade off theory was that elements that have strong theoretical support such as the tax advantage of debt interest and the need for collateral when issuing debt were supported in the study. Furthermore, the study shows that firms are concerned with the signal debt and equity issues send to the market and also that debt is raised when a firm perceives their stock to be undervalued.

A problem with the trade-off theory is that it predicts the relationship between leverage and earnings to be positive while numerous researchers present empirical findings of the opposite. Fama and French (1999) state that the big contradiction is the earnings-leverage relationship and that profitability seems to be negatively related to leverage. Similarly, Myers (1989) refers to the inverse relationship between financial leverage and profitability as the most striking proof against the trade off theory. Other factors contradictory to one of the fundaments in the trade off theory were found in the UK survey (Beattie et al., 2006) where it is stated that the respondents do not agree that the tax shield advantage and the costs of bankruptcy are balanced.

In contrast to determining the optimal mix of debt and equity, other theories suggest that there is a hierarchic preference order when firms decide upon their capital structure. The pecking order theory, as will be discussed next, suggests that firms have a preference for using internal equity over debt.

### 3.1.2 Pecking Order Theory

An alternative way of explaining why firms apply a certain capital structure over another is the pecking order theory presented by Myers in 1984. Donaldson (1961) proposed that management favors internally generated funds over external funds in his study of capital structures among large corporations. These findings by Donaldson gave a hint of a pecking order before the theory was presented by Myers (1984).

The pecking order theory is a preference order, explained as the law of least effort, and describes how companies raise new capital when financing their future activities and growth. This order contains three steps where every next step is less and less preferred. In order to finance its own growth companies prefer to use internally generated funds first, i.e. retained
earnings. When these funds are insufficient companies are forced to turn to external funding where debt is preferred over equity. Hence, the preference (pecking) order (Myers, 1984):

![Figure 3.1.2.1. Pecking order as presented in theory by Myers (1984).](image)

We would, however, point out that these steps are the preferred order of raising capital for companies and are not necessarily exactly followed in practice. This will be discussed further on.

As stated above, the preference order consists of three main steps where the use of internal funds is stated to be preferred by management when financing investments and future growth. If cash for investment activities or current dividend policy do not give space for investments a company must take on external sources of funds. According to the law of least effort, the pecking order theory suggests that a company will prefer to raise debt and only then external equity if the internally generated funds are not available in the first place (Myers, 1984). The reasoning behind this is based upon three observations; the preference for internal funds over external funds will have the consequence that investment and financing activities will be integrated, dividend policies will be set so that cash flows from past projects will match financing needs for future expected investments, and when external sources of funds are needed management will favor stakeholders they know from previous commitments rather than new stakeholders (Hamberg, 2001, pp. 215-216). Considering these observations a more thorough description of the three main steps within the pecking order can be derived (Hamberg, 2001, p. 216);

1. Internally generated funds
2. Already approved bank credits
3. Bank loan from current main lender
4. Issue of bonds
5. Issue of convertible securities
6. Issue of preferred stock
7. Issue of common stock to current owners
8. Issue of common stock to new investors

\[^1\] If converted into stock (equity) this would allow new investors parity with current owners and dilute the ownership rights of existing shareholders.
According to previous research, the preference order of capital structure decisions is based on a combination of different factors. A study of high growth firms made by Helwege et al. (1996), shows that the pecking order is not being followed by companies after their initial public offering (IPO). He also states that pecking order preference changes during a company’s lifetime so that taking on external debt and external equity respectively changes place. After having considered internal funds, IPO companies preferred to use external equity instead of external debt (Hogan, 2005, p. 383) to finance their future activities. Additionally, after having issued public equity (and not debt) companies have been more successful with regard to growth and extraordinary profit (Helwege et al., 1996, p. 456 ff). Similarly, Hogan (2005) states that the pecking order theory was not being followed by most of the sampled, non-listed companies in Ireland that he studied. Ni and Yu (2008) concurred in their study of SMEs in China. These results reject the main pecking order theory where companies are said to prefer step three, issuing external equity, before step two, issuing external debt. The rejection of the pecking order described in theory also seems to be confirmed when looking at firms listed in Sweden. Ekeroth and Wahlberg (2006) reject that the pecking order is being followed in their study of listed companies in Sweden and also add that these companies do not seem to have a capital structure that follows either theory discussed, i.e. the pecking order or the trade off theory. However, with regard to companies listed in Sweden, a comprehensive conclusion cannot be made since there appears to be an information gap regarding the capital structure, and capital structure decisions among Swedish firms. Actually, during an extensive search for information on the topic of companies’ capital structure in Sweden that went on for approximately five weeks our considered opinion is that there is not much research done in this area.

In contrast to the findings discussed above, there are empirical studies confirming the pecking order. Ni and Yu (2008) report that large companies in China, in contrast to small ones, do follow the pecking order which is similar to the findings of Hutchinson (1995) who stated that SMEs do follow the pecking order and that it is their typical behavior grounded in the cost of external equity. This rationale depends on information asymmetry where investors have limited information about small companies’ financial situation and therefore require a higher premium for investments. Such precautions in combination with investors increased exposure to risk increases the cost for the companies. The issue of transparency and information to the outside market will be discussed more in the oncoming section about agency theory and information asymmetry.

Pecking order theory is not supported in all situations in the research reviewed. Circumstances and conditions differ in each study that has been presented and a general conclusion cannot be made. Taking into consideration the lack of information on capital structures among Swedish companies and the weak support for the pecking order being followed, particularly among SMEs, there is an opening for a study of the kind we have done. Ekeroth and Wahlbergs’ findings are of particular interest since they have been limited to listed companies in Sweden.

Closely affecting the logic behind the pecking order is the principal-agent relationship, which has been touched upon when describing the law of least effort and the
observations/assumptions underlying the steps in the pecking order. These will be described in the following section.

3.1.3 Agency Theory
Being the agent of shareholders, managers are encouraged to expand the firm to maximize value for those shareholders. As the firm grows, managers tend to gain further control of capital resources. Control over capital resources enhances the position of power held by managers and might also be used to further boost the manager’s personal career. Hence, there is a risk that managers promote growth beyond what is optimal for the firm and its shareholders (Jensen, 1986). There is therefore a potential conflict of interest between shareholders and managers and between creditors and shareholders/managers that is referred to as the agency problem. Given the relationship between firm owners and managers, Jensen and Meckling (1976) state that it is virtually impossible for the owners of capital to ensure that the manager acts according to their objectives at zero cost. Monitoring and control costs, agency costs, are a critical issue in the relationship between firm owners and suppliers of external financing (Romano et al., 2001).

Cash payouts that reduce retained earnings limit a manager’s control and thus reduce the power that a manager possesses. This, in turn, creates incentives for managers to invest free cash flows in new projects rather than pay out dividends to shareholders (Jensen, 1986). Hence, the theory is closely connected to the pecking order theory which describes the tendency among firms to prefer internally generated funds rather than external funding. Jensen further states that debt creation can be used as a control mechanism by shareholders for reducing agency costs associated with the owner–manager relationship, and further that “By issuing debt in exchange for stock, managers are bonding their promise to pay out future cash flows in a way that cannot be accomplished by simple dividend increases.” (Jensen, 1986, p. 324). Substituting dividends for debt therefore allows a manager to use internally generated funds for investment and growth strategies rather than a dividend payout. Jensen’s reasoning therefore supports the pecking order in general. He also adds that the control hypothesis does not hold for high growth firms, who regularly have to go to financial markets to seek funds for project investments. This supports the preference among firm managers to use internally generated funds. However since they have insufficient cash flows they might be forced to move further down the ladder to external sources of funds and financial markets. In a similar fashion, stock prices normally rise with unexpected increases in payout ratios or when signaling to the market that an increase will take place. At the same time de-leverage strategies often result in decreases in stock prices (Jensen, 1986). The reasoning supports the general theory of the pecking order where another important factor affecting the pecking order is brought to attention; namely what signal various strategies of capital structure management send to the market.
3.1.4 Information Asymmetry

Together with agency theory, information asymmetry has also received a lot of attention. Haugen and Senbet (1979) defined information asymmetry as occurring when a company’s internal information regarding the financial and risk status is not known to others in the market. The implications of this dissonance are described below.

There is a significant difference in borrowing costs faced by entrepreneurs compared to larger firms due to information asymmetry (Tsai, 2008). This happens when investors cannot estimate the growth opportunities of a company and have their own expectations about future performance. The cost of information asymmetry can be measured directly as it affects company value and always is vital for the growing company’s financial situation (Tsai, 2008).

The issue of information asymmetry is greater for companies with mostly intangible assets. Intangible assets are harder to measure and value. Further on, Tsai (2008) states that the larger information asymmetry is the more uncertain investors will be regarding growth predictions. As a consequence, they will therefore prefer to have a higher premium for the risk they perceive. If the premium gets too high the company might not be able to pay it and will therefore be forced to get rid of the investment idea (Tsai, 2008). This means that declines in investments due to information asymmetry can have a direct effect on the growth rates predicted by the company. As we concentrate on high growth enterprises in this study, this point will be of importance when examining the relevance of information asymmetry on the capital structure decisions our companies have made.

3.2 Theory Discussion

The theories described above are well interconnected with the focus of our study. All of the chosen theories play a significant role in understanding capital structure decisions among different companies. The main theories presented provide an explanation for the underlying factors of why a firm employs one capital structure over another.

According to Leary and Roberts (2009) when factors typically used within other theories are combined with the pecking order theory the explanation for the capital structure choices can be theoretically motivated in more than 80 percent of cases. We have therefore decided to use this theoretical base, pecking order in combination with aspects of several other theories in our examination of capital structure decisions among high growth firms in Sweden. All of the chosen theories are repeated commonly in most peer reviewed articles and are also well interrelated with each other as described above.

The pecking order theory describes how a company raises funds according to a ladder of preferences whereas the trade off theory describes how a company aims at a specific value maximizing, optimal point for the mix of debt and equity. Thus, both theories support issuing debt over equity, but for different reasons. However, Beattie et al. (2006) stated that the respondents in their UK study did not view the pecking order theory and the trade off theory as either mutually exclusive or fully extensive, which suggests that firms capital structure choices cannot be explained by the application of one standard theory, but rather must be
examined from the perspective of several such theories at once. The tax shield advantage advocated in the trade off theory, and the law of least effort used to describe company behavior in the pecking order theory both support the use of external debt over external equity which, despite different motives, link the theories. The tax shield advantage may provide additional rationale for the preference for external debt. If this is the case, the trade off theory could thus be viewed as complementary to the pecking order theory.

Similarly, agency theory and information asymmetry theory could also be construed as complementary to pecking order theory. Information asymmetry is closely connected to risk uncertainty among investors where they perceive investments as riskier and therefore demand a higher premium (Watson, Wilson, 2002). Even though the present study will be used to look at listed companies where levels of information asymmetries could be assumed to be lower, the issue of transparency is tightly connected to the preference order of firms when raising funds. The degree of transparency towards the market should affect investor relations and thus also affect a firm’s access to various sources of funds which in turn determines the degree to which a firm can actively choose to structure its mix of liabilities. We would argue that lower levels of information asymmetry would lead to better transparency in the market which in turn would lead to better investor relations, access to capital markets and therefore enable a firm to actively make decisions regarding their capital structure. That is, lowering the degree of information asymmetry would increase the probability that the firm has better access to capital markets. This in turn, would allow them to actively choose between various sources of funds and therefore increase their flexibility. Describing the relationship between owners and managers and the incentives that exist for managers to retain control over resources, agency theory is connected to the issue of control in a bigger sense as well as to information asymmetry theory. Similar to the effect of information asymmetry on pecking order theory, when there is an agency conflict agency costs, associated with the monitoring and controlling of the agent, will increase as well as result in less control over information flows within the firm. This in turn would reasonably affect the flow of information in the market, as described in information asymmetry theory, and hence affect investor relations and access to capital markets. Agency theory as well as information asymmetry theory therefore helps to explain the underlying components of the pecking order used by firms. This explanation underlies the suggestion that companies take on debt before external equity. In that case it is an issue of information asymmetry where companies do not provide good information to investors who in their turn withdraw their willingness to finance the company. It also explains why management prefers to use internally generated funds as the first preference choice in the pecking order.

