Zero-leverage puzzle. Evidence from Switzerland.



Department of Banking & Finance

Master Thesis

Master of Arts UZH Business and Economics

21st August 2018

Executive Summary

Question

It is often discussed by the management how should the capital structure of the firm look like. The optimization of the capital structure is hence a crucial question. Several studies were already done in the past. Some examples of classical capital structure theories are the propositions I & II by Modigliani and Miller (1958) or the trade-off theory as well as the pecking order theory. More modern studies that were done more recently are researches of the extremely conservative low-leverage and/or even zero-leverage policy because the proportion of this type of firms increased in the past years a lot becoming more popular nowadays. The studies were country-specifically as well as internationally performed. The international studies provided already first evidences of large fractions of zero-leverage puzzle phenomenon explicitly in Switzerland, there is the incentive of this thesis to give further details and explanations to understand the behaviour to follow an extreme conservative debt capital policy. To find out the explanations regarding this puzzling behaviour also theories related to the financial constraints as well as the financial flexibility hypotheses are taken into consideration.

Procedure

Using the data source Bloomberg, the data is gathered and adjusted to achieve a useful data quality level for the purpose of this thesis. After all cleaning steps the whole sample is reduced to 268 unique Swiss listed non-financial firms, which correspond to 3639 firm-year observations. Hence, this sample size provides the basis for the whole research. Following the procedures of most recent studies like Strebulaev and Yang (2013) the thesis gives first insights regarding leverage and shows how the proportion of (almost) zero-levered firms changed over the last twenty years from 1997 until 2016. All the analyses performed base on the most recent studies that focused their research on low-leverage and/or zero-leverage companies and their puzzling behaviour. Similar to Bessler, Drobetz, Haller, and Meier (2013) the next inspection step is to get a closer look at firm size as well as the age of the firms. Subsequently, with the supplementary inspiration received through the studies done by Dang (2013) as well as Strebulaev and Yang (2013) the univariate analyses using t-tests are initiated. Also a proxy group is constructed for a more appropriate comparison. The t-test is also split up in dividend paying firms to get further information related to financial constraints and/or financial flexibility. Zero dividend paying firms are suggested to be more restricted and

thus most likely affected by financial constraints, while dividend paying firms are unrestricted and more likely affected by the financial flexibility hypothesis to eschew debt. Finally, for the multivariate analysis are built regression models according to inputs got for the exclusion of variables (Dang, 2013; El Ghoul, Guedhami, Kwok, and Zheng, 2017). There is a short and long version of the regression model similar to the study done by Strebulaev and Yang (2013). All these analytical methods serve to find the results described below.

Results and evaluation

The results are mostly consistent throughout the different analyses but sometimes also with weak disagreements. The fraction of (almost) zero-levered firms has considerably increased over the last twenty years but especially during the last decade such that it currently lies over ten percent. These firms have a tendency to be small-sized and young and they are mostly from the technology or communication sector, which are industry sectors known to consist mostly of high-growth firms. The univariate analyses combined with the multiple regression models illustrates how overall these firms following an extremely conservative debt policy are smaller, slightly more mature, less profitable, pay more taxes, have large growth opportunities and cash holdings, a low tangibility and less investments. Further outcomes are revealed through the distinction of firms paying dividends or not i.e. being unconstrained or constrained companies. Zero dividend paying (almost) zero-levered firms have similar firm-specific characteristics as the results received from the whole sample. Striking differences are that they are younger and pay less taxes. The properties of a firm that has a small size, is young and not really profitable matches with the ones of a constrained firm such that the interpretation might be possible that this type of firms is affected especially by financial constraints as a reason to eschew debt. Hence, for this reason they do not get the required access to debt capital markets and avoid debt involuntarily. For dividend paying (almost) zero-levered firms the situation is different since they have also other firm-specific characteristics than zero dividend paying ones. Their properties are also a small firm size, high growth opportunities and large cash holdings. Their profitability is also high as well as their dividend payments signalling economic soundness, but their capital expenditures are still low. The explanation to eschew debt rests more upon the financial flexibility hypothesis to mitigate the underinvestment problem and to preserve the borrowing ability for the ideal moment of investment.