The theories we have reviewed are connected to listed and non-listed companies as well as big and small companies. The lack of information when it comes to listed companies in Sweden seems to be significant (Ekeroth, Wahlberg, 2006). Ekeroth and Wahlberg concluded that companies prefer equity over debt mainly because of the need to have financial flexibility during tough economic times. Their result contradicts aspects of the pecking order theory as well as the reasoning underlying the trade off theory. As only one such Swedish study has been found to date, it is worthwhile to re-examine the financing decisions of high growth
Swedish SMEs listed on the NGM Equity stock market and determine what impact financial flexibility, tax shield advantages and control have on their capital structure. We will not separate companies according to the industry they operate in. Industry separation is not supported by the NGM Equity market where companies are not categorized into industries due to a narrow NGM Equity profile. Since there are only 26 companies listed on NGM we would encounter statistical problems if we were to further separate companies according to industry. Our main purpose is to investigate if there are contradictions between theory and empirics on capital structure and pecking order among listed SMEs and not to verify differences among industries.

Besides the theories that have been included in this study, there is a part of the theoretical background that has been left out. Even if the theory is often referred to in previous research we would like to shortly discuss why it should be excluded or not used instead of the theories chosen.

Modified pecking order theory takes both information asymmetry and the cost of financial distress into consideration. Companies might choose to force themselves down the pecking order in order to minimize costs of both financial distress and the issuance of risky securities (Myers, 1984). This type of pecking order is preferred in mixed structure companies which are described in Bontempi’s (2002) study of Italian firms. However, modified pecking order has been described as very simplistic and not useful for scientific research (Myers, 1984). We choose to rely on Myers description of the modified pecking order due to his credibility as a well-known researcher within the topic.

Furthermore, we have discussed how information asymmetry and agency relationships affect the pecking order which is also the basis for another theory; the signaling hypothesis. Hamberg (2001, pp. 217, 218) states that, similar to the pecking order theory, it is believed that problems arise when there are well informed managers and poorly informed shareholders. In essence the signaling hypothesis suggests that an issue, whether of debt or equity, sends a signal to the market; where a debt issue signals confidence about the future and an equity issue signals a negative feeling about the future. The reason we have excluded this hypothesis from the study is that it lacks empirical support and may be of less relevance when looking at Swedish companies as our study focuses on companies’ internal preferences when it comes to use of certain type of capital. Hamberg (2001) also states that a pattern within capital structure theory that is widely acknowledged is that profitable firms in general have lower debt ratios than firms that are less profitable which, following Hamberg’s reasoning, would suggest that if a firm issues debt it is rather a sign of weakness since it in general would suggest greater leverage and lower profitability and consequently not be a signal of confidence and high profitability, which contradicts the signaling theory. At the same time, defining financial flexibility as unused debt levels, a less levered firm would have more room for taking on debt and consequently be more financially flexible and according to the profitability – debt ratio equation in general send a signal of profitability and confidence when issuing debt. Regardless of how to interpret issues of debt and equity the theory might, according to Hamberg, be of less relevance when applied to firms in Sweden due to differences in voting
rights between countries where we have a closer relationship between owners (shareholders) and managers in the Swedish system.

### 3.3 Financial Flexibility

Financial flexibility refers to the overall financial structure of a company and its financial policies. Flexibility can be viewed as a need to “preserve debt capacity to make future expansions or acquisitions” and is a way to keep interest rates low by either already having debt at a fixed lower rate or having a certain cash reserve in case of a downturn in the economy (Graham, Harvey, 2001, p. 218). Thus, flexibility allows the firm to react to the unexpected, whether positive or negative.

Financial flexibility is often measured in terms of long term solvency and liquidity, which respectively refers to "the firm's long-run ability to meet its obligations" and "the firm's ability to pay its bills over the short run without undue stress" (Ross, Westerfield, Jordan, 2006, pp. 57-60). Moreover, the concept of financial flexibility is often referred to as unused debt levels and is stated to be broadly consistent with capital structure choices in which financial flexibility plays an important role (Denis, McKeon, 2010).

Furthermore, financial flexibility is stated to be dependent upon the direct cost of external financing as well as the corporate tax rate. Research has shown that financially flexible firms should be valued at a premium relative to less flexible firms (Gamba, 2008). Defining financial flexibility as unused debt levels, firms that borrow less are less likely to face costs of financial distress defined as “the direct and indirect costs associated with going bankrupt or experiencing financial distress” (Ross, Westerfield, Jordan, 2006, p. 553). The flexibility gain associated with lower levels of debt is therefore a factor that needs to be taken into consideration in addition to the effects of the tax shield and the effects of retaining control.

This review has touched upon the underlying determinants of the pecking order; the law of least effort, control and the advantage of the tax shield. We have seen that there seem to be some empirical findings that contradict parts of the theory. There is evidence that some companies tend to prefer raising equity over debt with regards to external funds when raising new capital while theory describes a preference for raising debt first. To explain this phenomenon that has been found in Swedish empirical research on listed growth firms (Ekeroth, Wahlberg, 2006), we suggest that the flexibility gains associated with lower levels of debt need to be examined to see if they are an additional determinant of the pecking order as has been suggested. Emphasizing financial flexibility as a determinant of capital structure is also consistent with findings in the work of Graham and Harvey (2001). They concluded that financial flexibility is the most important factor with regard to debt decisions. They state that firms strive to remain flexible by keeping interest obligations low in case of economic downturns.
3.4 Propositions

Based on theory and empirical findings of previous researchers, four propositions have been derived to test the inversion of the pecking order, the preference for equity over debt with regard to external funding and financial structure. We will first look for support or rejection of companies’ preference for equity over debt. We will then look for support for whether financial structure is affected by a need for financial flexibility, ownership control or a preference for tax shield advantage of debt interest deductibility.

With regards to external funding:

P₁: Listed, high growth SMEs in Sweden prefer raising equity over debt.

P₂: Financial structure is affected by a need for financial flexibility.

P₃: Financial structure is affected by a need for tax shield advantage of debt interest deductibility.

P₄: Financial structure is affected by a need for ownership control.
4. RESEARCH DESIGN

In the following Chapter the research design is presented. More specifically a description on how and why the practical part of the research has been done. Different steps that were taken throughout the process of collecting empirical data are explained. The research target group is presented as well as problems that arose with access to that group. Every step from how the survey was designed to how the data was processed is described below. Actual accounting figures have been included in this Chapter in order to describe the real outcome of the companies' capital structure decisions.

4.1 Choice of Research Method

Using a deductive approach where propositions have been drawn from theory and then tested on companies listed on the NGM Equity market implies that the research method used herein is quantitative. A quantitative method is used to describe, measure or explain a phenomenon and also to interpret and understand a phenomenon (Patel, Tebelius, 1987) which corresponds to the aim of this study; to describe the factors that influence capital structure decisions and whether the pecking order in Sweden corresponds to that described in theory. Aiming to describe high growth SMEs listed in Sweden, the NGM Equity market was used as research target group. This will be more thoroughly described in section 4.2. The NGM Equity market consists of 26 companies and due to the small population a questionnaire was sent out to all companies. Thus, we are conducting a census study.

The choice of the quantitative study is also supported by Bryman and Bell (2005, p. 40) who group deductive approach and objectivistic standpoints under the group of quantitative researches. These factors build up a methodological base for our study. A quantitative study is an opposite to the qualitative study and has an inductive scientific approach and is among others supported by the expounding point of view (Bryman & Bell, 2005, p. 297 ff).

4.2 Research Target Group

As mentioned in the literature review, empirical findings within the area of capital structure suggest that not all firms follow the pecking order described in theory. Whether one can apply those findings to firms listed in Sweden cannot be confirmed based on previous research. Ekeroth and Wahlberg (2006) suggest that the pecking order is not being followed based on their study, however, they as well as Hamberg (2001) state that there is an information gap with regard to capital structure decisions among firms listed in Sweden. The starting point when conducting the present study was thus to access SMEs listed in Sweden to verify whether the pecking order is being followed and to deepen knowledge about underlying factors affecting capital structure decisions.
Since we are located in Sweden, Sweden is of obvious reasons of particular interest to us. However, the main reason for focusing on firms listed in Sweden is the knowledge gap described above. The very limited information about firms listed in Sweden motivates the conduct of such a study and additionally, the very limited research that exists suggests that the pecking order is not being followed which further motivates investigating that particular aspect. Moreover, looking at the capital structure and the underlying factors that affects capital structure decisions among non-financial SMEs listed in Sweden, a group of particular interest is capital intense firms where capital structure management should be assumed to be of particular importance. Firms that grow above average, i.e. more capital intense firms, require a great deal of internal/external funding for financing that extraordinary growth. For that reason this study was aimed at high growth firms, which are defined as companies with financial growth above average. Furthermore, the reason for focusing on SMEs, as opposed to larger corporations, is due to their widespread positions within European business life. Small enterprises have consistently been an important discussion topic in the Swedish political arena due to their disproportionate contribution to the country’s total economic growth and to their role as a major source of employment nationwide (Hogan, 2005, p. 369). Moreover, SMEs account for 99.8 percent of European companies (Svenskt Näringsliv, 2010) which makes SMEs a suitable target group when aiming to describe the general picture with regard to firms’ capital structure decisions. There were no financial companies represented at the NGM Equity, they should, however, be excluded when undertaking a study of this kind due to their difference in terms of operations. Since the operations of a financial firm are based on financial products, the mix of debt and equity is heavily skewed towards debt which makes such firms unsuitable for a study of this kind.

Even though the research target group is narrow and very specific we believe that a combination of the chosen research target group with any other groups such as for example Aktietorget or Stockholm OMX Small Cap would interfere with the spot-on descriptions of the capital intense, listed high growth SMEs we aim to study. Aktietorget, for example would not be in line with our selection of SMEs as far as it is not an authorized stock market for listed firms. Another reason for that is that Aktietorget is not limited to high growth SMEs that are expected to be capital intense. Stockholm OMX Small Cap on the other hand includes companies grouped only by the total stock value of the companies without categorizing them in any other way making it possible to skew the results if a company outside the description is included. That can of course be a potential problem for generalization to all high growth listed SMEs. However, as far as this study is a census study and the whole population of the NGM Equity market is being studied we believe that a precise research target group is of great importance where generalization to other companies outside the research target group is of less importance.

There are also certain time constraints when undertaking a study of this kind and finding a distinct target group that allows for quick access is therefore crucial. NGM Equity Market fulfills these requirements and is therefore a suitable population for this study. The NGM Equity market is an authorized stock market where the listed companies are Nordic high growth SMEs (NGM Equity, 2009). NGM serves high growth firms and is not divided
according to industry. Firms that are listed on NGM are in a transformational stage and either do not meet the criteria for listing on the Stockholm OMX or for other reasons would rather position themselves on the NGM.

4.3 Questionnaire Construction
The questionnaire for this study consists of closed-ended questions. Closed-ended questions are easier to analyze once the data is collected compared to data gathered from open-ended questions. Closed-ended data can be easily coded and the respondent does not have as much freedom while answering specific question. Most of our questions are designed so that the respondent can choose the multiple choice alternative with which they agree the most on a vertical likert scale (Bryman, Bell, 2005, p. 168 ff).

The first introductory question (see Appendix 8.1) should be filled in with numbers. The remaining questions should be filled in with a cross near the best alternative offered on the likert scale. Eight of nine questions have five alternatives to choose from. This scale allows the respondents to place themselves in the middle if they wish to take a neutral position. At the same time these answers will give us the strength of their feelings about the statement presented in the question. Answer alternatives to questions four through seven do not contain any text on the side of the grading alternative of the likert scale. These alternatives grading 2 and 4 cover the range between the neutral alternative and extremities stated. However, the numbered blank alternatives should not give any biased results as the respondents are well introduced to function of the likert scale. Motivations for specific questions are described below.

1. **What is the number of employees in your company?**
The question is being asked in order to get a picture of the average number of employees the studied companies have. The aim is to verify the definition of the SMEs which this study is focused on. Answers to this question will give us knowledge of the average size of the studied companies. If the number of employees is below 250 per company then we will know that the studied group can be classified as SMEs.

Besides the criteria for the number of employees in an SME companies must fulfill the criteria for a turnover or balance sheet total limits. This data will be gathered separately through a broker, Avanza Bank, that publishes latest available financial data of the companies listed on NGM Equity market.

2. **Over the last three years, how would you consider your firm’s growth compared to other companies in your industry?**
Companies are asked to estimate their average growth compared to the industry they operate in. Answers to this question will define the average growth of the presented firms on the NGM Equity stock market and their potential need for new capital in order to grow rapidly. Companies that have an average or have above average growth will be in strong need for new capital in order to grow at a fast pace.
3. How actively does your company decide upon the mix of debt and equity when financing overall investments?
This question is used to determine whether capital structure decisions are made actively or are a result of random circumstances. In order to get the overall picture of how companies manage their capital structure it is of interest to look at their degree of activity in combination with other results.

4. To what extent does your company maintain an optimum debt level?
By asking this question we test the implementation of the trade off theory among companies. If companies on average do not maintain an optimum debt level this means that they do not aim to maximize the tax advantage as hypothesized in the trade off theory. In combination with question six the strength of their answer would further indicate the strength of the application of trade off theory.

5. With regard to capital structure decisions, how important is financial flexibility?
6. With regards to capital structure decisions, how important is tax advantage of debt interest deductibility?
7. With regards to capital structure decisions, how important is ownership control?
These three questions are intended to verify the relative impact of financial flexibility, tax advantages and ownership control on capital structure and/or the application of the pecking order theory to companies included in the study. By ranking the importance of each variable we will also be able to verify the influence of these factors, considered by researchers to be of importance in capital structure decisions. If companies value financial flexibility the most this will indicate that they prefer to maintain low levels of debt in order to be as financially flexible as possible. This would provide an explanation for companies that prefer to take on more external equity than external debt. On the other hand if companies value the tax shield advantages of debt and/or ownership control this will offer an explanation for preferring external debt rather than external equity.

8. Given equal access to external debt and external equity when financing overall investments in your company external debt is preferred over external equity.
This question verifies whether firms raise capital with regard to external funding in accordance with the pecking order as described in theory. Answers to this question will provide information about the average preference order within our sample and whether companies prefer to take on external debt or external equity when raising new capital. We will be able to see where on the likert scale an average company places their preferences and draw conclusions on whether external debt or external equity is preferred after internal funding has been considered. We believe, however, that the construction of these questions and options will not have any influence on how the companies will interpret them as far as the likert scale allows for any of the companies’ possible preferences.

9. If available, when financing overall investments internally generated funds are preferred over external funds.
Answers to this question show how strong the preference for using internal equity is within the company on average. We also test how strong the desire to use internal equity is among the various companies’ management teams. The results will show whether the pecking order step one, where companies use the internally generated funds first, does come before steps two and three or is less preferred than either alternative two or three.

The questionnaire is relatively brief and consists of nine questions. The reason for keeping the questionnaire brief is to keep the focus within the particular area of interest while also increase the probability of a higher response rate due to the short amount of time needed for attending to the survey. Most of the questions are very specific and some terms may seem to be too ambiguous, however, we believe that the terms such as “financial flexibility” and “ownership control” are used in their basic and common sense definition. As with most questionnaires there is a probability that something will be misunderstood or interpreted in a way that was not foreseen by authors. However, we believe that when no other that basic definition of words is applied there is low possibility of words being misunderstood and misinterpreted. Financial flexibility is often interpreted by people as a possibility to adjust their economical situation during unforeseen happenings during any period. At the same time ownership control describes control of the specific company by their owners. In this case we believe that as far as basic definitions are applied as well as interviewed people are professionals in the financial area of their own business the words are interpreted in the right way. One can also eliminate such potential problems with several questions that aim to study the same thing. In our case this would be a limitation as far as such solution would make the questionnaire much longer increasing risk of getting too few answers due to a very long response time needed from the companies. We also believe that such terms as financial flexibility are well-known and often used by professionals that are supposed to answer our survey.

The strength of this questionnaire is that it allows us to see the empirical picture of preferences among companies regarding the pecking order in the same basic, hypothetical way as it is described in the theory. This can however be a problem if the questionnaire construction is not adjusted for the variety of extraordinary factors that might influence companies’ pecking order. Although, this cannot be foreseen and a deeper analysis of the results must be conducted only when certain, if any, contradictions emerge.

Another limitation of the short survey is that the results one gets back might raise new questions where such problem might also be covered by the solution with more questions studying same area. In this case we have tried to decrease the risk of this happening by arranging a pilot study which will be described in the next part.

4.4 Respondents and Access
After having constructed the questionnaire according to the description above we first tested the questionnaire on a few anonymous representatives of different companies not represented on the NGM Equity stock market. A pilot study is of great importance when testing a
questionnaire with closed-end questions and when the interviewer is not present to sort out any problems regarding the questionnaire and its interpretation (Bryman, Bell, 2005). The pilot study gave us valuable information on how the questions were being interpreted, but there did not seem to be any problems with understanding the questions. The only minor problem that we had to correct was the understanding of the alternatives presented on the likert scale. In order to make the understanding of the likert scale easier we added a descriptive text explaining how the questions should be answered and what the options represented. After the pilot study and after testing that answers can be decoded we sent out the real survey contacting companies on the NGM Equity market.

In order to save time and money we converted our survey document to a web based survey keeping the main design and order of the questions. This enabled better access to companies who in response to a telephone call could easily enter the web survey in order to answer the questions. This could be done directly during the phone call or sent directly via e-mail to the respondent so that the survey could be answered a bit later if he or she was busy at the moment. We decided that the CFO or a person well introduced to the financing activities within the company should be suitable for answering our questions. Phone numbers to such persons were entered into our database from either companies’ websites or by contacting companies’ call centers. After that we started to contact people of interest in order to gather answers to the survey questions. We introduced ourselves and presented the main purpose of our study. During the call we asked the selected company representatives how they preferred to answer the survey; whether through a web link or by filling in a printed paper copy sent directly to their office and including a stamped envelope for return mail. However, all of the companies chose the web based survey in order to save time and skip paperwork. All companies were also offered an electronic copy of the results made in this research as an appreciation for the commitment of their time.

There are 26 companies represented on the NGM Equity market. We managed to gain access and contact all of them in order to get the best possible dataset and be able to generalize the findings to listed high growth companies on the NGM Equity stock market. The majority of companies were positive to answering the questionnaire, however most of them asked for more time before responding. It was also easy to get in touch with most of the representatives because many of the companies had quite a small number of employees. The time frame chosen by us was acceptable even though it took a longer time than expected to get the data from companies. This issue can be explained by the fact that they were busy with annual and quarterly reports.

Summarizing access to respondents and gathering of data we can ascertain that the total population of the NGM Equity stock market consists of 25 companies. During the period of gathering data one company was in the process of leaving the NGM Equity stock market for an unknown reason. Therefore we decided to exclude that company from the studied population, i.e. we excluded one company among 26 of those represented on the NGM Equity market during the collection process. Furthermore, during the process of gathering the final data while trying to gain a 100 percent response rate we contacted the companies that did not
manage to answer the questions during first two weeks. All of the companies were coded so that we could trace their answers and if the company did not answer we could contact them with a short reminder regarding their answers to the survey. Even though we constantly reminded and asked company representatives to answer the survey two companies declined due to their busy time schedule. We managed to gain a 92 percent response rate taking 23 out of 25 companies into consideration as well as adjusting for the excluded company. A census study requires a high response rate which could be achieved due to the relatively low number of respondents as well as a succinct questionnaire. We believe that equally good results could not be achieved if the studied group would have been bigger taking budget and time limitations into consideration. Both companies that have fallen out are active within the medical industry and have a low number of employees (under 25 employees each). Why these companies did not manage to attend to the survey might be explained by the low level of resources available for such activities.

4.5 Financial Ratios
As noted above, at the centre of attention in this thesis are the pecking order theory and pecking order preferences with regard to sources of finance. We also aim to investigate the relative importance of various factors that are assumed to influence the preference order. In this thesis as well as in theory the emphasis is put on preferences rather than actual accounting figures. However, to better understand the financial situation and the actual reality facing the firms that are included in this study it might also be of great interest to look at actual accounting figures and how these figures correlate to stated preferences and the stated relative importance of influencing factors.

When assessing these companies’ actual financial position we will look at financial ratios that enables a comparison among firms included in the study as well as a comparison between the actual financial position and the stated preference and the stated relative importance of influencing factors.

Current Ratio - Current Assets/Current Liabilities
The Current Ratio is a measure of a firm’s short term solvency and liquidity. Current assets are assets that are assumed to be converted into cash within a year and similarly current liabilities are obligations that are assumed to be settled within a year. (Kothari, Barone 2006, Ross et al. 2006) The current ratio therefore indicates the ability of a firm to meet current obligations and hence this measure indicates a firm’s degree of short run financial flexibility.

Debt Ratio – Total Debt/Total Assets
The Debt Ratio is a measure of total debt as a percentage of total assets, the higher the ratio the higher the percentage of debt and thus the degree of leverage (Kothari, Barone, 2006). Often financial analysts will be more interested in the long term debt as opposed to total debt since it also includes short term debt which by nature is constantly changing (Ross et al.). However, since many of the firms included in this study are subsidiaries to larger parent companies total debt (including short term debt) has been used as a measurement for the long
term solvency since many firms relies on the parent company for guaranteeing their long term 
finance and the portion of long term debt among these companies therefore appear to be very 
small which might not be the real case.

**Debt – to – Equity Ratio** – Total Debt/Owner’s Equity

The Debt - to – Equity Ratio is another way of assessing a firm’s level of debt, this ratio often 
has a practical implication since credit agreements often are based upon this measure where 
agreements include a covenant expressing the maximum debt – to – equity level (Kothari, 
Barone, 2006). Similar to the Debt Ratio this ratio reveals a firm’s degree of leverage.

4.6 Processing the Data

In order to analyze the data we have used SPSS software which allowed us to encode, analyze 
and make histograms, pie charts and crosstabulations based on the gathered data.

All answers on the survey questions were gathered in one database where each question 
represented one variable. This gave us 9 variables. In order to make a cross analysis of the 
data and group extremities new variables were built up. Question eight has been such a case 
where respondents who answered 1. *Strongly disagree, equity is preferred over debt* and 2. 
*Disagree* have been gathered as group 0 and those who answered 4. *Agree* and 5. *Strongly 
agree, debt is preferred over equity* have been regrouped to group 1. This variable has been 
called *Debt over equity or equity over debt* where the respondents who answered neutrally 
have been excluded. Additionally a similar procedure has been done where we separated 
alternatives to question 8; 1. *Strongly disagree, equity is preferred over debt* and 2. *Disagree* 
we gathered in group 1, 3. *Debt and equity are equally preferred* were gathered in group 2 
while alternatives 4. *Agree* and 5. *Strongly agree, debt is preferred over equity* were gathered 
in group 3. These procedures gave us a total of 11 variables.

The database followed a certain pattern of encoding the answers. Questions two to nine had a 
likert scale where respondents put a cross near the best alternative offered. Every likert scale 
consisted of five alternatives where each has been given a number from 1 to 5 starting from 
top to bottom of every likert scale in each question. This number has then been entered in the 
database and labeled in SPSS for easier interpretation.

All the data has been prepared for a descriptive analysis and results will be presented 
thoroughly in the next Chapter. A descriptive analysis is motivated by the fact that we are 
doing a census study and trying to study the whole population of companies presented on the 
NGM Equity stock market. Due to the low number of companies presented on the NGM 
Equity market any generalizing to similar companies on any other market might not be 
statistically applicable. Statistical significance testing is therefore not appropriate and will not 
be conducted. Of course one can conduct a t-test to show how mean answers from a sample of 
respondents vary from the mean of total studied population, but a statistical test of this kind 
would not be reliable. In order to conduct a t-test there should be three limitations fulfilled. 
They are: equal variance, sample independence and that samples follow a normal distribution
(Tech/Me Data Analysis, www.vias.org, 23-10-2010). According to Central Limit Theorem the normal distribution can be seen better the larger the number of observations is and therefore can the results of a test be more reliable (Grinstead, Snell, 1997). Number of observations, or number of respondents that have answered our survey can reasonably be assumed to be low in order to be able to generalize to any large group of companies outside the NGM Equity market. This has also been supported by Vladimir Vanyushin (Umeå University, April, 2010) who stated that a small sample of under 30 observations would give statistically insignificant results and that a descriptive should be used in such cases of a census study. In our case we believe that our solution with presenting the descriptives while comparing the groups of companies with regards to financial flexibility, tax advantage and ownership control is a better way to present our results which is also in line with the proposition use in the study.
5. RESEARCH FINDINGS

The following Chapter contains gathered data presented solely for descriptive purposes. Each question is presented showing the descriptive statistics as well as a succinct analysis of the results. Where appropriate, figures summarizing the data have been included. These are followed by crosstabulations where answers to different questions were interconnected for an in depth analysis. Companies’ actual accounting numbers have been included to show the differences between basic theoretical preferences of the pecking order and actual outcome of the capital structure decisions that in turn might influence the theory.

5.1 Survey Findings
   5.1.1 Descriptives

1. How many employees are there in your company?
The first question was introductory and determined the average number of employees and the studied population’s correspondence to the definition of SMEs. According to results the studied population is in line with the definition of SMEs by European Commission. From the total population of 25 companies, as already indicated, 23 companies responded to the questionnaire and all have answered this question. According to the gathered data 3 out of the 23 companies have a number of employees way above 250 - ranging from 310 to 1100 employees which is not in line with the definition of SMEs. These three companies were excluded from the population. They will be treated as outliers, due to them being listed on the NGM Equity market, and analyzed separately for patterns to be compared with the main population (see Appendix 8.3). The remaining 20 companies have a number of employees ranging from 1 to 237 employees with a mean of 58.15.

In addition to number of employees, in order for a company to be classified as an SME by the definition of the European Commission, a turnover of up to 50 million EURO or a balance sheet total of up to 43 million EURO is needed. Out of the population of 20 companies all companies fulfilled these criteria while the outliers’ turnover and balance sheet total exceeded the maximums of the definition.

2. Over the last three years, how would you consider your firm’s growth compared to other companies in your industry?
This question was asked to determine companies’ average growth during the last three years. Companies’ average growth will show their need for capital in order to grow. The answers range from way below average to way above average with a mean of 3.10 which indicates that the average firm on NGM has grown at a rate close to the average growth rate in their respective industry. This indicates that the SMEs listed on the NGM have not had extraordinary growth during the past three years. Similarly, looking at the three outliers two
respondents responded that their company has had a growth rate below average and one respondent stated a growth rate above average. Their answers are thus in line with the main population. One plausible reason for this result might be the recent economic downturn that might have slowed down the growth rate among these firms. Had we examined these firms for a longer period, their growth in comparison to their industries may have reflected an above average rate.

![Figure 5.1.1.1. Companies’ growth.](image)

1=Way below average; 2=Below average; 3=Average; 4=Above average; 5=Way above average.

Figure 5.1.1.1. Companies’ growth.

Non-SMEs that were excluded from the study have indicated a growth rate slightly below average when looking at the mean which is a lower growth rate over the past three years than that of the population.

3. How actively does your company decide upon the mix of debt and equity when financing overall investments?

The rationale behind this question was to clarify whether the firm’s management was involved in capital structure decisions. Low involvement would somewhat support the law of least effort underlying the pecking order theory. High involvement would in contrast give more strength to debt and equity preferences and provide greater support for the trade-off theory or the influence of another factor other than tax avoidance and financial distress. 18 respondents provided answers and an overwhelming majority of respondents reported that they were active, where the answers range from active to a certain degree and with external assistance, such as their bank, to active to a great degree where the capital structure is managed within the firm. This implies that on average firms are greatly concerned with capital structure management and that debt and equity levels are rationally determined. Management’s active involvement in the capital structure decision means that the factors contributing to the funding decision, whether financial flexibility, the advantage of the tax shield, ownership control or another factor, are worth examining more closely.
Looking at the three larger firms that were separated from the population the answers ranged from active to active to a great degree. The mean value is slightly higher, 4.67 vs. 4.00, but these companies appear to have a similar view on capital structure management as have the average SMEs listed on the NGM.

4. **To what extent does your company maintain an optimum debt level?**

The fourth question asked to what extent the respondent’s company attempted to maintain an optimum debt level. This question was intended to determine whether the trade off theory could be applied to the firms in the study. To the extent that firms are said to be seeking optimal levels of debt, they are not randomly following the law of least effort. Not all firms indicated a preference for optimizing debt level as some indicated a desire to avoid debt altogether. The responses to this question are to be correlated with those to question 6 in the crosstabulation analysis that follows this section.

19 respondents provided answers across the range of possible categories from a total avoidance of debt to active optimization. The mean is, however, slightly above the level where companies are indifferent to a particular level of debt. The Figure below shows the range of answers and the number of companies that have chosen a specific alternative. The largest group of respondents, seven, has indicated that they do actively maintain an optimum level of debt while the majority of the respondents, 12, have indicated that they are indifferent to maintaining a particular level of debt or avoid the use of debt altogether. The mean was 3.16 with a standard deviation of 1.642. The maintenance of an optimum debt level thus appears to vary among the studied population.
1=1. We avoid the use of debt; 2=2.; 3=3. We are indifferent to maintaining a particular level of debt; 4=4.; 5=5. We do actively maintain an optimum debt level.

Figure 5.1.1.3. Companies’ preference for an optimum debt level.

Among the non-SMEs that were excluded from the population two respondent’s have indicated an answer of 4, that they to some degree actively maintain an optimum debt level while one respondent has indicated that the company to some degree avoids the use of debt. This gives a mean value of 3.33 and a standard deviation of 1.155. The overall result is thus largely in line with that of the studied population.

5. With regard to capital structure decisions, how important is financial flexibility?

Defining financial flexibility as unused debt levels or preserved debt capacity this question was intended to determine the relative importance of financial flexibility to tax shield advantage and ownership control. Ranking financial flexibility as more important in relation to the tax shield advantage would suggest an aversion to debt and a tendency to follow the inverted pecking order with regard to external funds. This would mean that if companies view being financially flexible as most important they would want to keep their debt levels low to enable them to react to unexpected changes in the market. This, in turn, indicates a preference for retained earnings and/or equity as opposed to debt. Ranking financial flexibility as more important than ownership control would also have implications for our theoretical stance as both gaining advantage from the tax shield and remaining in control by not diluting ownership implies a preference for debt and/or retained earnings as opposed to equity.

19 companies responded to this question and as can be seen in the Figure below the result implies that financial flexibility is viewed as important to the firms in the study where answers range from important to very important with a mean of 4.05 with a standard deviation of 0.97. No company responded that financial flexibility is unimportant.
• Missing: 1
• 1. Not important at all: 0
• 2.: 0
• 3. Important: 8
• 4.: 2
• 5. Very important: 9

Figure 5.1.1.4. Importance of financial flexibility.

The non-SMEs that were excluded from the population also view financial flexibility as important where all three firms have indicated alternative 3, important. Hence, the result indicates that financial flexibility is viewed as important, but slightly less important than the view of the studied population.

6. With regards to capital structure decisions, how important is the tax advantage of debt interest deductibility?

In the same fashion as in the previous question, this question was included to determine the relative importance of tax advantage of debt interest deductibility to financial flexibility and ownership control. The intention was also to verify the application of trade off theory and whether the responding firms are concerned with optimizing their use of debt in order to gain tax advantages. The question will hence be evaluated in combination with answers to question 4 later on in this Chapter.

Ranking the tax shield advantage of debt interest deductibility as more important in relation to financial flexibility and ownership control one would expect to see a preference for debt as opposed to retained earnings and/or equity and fairly high levels of debt. As can be seen in the Figure below the answers range from not important at all to very important where an overwhelming majority view the tax shield advantage as relatively unimportant.
- Missing: 2
- 1. Not important at all: 6
- 2.: 6
- 3. Important: 4
- 4.: 0
- 5. Very important: 2

Figure 5.1.1.5. Importance of tax advantage of debt interest deductibility.

Similar to the population as a whole, the three firms that were excluded view the tax shield advantage as unimportant where all three have indicated a 2 which can be compared to the 2.22 for the larger population.

7. With regards to capital structure decisions, how important is ownership control?
This question was asked to verify the relative importance of ownership control to financial flexibility and the tax advantage of debt interest deductibility. From a firm owner perspective, in order to retain ownership control and to limit dilution of ownership, equity issues would be assumed to be a financing option of last resort and a preference for debt as opposed to retained earnings and/or equity would thus be assumed. The issue of ownership control is therefore also somewhat connected to agency theory; to avoid dilution of ownership debt is assumed to be preferred to internal/external equity.

As can be seen in the Figure below, 20 firms responded to this question and an overwhelming majority of the firms have indicated that ownership control is important to some degree. Only two firms have indicated that ownership control is less than important and the remaining answers range from important to very important.
- Missing: 0
- 1. Not important at all: 1
- 2.: 1
- 3. Important: 10
- 4.: 2
- 5. Very important: 6

**Figure 5.1.1.6. Importance of ownership control.**

In line with these findings the three firms excluded from the main population also view ownership control as important where the respondents have indicated alternative 3, 4 and 5 respectively. On average these three firms thus view ownership control as the most important factor with regard to capital structure decisions.

Since all variables in question 5 through 7 are assumed to be important to some degree what is of particular interest is the relative importance of these factors. Financial flexibility is on average viewed as the relatively most important factor implying that on average there should be a tendency to keep debt levels low and a tendency toward preferring equity to debt. Ownership control is on average viewed as the second most important factor affecting capital structure decisions while the advantage of debt interest deductibility on average is stated to be unimportant. The relative importance and the ranking of the three factors stated to influence the capital structure decision can be seen in the Figure below.
1. Financial flexibility

2. Ownership control

3. Tax advantage

Figure 5.1.1.7. Ranking of the three factors.

In contrast to the population, the three larger firms that were excluded from the population rank the importance of these factors slightly different where ownership control is indicated to be the most important factor affecting capital structure decisions followed by financial flexibility which is also indicated to be an important factor. Similar to the population, these three firms view the tax advantage of debt as unimportant.

8. Given equal access to external debt and external equity when financing overall investments in your company external debt is preferred over external equity.

This question is at the center of the survey where the inversion of the pecking order thesis is tested. Where theory describes a preference order ranging from internally generated funds to external debt to external equity, empirical research findings suggest an inversion of the pecking order where external equity is preferred to external debt. A preference for equity as opposed to debt would support proposition 1 and would in turn contradict the pecking order as described in theory.

Gathered data with the answers to this question will also be further analyzed in combination with the answers to question 5 through 7 in order to see how well the preference for debt/equity corresponds with the relative importance of financial flexibility, the tax advantage of debt interest deductibility and ownership control. Moreover, this question will be analyzed in combination with question 3 and question 4 in order to see how the indicated preference corresponds with the stated level of activity and the maintenance of an optimum debt level.

19 respondents answered this question and as can be seen in the Figure below a majority of answers range from strongly disagree to agree. With a mean of 2.74 and a standard deviation of 1.240. The result is slightly skewed towards equity, but external debt and external equity appear to be close to equally preferred.
1=Strongly disagree, equity is preferred over debt; 2=Disagree; 3=Debt and equity are equally preferred; 4=Agree; 5=Strongly agree, debt is preferred over equity.

Figure 5.1.1.8. Preference of external debt and external equity.

To further illustrate the preferences with regard to external sources of finance we have grouped the answers according to stated preference for debt, stated preference for equity and equal preference. As mentioned above, the preference for external debt or external equity appears to be close to equal. This grouping can be seen in the Figure below. Respondents who answered 1 or 2 have been grouped into the first category, indifferent respondents are grouped as category 2 and respondents with high preference for debt over equity are grouped in category 3.

1=External equity is preferred over external debt; 2=External debt and external equity are equally preferred; 3=External debt is preferred over external equity.

Figure 5.1.1.9. Grouped preference of external debt and external equity.
In contrast, looking at the three firms that were excluded from the population all respondents have indicated that they agree with the statement, thus preferring debt to equity with regard to external sources of finance. The result among these firms therefore differs from the result of the population where there appear to be a tendency of a preference for debt among larger firms whereas there is an equal preference among the studied SMEs.

9. If available, when financing overall investments internally generated funds are preferred over external funds.

This question was asked to determine whether the first step described in the pecking order hypothesis; that internally generated funds, i.e. retained earnings, are preferred over externally generated funds. An overall answer opposing this would result in a rejection of both the pecking order as described in theory as well as the inversion of the pecking order stated in proposition 1. The first step is fundamental in the description of the pecking order which relies on the law of least effort. Conversely, if there is support for the first step in the pecking order this would be in line with the fundamental description of the theory which would indicate that the firms in the study follow either the pecking order as described in theory or the inverted pecking order. The latter version has empirical support in the literature we have reviewed and was the basis for proposition 1.

19 respondents provided answers ranging from disagree to strongly agree as can be seen in the Figure below. A majority indicated that they agree with the statement and therefore prefer internally generated funds to externally generated funds. The mean was 3.53 with a standard deviation of 0.772 and even though eight firms did not indicate a preference for internally generated funds, based on the average SME listed on NGM the first step in the pecking order is supported.

![Figure 5.1.1.10. Preference of internally and externally generated funds.](image)

1=Strongly disagree; 2=Disagree; 3=Internally and externally generated funds are equally preferred; 4=Agree; 5=Strongly agree.

Figure 5.1.1.10. Preference of internally and externally generated funds.
Among the firms that were excluded from the population the answers ranged from disagree to strongly agree with a mean value of 3.33 and a standard deviation of 1.528. This is largely in line with the population where the average indicates a preference for internally generated funds.

**5.1.2. Crosstabulations**

As stated in the research question and in the propositions, we were specifically interested in the connections between financial structure preferences and the three factors that may influence those preferences. We therefore start analyzing the answers given to the question of capital structure preference with regard to external funding and the answers given to the questions about the importance of the variables; financial flexibility, the advantage of debt interest deductibility, and ownership control. In the same fashion we will then analyze if there are any connections or patterns between preferences for sources of external funds and the question relating to whether firms maintain an optimal debt level. Lastly, we will look at the answers given to the questions about whether the firms maintain an optimum debt level and the stated importance of debt interest deductibility on tax to verify whether firms stating they maintain an optimum debt level consistently view the advantage of the tax shield as an important factor as would be expected if the trade-off theory of capital structure holds.

We first tested the importance of financial flexibility against the variable Debt over equity or equity over debt preference where we looked for patterns between answers to questions 5 and 8. When looking at the preference for external funds and the stated importance of financial flexibility one would expect to find a pattern where firms stating a preference for equity also view financial flexibility as highly important. One would also expect to find financial flexibility to be relatively more important than the advantage of the tax shield and ownership control. By contrast, those stating a preference for debt would be expected to view the tax shield advantage and ownership control as highly important factors and relatively more important than being financially flexible.

However, as can be seen in the Table below all firms included in the study viewed financial flexibility as highly important to various degrees despite a relatively even distribution between those who maintained either a debt or an equity preference.

<table>
<thead>
<tr>
<th>Importance of financial flexibility</th>
<th>Debt over equity or equity over debt</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0. External equity is preferred over external debt</td>
<td>1. External debt is preferred over external equity</td>
</tr>
<tr>
<td>3. Important</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>4.</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>5. Very important</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>8</td>
<td>6</td>
</tr>
</tbody>
</table>

*Table 5.1.2.1. Crosstabulation. Importance of financial flexibility against Debt versus equity preference variable.*
Looking at the three firms that were excluded from the population the respondents all indicated a preference for debt with regard to funding as well as viewing financial flexibility as important. Moreover, looking at the distribution of answers among the three non-SMEs one can clearly see a pattern developing. (see Appendix 8.3.2.)

Further on, the stated importance of the tax shield ranged from \textit{not important at all} to \textit{important} where the answers were quite evenly distributed regardless of debt or equity preferences as can be seen in the Table below. If the tax shield advantage is stated to be of importance a preference for debt would consequently be expected.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|}
\hline
Importance of tax advantage & 0. External equity is preferred over external debt & 1. External debt is preferred over external equity \\
\hline
1. Not important at all & 2 & 2 \\
2. & 3 & 2 \\
3. Important & 3 & 1 \\
\hline
\textbf{Total} & \textbf{8} & \textbf{5} \\
\hline
\end{tabular}
\caption{Table 5.1.2.2. Crosstabulation. Importance of tax advantage against Debt versus equity preference variable.}
\end{table}

The excluded firms all indicated a preference for debt with regard to external funding while also responding that the tax shield advantage is less than important. Since debt is preferred among these firms despite seeing the tax shield advantage as less than important, these firms’ preference for debt is expected to be influenced by another factor such as ownership control or the contractual relationship between firm owners and debt holders that makes debt the cheaper source of capital. (see Appendix 8.3.3.)

No patterns were apparent when examining the stated importance of ownership control and the preference for external funds. All firms included in the study view ownership control as an important factor where most answers (with two exceptions) ranged from \textit{important} to \textit{very important} regardless of equity/debt preference.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|}
\hline
Importance of ownership & 0. External equity is preferred over & 1. External debt is preferred over \\
control & external debt & external equity \\
\hline
1. Not important at all & 1 & 0 \\
2. & 0 & 1 \\
3. Important & 4 & 2 \\
4. & 1 & 1 \\
5. Very important & 2 & 2 \\
\hline
\textbf{Total} & \textbf{8} & \textbf{6} \\
\hline
\end{tabular}
\caption{Table 5.1.2.3. Crosstabulation. Importance of ownership control against Debt versus equity preference variable.}
\end{table}
Similarly, non-SME’s view on ownership control ranges from *important* to *very important*. In contrast to the main population all three firms have also indicated a preference for debt which is in line with viewing ownership control as a highly important factor in order not to dilute ownership. (see Appendix 8.3.4.)

Moreover, when looking at the preference for external funds and the maintenance of an optimum debt level there does not appear to be a clear pattern. The answers range from *debt avoidance* to *active maintenance of an optimum debt level* regardless of preference for external funds. One respondent has indicated that they avoid the use of debt while stating a preference for debt as opposed to equity and similarly three firms stating that they maintain an optimum debt level also state a preference for equity which appears somewhat contradictory. The result can be seen in the Table below.

<table>
<thead>
<tr>
<th>Maintaining an optimum debt level</th>
<th>Debt over equity or equity over debt</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0. External equity is preferred over external debt</td>
<td>1. External debt is preferred over external equity</td>
</tr>
<tr>
<td>1. The company avoids the use of debt</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>2. The company is indifferent to maintaining a particular level of debt</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>3. The company is indifferent to maintaining a particular level of debt</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>4. The company actively maintains an optimum debt level</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5. The company actively maintains an optimum debt level</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>8</td>
<td>6</td>
</tr>
</tbody>
</table>

*Table 5.1.2.4. Crosstabulation. Maintaining an optimum debt level variable against Debt versus equity preference variable.*

Non-SMEs indicated a preference for debt where two firms also indicated a desire to maintain an optimum level of debt and one firm indicated indifference to maintaining a particular level/avoid the use of debt. The latter answer appears to be somewhat contradictory since a preference for debt is indicated. (see Appendix 8.3.5.)

When examining the importance of the tax shield we also looked at the correspondence with answers regarding maintenance of an optimum debt level. As can be seen in the Table below there is a slightly noticeable pattern where firms indicating they avoid the use of debt on average viewing the importance of the tax advantage as less than important. Similarly, firms indicating indifference to a particular level of debt view the importance of the tax advantage as slightly less important and three firms indicating that they maintain an optimum debt level consequently view the importance of the tax advantage more highly. However, as above, the pattern is far from obvious and the correlation between these two variables was expected to be stronger.
Importance of tax advantage

<table>
<thead>
<tr>
<th>Maintaining an optimum debt level</th>
<th>1. Not important at all</th>
<th>2.</th>
<th>3. Important</th>
<th>5. Very important</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The company avoids the use of debt</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>2.</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>3. The company is indifferent to maintaining a particular level of debt</td>
<td>0</td>
<td>3</td>
<td>2</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>4.</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5. The company actively maintains an optimum debt level</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>18</td>
</tr>
</tbody>
</table>

Table 5.1.2.5. Crosstabulation. Maintaining an optimum debt level variable against the importance of tax advantage variable.

Among the excluded non-SMEs two firms have indicated that they maintain an optimum level of debt and one firm has indicated it is indifferent to maintaining a particular level of debt/avoid the use of debt. The average result is therefore similar to the findings about the population where a slight noticeable pattern can be seen where the correspondence between maintenance of debt level and the tax advantage appeared to be moderate. (see Appendix 8.3.6.)

Furthermore, we went on to examine the importance of financial flexibility, tax advantage and ownership control. Crosstabulation 5.1.2.6. grouped respondents whose answers on questions 5, 6 and 7 were Agree and Strongly agree, debt is preferred over equity to the statement in question 8. Similarly, crosstabulation 5.1.2.7. groups respondents who answered Strongly disagree, equity is preferred over debt or disagree to the statement. We can therefore see how respondents who prefer debt to equity and vice versa rank financial flexibility, tax advantage and ownership control. The two Tables below show that financial flexibility is regarded as the most important, followed by ownership control and the tax advantage of debt regardless of preference for type of external funding.

<table>
<thead>
<tr>
<th>External debt over external equity preference</th>
<th>Mean</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial flexibility</td>
<td>3, 3, 3, 5, 5</td>
<td>4</td>
</tr>
<tr>
<td>Tax advantage</td>
<td>0, 1, 3, 2, 2, 1</td>
<td>1.5</td>
</tr>
<tr>
<td>Ownership control</td>
<td>4, 3, 2, 3, 5</td>
<td>3.67</td>
</tr>
</tbody>
</table>

Table 5.1.2.6. Crosstabulation. Preference for external debt over external equity against the preference for the three variables.

<table>
<thead>
<tr>
<th>External equity over external debt preference</th>
<th>Mean</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial flexibility</td>
<td>4, 5, 4, 3, 3, 3, 5</td>
<td>3.75</td>
</tr>
<tr>
<td>Tax advantage</td>
<td>2, 2, 3, 1, 1, 2, 3, 3</td>
<td>2.13</td>
</tr>
<tr>
<td>Ownership control</td>
<td>4, 3, 3, 1, 5, 3, 3, 5</td>
<td>3.38</td>
</tr>
</tbody>
</table>

Table 5.1.2.7. Crosstabulation. Preference for external equity over external debt against the preference for the three variables.
In summary, no clear patterns could be found among our crosstabulations with regard to the studied population. The stated importance of financial flexibility, the advantage of debt interest deductibility on tax and ownership control did not appear to correlate to a specific preference for debt or equity with regard to external funding. Similarly, maintenance of an optimum debt level did not correlate to a specific preference for external financing. Looking at the correlation between maintenance of an optimum debt level and the tax advantage of debt interest deductibility a slightly noticeable pattern could be seen where firms indicating a desire to maintain an optimum debt level appeared to value the tax shield advantage more highly. However, this pattern was expected to be much stronger. The confusion displayed in these responses indicated, to us, that there was no strongly held belief in a particular financial strategy among the firms studied. Considering the size of the firms and the capital intense nature of high growth firms this might reflect financing activities on a day to day basis rather than an overall financial strategy. These firms are relatively small and relatively exposed and vulnerable with regard to financing options and it is not far-fetched to imagine a scenario where they take what they can get despite a desire to do things differently.

Summarizing the findings from our crosstabulations regarding the non-SMEs that were excluded from the population their answers appeared to be broadly consistent within the sub-group and also appeared to somewhat differ from the studied population. In contrast to the studied population these three firms viewed ownership control as the most important factor affecting capital structure decisions followed by financial flexibility. Further, even though they all indicated a preference for debt with regard to external sources of funding none of these firms stated the view that the tax shield advantage was an important factor which leads to the conclusion that the preference is influenced by a need for ownership control or influenced by another factor such as the fact that debt is the cheaper source of capital even when the tax advantage of debt is not considered.

Regardless of preference for external finance the overall result with regard to the studied population indicated that financial flexibility was the most important factor in their capital structure decisions followed by ownership control. They were least interested in the tax shield offered by debt.

<table>
<thead>
<tr>
<th><strong>External debt over external equity</strong></th>
<th><strong>External equity over external debt</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Financial flexibility</strong></td>
<td><strong>1. Financial flexibility</strong></td>
</tr>
<tr>
<td><strong>2. Ownership control</strong></td>
<td><strong>2. Ownership control</strong></td>
</tr>
<tr>
<td><strong>3. Tax advantage</strong></td>
<td><strong>3. Tax advantage</strong></td>
</tr>
</tbody>
</table>

*Figure 5.1.2.1. Ranking of the three factors according to preference for external funding.*
5.1.2 Actual accounting numbers

The actual financial position of the firms included in the study is assessed by looking at actual accounting figures and how these figures correlate to the stated preference for debt vs. equity as well as the stated importance of the assumed influencing factors; financial flexibility, tax shield advantage and ownership control. In the previous section the firms included in the sample were grouped according to stated preference and the stated relative importance of specific factors. In this section the firms within the sample were divided according to actual financial position and their stated preferences and the relative importance they put on specific factors was then analyzed in correspondence to the actual financial position as shown in annual reports. This section is treated as complementary to the main study and was intended to highlight how stated preferences that were revealed in the questionnaire correspond to the actual reality and the actual financial position of firms included in the study.

When doing the comparison we took into consideration a firm’s short run solvency and liquidity by looking at the current ratio. A ratio of 1 was used as a benchmark suggesting an equal amount of current assets and current liabilities. All firms were divided into two groups based on a current ratio above 1 and a current ratio below 1. A ratio above 1 indicates a liquid and financially flexible firm whereas a ratio below 1 indicates that the amount of obligations that are due within a year exceeds the amount of assets that will be converted into cash within the same period and thus gives an indication of a greater level of short term debt. This measure is of interest since financial flexibility is an important concept within this thesis and looking at short term solvency and the stated importance of influencing factors this provides an important insight. A firm’s degree of leverage and the actual debt versus equity preference is better described by looking at long term debt measures and the last two questions about debt and equity preferences as well as preferences for internally or externally generated funds will therefore only be analyzed when looking at the long term debt measure.

Long term solvency was taken into consideration by looking at the total debt ratio as well as the debt-to-equity ratio. In essence the two ratios measure the same thing where the total debt ratio reflects the amount of debt as a percentage of total assets and the current ratio measure the relationship between debt and equity (from which we can easily calculate a firm’s percentage of debt). Using a benchmark of 50 percent this indicates that the amount of debt is backed up by an equivalent portion of own capital. A debt ratio of 50 percent is also commonly used for accepting a firm’s degree of leverage without doing a further investigation (Kothari, Barone, 2006). All firms are divided into two groups based on a debt ratio of above 50 percent which indicates a greater degree of leverage and a debt ratio below 50 percent which indicates a lower degree of leverage. Looking at these groupings we will mainly be using the average response within a group to compare stated preferences and the importance of influencing factors to actual accounting figures. Individual responses to a specific question will also be used and compared to the specific financial position of that individual firm when it is of particular interest.
As can be seen in the table below firms with a current ratio of above 1, thus by our definition liquid and financially flexible, appear to be larger in terms of number of employees. However, when looking at the two largest firms in terms of employees these two firms have the lowest current ratio within the group which leads to the conclusion that firm size and short term financial flexibility is not strongly correlated. Firms with lower level of short term debt also estimate their growth rate over the past three years slightly higher than does firms with a current ratio below 1. Looking at the stated activity in capital structure decisions more liquid firms also appear to be more active. Firms with a greater degree of financial flexibility also appear to view their optimization of debt levels lower than firms with greater levels of debt which is in line with what would be assumed. Similarly, in line with what would be assumed financially flexible firms also view the importance of financial flexibility slightly higher than less flexible firms. Looking at the stated importance of debt interest deductibility firms with a current ratio above 1 view debt interest deductibility as less important which also is in line with a more moderate approach to taking on short term debt. In contrast the importance of ownership control, which by the definition used in this thesis suggests a willingness to take on debt in order to not dilute ownership, is viewed as less important by firms with a greater level of debt.

In summary the stated preferences and the stated importance of influencing factors appeared to correspond to the level of short term debt in a logical fashion. Financially flexible firms estimate their growth rate higher, their activity in capital structure management higher and being financially flexible higher. Moreover, they put less emphasis on the importance of the tax shield advantage which is in line with what would be assumed. Interestingly, firms with lower levels of short term debt view the importance of ownership control slightly higher which by definition in this thesis rather would correspond to greater levels of debt.

<table>
<thead>
<tr>
<th>Current Ratio</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q5</th>
<th>Q6</th>
<th>Q7</th>
<th>Q8</th>
<th>Q9</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.02</td>
<td>40</td>
<td>3</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2.80</td>
<td>20</td>
<td>2</td>
<td>5</td>
<td>1</td>
<td>5</td>
<td>1</td>
<td>5</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>2.91</td>
<td>25</td>
<td>5</td>
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<td>2</td>
<td>5</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>3.13</td>
<td>45</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>1</td>
<td>3</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>2.65</td>
<td>66</td>
<td>3</td>
<td>4</td>
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</tr>
<tr>
<td>1.07</td>
<td>200</td>
<td>3</td>
<td>-</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>3.09</td>
<td>45</td>
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<td>1</td>
<td>5</td>
<td>2</td>
<td>5</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>1.37</td>
<td>237</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>3</td>
<td>1</td>
<td>5</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>3.26</td>
<td>64</td>
<td>2</td>
<td>5</td>
<td>1</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>2.26</td>
<td>19</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>1</td>
<td>5</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>761</td>
<td>33</td>
<td>34</td>
<td>24</td>
<td>37</td>
<td>14</td>
<td>40</td>
<td>27</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td>76.1</td>
<td>3.30</td>
<td>4.25</td>
<td>2.67</td>
<td>4.11</td>
<td>1.56</td>
<td>4.00</td>
<td>3.00</td>
<td>3.56</td>
<td></td>
</tr>
</tbody>
</table>


Turning to the debt ratio and how stated preferences and the stated importance of influencing factors correspond to the actual degree of leverage the sample is divided into two groups. The first group has a debt ratio that is below 50 percent which in this thesis is viewed as firms with a relatively low degree of financial leverage and consequently a relatively high degree of financial flexibility. The second group has a debt ratio above 50 percent and is viewed as a group of high leveraged firms. Looking at firm size firms with a greater number of employees show a higher percentage of debt, hence they have a greater degree of leverage. The two largest firms however, have a debt percentage of 28.7 percent of total assets and 69.94 percent of total assets respectively which indicates that firm size does not necessarily have to be correlated to the degree of leverage. Looking at the stated growth over the past three years the average result is very similar for the two groups where less levered firms appear to have experienced a slightly higher growth rate. Less leveraged firms also appear to view themselves as more active in capital structure decisions than firms with greater leverage. The conclusion is thus that firms with greater financial flexibility view themselves as more active which is in line with the findings when looking at financial flexibility from a current ratio perspective. Looking at the question of whether the firm perceive that they maintain an optimum debt level firms with greater degree of leverage appear to view themselves slightly higher in this question. The findings are thus in line with what would be expected but it should be noted that the average for both groups are very similar, 3.08 vs. 3.29. Similarly, firms with a lower degree of leverage also view financial flexibility slightly higher which is in line with what would be expected but the figures are once again very close, 4.08 vs. 4.00. Moreover, looking at the stated importance of the tax shield advantage firms with a greater degree of leverage consequently put a greater importance on the tax shield advantage which is in line with what would be expected. Similar to the previous section where current ratio was used, the stated importance of ownership control is correlated to degree of debt in an
unexpected way. Less leveraged firms appear to view ownership control a slightly more important than firms with greater degrees of leverage which is contrary to what would be expected; that firms issue debt as opposed to equity in order not to dilute ownership. Turning to the question regarding a preference for debt vs. equity, the answers appear to be similar regardless of degree of leverage. The result is similar when looking at the preference for internally vs. externally generated funds. Both groups indicate that both sources of funds are close to equally preferred regardless of degree of leverage.

In summary, firms with lower levels of debt appear to view themselves as more active in capital structure decisions, they put less emphasis on the importance of the tax shield advantage and slightly more emphasis on being financially flexible which is in line with what would be expected. An interesting finding is that ownership control appears to be correlated with lower levels of debt as opposed to greater levels of debt that would be assumed to be the case. This is in line with the findings when looking at current ratio where short term financially flexible firms appeared to view ownership control as more important than firms with higher levels of short term debt. The most interesting finding, however, was that the stated preference for debt does not correlate to higher levels of debt and higher degrees of leverage which appears to be rather contradictory. Looking at the firms with higher levels of debt they still perceive financial flexibility and ownership control as more important than debt interest deductibility on tax even though this factor was valued slightly higher among these firms in comparison to less leveraged firms.

<table>
<thead>
<tr>
<th>Debt Ratio</th>
<th>D/E</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q5</th>
<th>Q6</th>
<th>Q7</th>
<th>Q8</th>
<th>Q9</th>
</tr>
</thead>
<tbody>
<tr>
<td>27,15%</td>
<td>0.37</td>
<td>40</td>
<td>3</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>24,66%</td>
<td>0.33</td>
<td>20</td>
<td>2</td>
<td>5</td>
<td>1</td>
<td>5</td>
<td>1</td>
<td>5</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>28,55%</td>
<td>0.40</td>
<td>9</td>
<td>2</td>
<td>5</td>
<td>3</td>
<td>5</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>36,96%</td>
<td>0.59</td>
<td>62</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>2</td>
<td>4</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>28,96%</td>
<td>0.41</td>
<td>25</td>
<td>5</td>
<td>2</td>
<td>5</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>20,97%</td>
<td>0.27</td>
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<td>4</td>
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<td>3</td>
<td>1</td>
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<td>4</td>
</tr>
<tr>
<td>32,64%</td>
<td>0.48</td>
<td>9</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>24,30%</td>
<td>0.32</td>
<td>23</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>10,74%</td>
<td>0.12</td>
<td>1</td>
<td>1</td>
<td>5</td>
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<td>3</td>
<td>1</td>
<td>1</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>23,80%</td>
<td>0.31</td>
<td>45</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td>5</td>
<td>2</td>
<td>5</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>28,70%</td>
<td>0.40</td>
<td>237</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>3</td>
<td>1</td>
<td>5</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>14,57%</td>
<td>0.17</td>
<td>64</td>
<td>2</td>
<td>5</td>
<td>1</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>18,35%</td>
<td>0.22</td>
<td>19</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>1</td>
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<td>5</td>
<td>4</td>
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<tr>
<td></td>
<td></td>
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<td>37</td>
<td>49</td>
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<td>47</td>
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<td>45</td>
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<tr>
<td></td>
<td></td>
<td>46,08</td>
<td>3.15</td>
<td>4.33</td>
<td>3.08</td>
<td>4.08</td>
<td>2.00</td>
<td>3.62</td>
<td>2.75</td>
<td>3.75</td>
</tr>
</tbody>
</table>

5.1.3.4. Debt Ratio above 50 percent together with D/E-ratio. Survey questions in Appendix 8.1.
Since no financial strategies and no consistent preferences could be found we decided to go back and do a follow up interview with a few randomly selected firms. We wanted to allow them to clarify their responses to the questionnaire in order to increase our understanding of their thoughts and attitudes towards capital structure management and strategy. The motivation behind undertaking these follow up interviews was due to the contradictory responses received from respondents. This further probe into answers was intended to allow us to understand the basis for the results obtained.
6. DISCUSSION & CONCLUSIONS

In the following Chapter supplementary interviews are presented and interconnected with findings. The fact that interviews were added to the data at a late point, given conflicting results in the research findings, means that they are presented here first as a preamble to our discussions. After that, each proposition will be evaluated, supported or rejected. Thorough discussion is followed by the answer to the research question. Our general discussion of the findings is linked back to the implications for firms in the application of theory. All of this is followed by suggestions for future research based on evaluation of the purpose and practical implications of the study. Finally, we draw the reader’s attention to the criteria applied in this study that is intended to make the thesis replicable and trustworthy. We critically discuss quality criteria and the importance of validity and reliability in our study.

6.1 Interviews

This study is in essence a quantitative study, but several results proved to be contradictory. As a result interviews were conducted to clarify respondents’ answers to our survey instrument. Including a qualitative part in a study such as this is in line with the reasoning of Patel and Tebelius who state that it is neither unusual nor a problem to include an element of qualitative research in a quantitative study (1987, p. 43). It will also make it easier to understand the underlying factors behind the answers that have been gained from a quantitative study. Even though we have tried to self-eliminate the problem of misinterpretation of the questions and terms by maintaining their basic definitions this proved to be more difficult. After having conducted the quantitative study we understood that such complicated subject cannot fully be enfolded by basic terms as well as theory is not covering the real life situations to a hundred percent making this a complex situation to generalize on taking our research target group in consideration. A certain element of a qualitative study has been implemented. Bryman and Bell (2005, p. 40) describe a qualitative research method to have an expounding point of view. This is in line with the fact that we would like to gain more knowledge on the contradictory results and try to expound them on a more complex basis than it could be done with only a quantitative study.

Two companies were randomly selected for a follow up interview. They were asked to share their view on the relative importance of financial flexibility, the advantage of the tax shield and ownership control. We also asked them explain their motivations for becoming active in capital structure management since the overall result suggested that a majority of the respondents were active. For each randomly selected company we also looked for contradictions in their answers and asked them to explain why they answered the way they did.

Not surprisingly, the answers gave a much more complex picture of capital structure management than what is advocated in theory. In line with our expectations, the findings also
suggested that many firms have a hard time applying certain strategies and theories since they simply do not have access to more than one source of funds. One of the respondents said that they do prefer debt, but debt is not an option since they do not have access to debt. Thus, our question that had them assume that they did have equal access to all sources of capital meant that the ideal was being confused with the actual in their response. Small firms simply have less access to debt markets and rely to a greater extent on equity, for example through venture capitalists, to finance investment activities. The other respondent interviewed said that equity was preferred which was in line with the importance they attached to ownership control relative to the tax shield advantage or financial flexibility. There appears to be some contradiction to theory here as it has been assumed that viewing ownership control as the most important factor in capital structure decisions would be to prefer debt to external equity in order not to dilute ownership. However, in this case while stating that ownership control was important, their majority share holders guaranteed their current existing line of credit allowing them to remain financially flexible. They constantly evaluated and searched for potential new equity owners that were well-known and credit worthy to maintain their access to the debt market. Thus, while being publicly listed, they rely on private offerings and these are approved by existing shareholders as it allows the firm to maintain its requisite levels of flexibility and growth. All of this demonstrates that capital structure management, equity and debt preferences might be interconnected in a rather complex way.

Further, one firm that was included in this follow up interview also stated that while they actively maintain an optimum debt level they also have a preference for equity, indicating that our questions probably did not get at the center of the problem adequately. In the interview they clarified this assertion by saying that while equity and financial flexibility was their preferred position, they still use debt to some extent for which they have target debt levels and guidelines in order to optimize their use of debt. However, no firm appeared to optimize debt levels to gain tax advantages and the advantage of the tax shield as a factor was consequently viewed as relatively unimportant.

In essence these interviews gave a deeper insight into capital structure management in practice. There seemed to be support for the assertion that firms do not have access to multiple sources of funds. Another important factor that was highlighted was the interconnection between debt and equity issues where it appears to be common to balance the use of debt and equity. In order to get access to debt markets, credit worthy equity holders are needed, at least among small growth firms. While preferring equity to debt, debt is still used and kept at a level that could be viewed as optimized in order to remain financially flexible. These findings appear to be in line with the findings in the survey where debt and equity were close to being equally preferred. It also supports the finding that financial flexibility and ownership control was of greater importance than the advantage of debt interest deductibility on tax.
6.1 Propositions
We now return to the propositions that we outlined in the Literature Review Chapter above. Each is assessed in the light of the results discussed in the previous Chapter. A combination of results will allow us to find support for or reject the propositions.

P1: Listed, high growth SMEs in Sweden prefer raising equity over debt.
Results presented in Chapter 5 showed that there was no evidence supporting the assertion that listed, high growth SMEs in Sweden preferred raising equity over debt. Companies do not tend to have any specific preference order for raising external funds and debt and equity seem to be equally preferred. This equal preference means that the pecking order theory was also unsupported as we found no demonstrable preference for external debt over external equity. What we did find support for was that internally generated funds were preferred over externally generated funds as is suggested in the pecking order theory. Companies appeared to raise capital in accordance with the law of least effort where firms take what they can when they can, whether it is debt or equity. This notion was also supported when looking at the actual accounting figures where no consistent correlation was found between stated preferences for debt and actual levels of debt. Given these results, we reject our first proposition SMEs in Sweden have not been shown to prefer raising equity over debt.

A need for financial flexibility may provide some support for the trade off theory as that theory assumes that debt is useful only up to the point where it begins to threaten the firm with prospects for financial distress. Thus this next proposition essentially tested the second major capital structure theory previously described.

P2: Financial structure is affected by a need for financial flexibility.
Crosstabulations did not provide a noticeable pattern between a companies’ choice of debt or equity and the degree of importance manager’s placed on financial flexibility. Taking the overall response mean into consideration, however, seemed to indicate that financial flexibility is highly preferred by companies in our study. The results also showed that companies that preferred external equity over external debt highly valued financial flexibility, a result that tends to support the proposition although it is somewhat at odds with the trade-off theory. We did not, however, directly examine the role of financial distress in these decisions and can only state that the second proposition found some support as financial structure seems to be affected by a need for financial flexibility.

A major component of the trade-off theory is the utilization firms make of the tax shield provided by the use of debt in their capital structure. The third proposition was developed with regard to this aspect of the theory.

P3: Financial structure is affected by a need for the tax shield advantage of debt interest deductibility.
Findings regarding the tax shield advantage of debt interest deductibility show that it was the least valued factor and had a minimal affect on the financial structure of companies included in the study. The tax shield advantage of debt interest deductibility had the lowest mean
response numbers (indicating low levels of importance) of any contributing factor. This was true both when looking at the mean number for the total population and when dividing the population according to their stated preference for external finance. Both groups of companies that preferred external equity over external debt and vice versa seemed to value financial flexibility and ownership control more than tax shield advantages. Moreover, companies that actually had high levels of debt also appeared to view the other factors higher even though they placed a somewhat greater emphasis on the importance of the tax shield advantage in comparison to companies with lower levels of debt. According to the findings presented above we can state that there was no support for the third proposition since the tax shield advantage of debt interest deductibility was said to have no important affect on the financial structure of the studied population.

P₄: Financial structure is affected by a need for ownership control.
When analyzing the need for ownership control our results showed that together with financial flexibility ownership control was one of the most highly valued factors. No noticeable difference could be seen when dividing the population according to their stated preference for external finance. Taking all results into consideration we conclude that there was support for the fourth proposition that financial structure is affected by a need for ownership control.

6.2 Research Question
What influences the capital structure and the pecking order among high growth, listed SMEs in Sweden?
Two factors were found to influence capital structure, financial flexibility and ownership control. These two factors had a very different affect on capital structure decisions however. Being financially flexible means that the firm retains a certain degree of preserved debt capacity to respond flexibly towards opportunities and threats that arise. Ownership control, on the other hand, is regarded as a highly important factor since small firms appear to be largely dependent on their owners. In order to gain access to the debt market credit worthy and well-known equity owners, one firm confirmed, are needed. Ownership control may also refer to retaining ownership control as discussed throughout this study and implies a greater degree of leverage in order either not to dilute ownership or to control management choices. Connecting back to the actual accounting figures that were provided, these figures provided some support for the notion that ownership control is viewed as an important factor for gaining access to debt markets as opposed to retaining ownership control by not diluting ownership since emphasizing ownership control proved to be correlated to lower levels of debt as opposed to higher levels of debt that was initially discussed. We can therefore conclude that financial flexibility and ownership control are the two major factors affecting the capital structure of the studied firms, but we cannot therefore draw any conclusions about how these factors are incorporated into financial structure decisions.

Further, a majority of the respondents have indicated that they are very active with regard to capital structure management but, as could be seen in the previous Chapter, many answers
still remain rather confusing. Our additional interviews provided several plausible reasons for this confusion. To some extent, there appears to be insufficient access to debt markets which can explain that one factor might be highly valued, but due to the current situation faced by the firm, the option to choose from external sources of funds is not a given. Due to the relatively small size of these firms they are not likely to have the option to lever the firm to the same extent as larger firms which thus leads to a situation where equity capital is needed as collateral and where equity holders are needed as guarantors to enable debt issues. In line with previous reasoning, the questions that were asked in the questionnaire are also very hypothetical where the respondent was asked to assume the firm had equal access to multiple sources of funds. It is reasonable to believe that the hypothetical nature of the questions and the very different reality facing the firm can lead to inconsistencies in the answers.

We believe that we have fulfilled the purpose of this study by investigating the contradictions between theory and empirics and showing that basic theory is not always applicable on different situations of real life. We have shown that companies’ preference order regarding the external equity or debt does vary from the pecking order that theory suggests by grading the strength of the influencing factors. The differences of the real outcome on whether companies do take on more external equity than external debt is compared to their actual preferences with the help of accounting figures. Our research questionnaire that followed the basic pattern of the groundwork theories has not allowed us to get strongly definite answers, however the answers that we did get showed that a more thorough research is needed. A follow up interview has given us more clear results on why contradictions between theory and empirics do occur, which has been described above. One can also see that answers to the questionnaire also follow a basic pattern and may therefore be difficult to generalize to a variety of empirical situations. Simplified answers have created certain gaps in knowledge regarding the contradictions between theory and empirics, however we believe that a follow up study that has been done by us has given reasonably good explanations for covering the knowledge gaps. Besides a follow up interview that has increased the understanding of the survey answers we have included the real accounting figures of the studied companies. These figures have shown the actual outcome for the companies’ chosen capital structure and pecking order in contrast to their theoretical preferences.

Moreover, this study has increased knowledge regarding the impact strength of the financial flexibility, tax shield advantage and ownership control. Survey answers have given us an ability to grade the impact strength of the three factors that might influence company’s capital structure. This has in turn shown the pecking order preferences and how they separate from the pecking order theory.

However, there also appear to be a lack of financial strategies among the studied firms. Despite the fact that the reality facing a smaller firm might be complex with regard to access to capital markets and feasible financing options, greater awareness and a clear financial strategy would be beneficial to these firms. Targets and outcomes are not the same and one would expect to see evidence of patterns and more of an underlying strategy when looking at the overall result.
Moreover, the three non-SMEs that were excluded from the population still provided interesting (although not statistically significant) answers for comparison with those of the population. Retaining ownership control was viewed as the most important factor affecting capital structure decisions followed by financial flexibility which differs from the result provided by the population of smaller firms. Problems that a smaller firm might face, such as insufficient access to debt markets, are not likely to affect larger firms to the same extent. Larger firms therefore often have the option to use greater degrees of leverage leading to the conclusion that these three firms might value ownership control for reasons different than those of the smaller firms.

Financial flexibility was also viewed as an important factor affecting capital structure decisions which further provided some support for the trade off theory; that debt is useful to a point where financial distress might start threatening the firm.

Connecting back to theory, we found some support for trade off theory. On average, the firms included in this study did not view the advantage of debt interest deductibility on tax as an important factor in their decision making. They do not appear to optimize debt levels in accordance with what is described in trade off theory. However, financial flexibility was on average viewed as the most important factor affecting capital structure decisions which, as stated above, gives some support to the trade off theory. We did not, however, check their levels of financial distress assuming that listed growth firms who were performing on average for their industries were not in any such case. In contrast, we could see no evidence in support for either the traditional or the inverted version of the pecking order as described in theory. We can conclude that the firms included in the study do prefer internal funds to external funds and the result therefore supports the first step of the pecking order theory. Moreover, the result also supported the underlying notion in the pecking order theory that a firm’s capital structure is based on the law of least effort where firms raise capital based on its availability, starting with internally generated funds and then external funds, equity or debt, depending on what is available. With regard to external funds we cannot, however, find support for a preference for debt as described in theory or equity as suggested in the empirical findings of other researchers and stated in proposition 1. Debt and equity came close to being preferred equally. Based on these findings the theory may need some revision.

As mentioned in the introduction to this thesis, these conclusions can only be generalized to the population that we have studied, but being capital intense high growth firms in need of a great deal of capital to finance their activities, the NGM Equity population is of interest when looking at capital structure from a broader perspective as well. Due to the specific nature of these firms in combination with Sweden’s prominent position with regard to corporate structures and business life as stated by Thorsell and Cornelius (2009) the findings herein also give an indication of capital structures in general and may therefore be valuable to future researchers within the area.
6.3 Future Research

Most studies can be improved and other points of view can be taken. There are several areas where we would have liked to have done things differently and would recommend alternative strategies to researchers following after us. This is particularly relevant to those who want to gain further knowledge about capital structure decisions among high growth SMEs.

Considering the fact that the studied NGM Equity stock market in Sweden consists of 26 high growth firms we believe that our quantitative case study of the total population has been successful due to the high response rate. However, in order to gain a significant statistical applicability on other similar populations a study containing a bigger sample of companies might be suggested. Research on high growth listed SMEs in Sweden have been conducted and future researchers might consider a study of high growth listed SMEs in other regions than Sweden where bigger samples would be available. This might give more definite distribution of companies’ preferences on their capital structures. These results would then be applicable to different similar groups and not represent a case study as it was done here.

There were problems with our questionnaire that, with hindsight, we would have liked to address. This is particularly true with regard to hypothetical questions used when trying to probe real problems. Additionally, we believe we should have included questions about financial distress even though there were no indicators that this was a problem for our population of firms. There was also a real problem of limited resources for high growth SMEs among the studied companies that might have affected the answers.

We also believe that a bigger sample might allow a separation into different groups according to the industries companies operate in. As far as different industries are capital intense to a different degree this might also affect the results due to the fact that companies may adjust their strategy to industry benchmarks. However, not only a bigger sample and industry separation is suggested for any possible future research. We believe that company size might affect the outcome as well. Due to the companies’ limited resources described above and findings in the Literature Review Chapter we believe a separation into big companies and SMEs similar to our study is still relevant.

We believe that any possible future research on the issue of capital structure preferences among high growth listed companies would increase knowledge about factors affecting company decisions. We consider our study to be a good starting point for future researchers within the area.

6.4 Quality Criteria

Validity and reliability are closely connected in the process of transferring something theoretical into something empirical (Johansson–Lindfors, 1993, p. 108). Being a (largely) quantitative study where propositions have been deduced from capital structure theory and reformulated into questions to be asked of the population, validity and reliability is of critical importance for the trustworthiness and replicability of the study.
6.4.1 Validity

Validity refers to the correspondence between what is being measured and what is intended to be measured (Patel, Tebelius, 1987, p. 72) and how a theoretically defined variable is turned into an operationally defined variable (Johansson–Lindfors, 1993, p. 108). Thus the validity of this study refers to the correspondence between what we intended to measure based on variables that were derived from the theoretical framework and what we actually measured based on the questionnaire.

The variables and measures used within the field of finance are quite standardized and well known and thus the process of transferring a theoretically defined variable, i.e. interest deductibility on tax, into an operationally defined variable and into a question was quite straightforward. The subject at hand does not require much interpretation of theoretical variables and ways to go about it when formulating it into a question as do many other scientific areas and the firm representatives who participated in the study all had a good understanding of the financial field which decreased the risk of misinterpretations. Thus, the validity should be expected to be relatively high. Before gathering the data we also tested the content validity by performing a pilot study where we got feedback from the respondents on the understandability and quality of the questions. Looking back at the case of answer alternatives to questions 4 through 7 that consisted of “blank” alternatives without any attached statements we can see that “blank” second and fourth alternatives to questions 4 and 5 might have been misleading. At the same time a relatively high number of respondents have chosen to tick the box without any attached statement in questions 6 and 7. Since respondents have ticked the boxes with “blank” alternatives we can assume that they have understood the logic behind the likert scale as well as answer alternatives and their answers were motivated only by their preference strength.
6.4.2 Reliability

The main criteria for reliability require a study to be replicable as well as the results to be trustworthy (Gerring, 2001, p. 164). High reliability means the study can be done over and over again getting the same results without any accidental issues influencing the measurements and therefore the results at any given point in time (Bryman, Bell, 2005, p. 48; Patel, Davidson, 1994, p. 86 ff). A study with good replicability contains thorough and relevant steps describing how the study has been done (Gerring, 2001, p. 193). It is important in order to verify whether the result has a high degree of reliability (Bryman, Bell, 2005, p. 48).

We believe that our study has relatively high reliability as we thoroughly described the steps taken regarding the process of data collection and data analysis. In addition, we also made a critical analysis of the outliers and the total population that has been studied. Trustworthiness of answers that we have based results upon can be considered reliable since the respondents have been given a chance to answer the questions anonymously. Of course some variations may occur due to potential changes in the capital structure of the companies. However, we believe that a reproduction of our study would produce a result close to the one presented in this study.
7. LIST OF REFERENCES


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Vanyushin, V., Umeå University Lecturer, Sample size and analysis of gathered data, April 2010

Hello!
We are Alex Persson and Niklas Dahlström – graduate year Business Program students at Umeå School of Business. We are studying capital structure among all companies represented on the NGM Equity stock market and we would appreciate if you could spend a maximum of 8 minutes answering this survey.

Our main purpose is to investigate why there are contradictions between pecking order theory and empirical research findings regarding companies’ capital structure. Moreover, the purpose is to gain more knowledge about underlying factors that effect a firm’s choice with regards to capital structure; the tax advantage, control of the company and financial flexibility.

Answering this survey is optional. Answers will be anonymous and will be the basis for our Master’s Degree thesis where all responses will be presented in an aggregated form only.

Thank you very much for your answers!
If you would like to get in touch with us or get the results of this study electronically, please use the following contacts or fill in your e-mail at the end of the survey.

Alex Persson
+46 (0) 73 997 80 64
alex@alexpersson.se

Niklas Dahlström
+46 (0) 70 207 39 99
niklas.dahlstrom@live.com
Survey
Questions in this survey should be answered by either filling the empty fields (___) or putting a cross against the alternative (☐) that suits your own opinion the best.

1. How many employees are there in your company? _______ employees.

2. Over the last three years, how would you consider your firm’s growth compared to other companies in your industry?
   - Way below average
   - Below average
   - Average
   - Above average
   - Way above average

Following questions refer to company’s capital structure. Capital structure refers to the mix of debt and equity in a company.

3. How actively does your company decide upon the mix of debt and equity when financing overall investments?
   - Not active at all
   - Not active, external part such as bank does it for our company
   - Active to a certain degree, external part such as bank cooperates with our representative
   - Active, external part gives advices on our company’s own decisions
   - Active to a great degree, we manage our capital structure on our own

Following questions should be ranked according to your preference where numbers 1 to 5 represent increasing levels of involvement in maintaining an optimal level of debt.

4. To what extent does your company maintain an optimum debt level?
   - 1. We avoid the use of debt
   - 2.
   - 3. We are indifferent to maintaining a particular level of debt
   - 4.
   - 5. We do actively maintain an optimum debt level

The pre-research of our study has shown three main important factors of why companies employ certain mixes of debt and equity. The three factors are: control through ownership, financial flexibility and the tax advantage of debt interest deductibility.

5. With regard to capital structure decisions, how important is financial flexibility?
   - 1. Not important at all
   - 2.
   - 3. Important
   - 4.
   - 5. Very important

6. With regards to capital structure decisions, how important is the tax advantage of debt interest deductibility?
   - 1. Not important at all
   - 2.
   - 3. Important
   - 4.
   - 5. Very important
7. **With regards to capital structure decisions, how important is ownership control?**

- [ ] 1. Not important at all
- [ ] 2.
- [ ] 3. Important
- [ ] 4.
- [ ] 5. Very important

The following questions refer to sources of funds where:

- Internal funds refer to retained earnings and savings of the company.
- External funds refer to debt and equity issues.

8. **Given equal access to external debt and external equity when financing overall investments in your company external debt is preferred over external equity.**

- [ ] Strongly disagree, equity is preferred over debt
- [ ] Disagree
- [ ] Debt and equity are equally preferred
- [ ] Agree
- [ ] Strongly agree, debt is preferred over equity

9. **If available, when financing overall investments internally generated funds are preferred over external funds.**

- [ ] Strongly disagree
- [ ] Disagree
- [ ] Internally and externally generated funds are equally preferred
- [ ] Agree
- [ ] Strongly agree

Your e-mail: ________________________________________________________________

Thank you very much for your answers!
8.2 Descriptives to Crosstabulations

8.2.1 Descriptives to Table 5.1.2.1.

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<td>N</td>
<td>Percent</td>
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8.2.2 Descriptives to Table 5.1.2.2.

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8.2.3 Descriptives to Table 5.1.2.3.

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8.2.4 Descriptives to Table 5.1.2.4.

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8.2.5 Descriptives to Table 5.1.2.5.

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8.3 Descriptives to non-SMEs, Excluded from the Population

8.3.1 Table 8.3.1.

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<td>1100</td>
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<td>Company Growth</td>
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<td>Desicion Upon Debt and Equity mix</td>
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<td>4</td>
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<td>1.155</td>
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<tr>
<td>Importance of Financial Flexibility</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3.00</td>
<td>.000</td>
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<td>Importance of Tax Advantage</td>
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<td>2</td>
<td>2.00</td>
<td>.000</td>
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<tr>
<td>Importance of Ownership Control</td>
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<td>5</td>
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<td>External Debt Preferred Over External Equity</td>
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<td>4</td>
<td>4.00</td>
<td>.000</td>
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<tr>
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<td>5</td>
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### 8.3.2 **Table 8.3.2.**

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<th>Debt over equity or equity over debt</th>
<th>Total</th>
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### 8.3.3 **Table 8.3.3.**

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<th>Debt over equity or equity over debt</th>
<th>Total</th>
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<tbody>
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<td>2.</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
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</table>

### 8.3.4 **Table 8.3.4.**

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<th>Debt over equity or equity over debt</th>
<th>Total</th>
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<tr>
<td>3. Important</td>
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<td>1</td>
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<tr>
<td>4.</td>
<td>1</td>
<td>1</td>
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<tr>
<td>5. Very important</td>
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### 8.3.5 **Table 8.3.5.**

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<th>Total</th>
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<tbody>
<tr>
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<tr>
<td>4.</td>
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### 8.3.6 **Table 8.3.6.**

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