DOI URL: https://doi.org/10.3126/jbssr.v9i1.67991

Financial Constraints and Corporate Finance:
Insights from Nepalese Firms

Prem Prasad Silwal[1]

Article History
Received 29 April 2024
Reviewed 9 May 2024
Revised 15 May 2024
Plagiarism Checked
26 May 2024
Revised 28 May 2024
Accepted 30 May 2024

Keywords
Debt finance, financial constraint, firm size, internal equity, Nepalese firms.

Journal of Business and Social Sciences Research (ISSN: 2542-2812).
Vol IX, No. 1,
June 2024

Abstract
The purpose of this study is to investigate how managers navigate the capital market amidst financial constraints. Expanding upon the findings of Graham and Harvey (2001), Campello et al. (2010), and Bancel and Mittoo (2014), we confine our attention to Nepal as a developing nation. Our approach encompasses criteria and delves into the challenges associated with securing financing, utilizing descriptive analysis. The study entailed surveying 198 financial executives using a structured questionnaire. Among the respondents, nearly half of them indicated that they experienced financial issues at a specific point in time. The survey focused on the financing challenges that managers face when considering potential projects for their undertakings. The findings revealed that managers prioritize the use of internal equity, followed by external equity, and lastly, debt. Interestingly, this order contradicts the hierarchical theory. Financially constrained firms identified several major obstacles when raising funds from banks, including high interest rates, lengthy banking processes, and bank fees. Additionally, it has been uncovered that maintaining financial flexibility and considering firm size are crucial factors for the company in addressing their financial shortfall.

INTRODUCTION AND STUDY OBJECTIVES

During the 1960s, scholars worldwide dedicated efforts to advancing models and theories aimed at encouraging firms' financial management capabilities. Finance theorems such as capital structure and capital asset pricing models emerged, earning recognition through Nobel Prizes for their contributors. While these theories were extensively discussed within academic circles, their integration into corporate boardrooms remained obscure. While issues concerning financial management among executives have

[1] Dr. Silwal is a senior finance faculty at Nepal College of Management, Kathmandu University, Nepal. He can be reached through silwal.prem328@gmail.com

been extensively explored in the USA and other Western nations through surveys, the application of theoretical frameworks in Asia, particularly in underdeveloped countries like Nepal, remains relatively opaque. This paper endeavours to bridge the gap between academia and industry practitioners by conducting surveys among corporate executives. We aim to glean insights into how executives navigate various market scenarios in their financing decisions, offering potential perspectives for consideration.

Studies on survey, Bancel and Mittoo (2004) documented the cross-country determinants of financing choice of European firms. Graham and Harvey (2001) and (Graham 2022) examine the theory and practice of corporate finance by surveying chief financial executives in United States. Similarly, Campello et al. (2010) examine the real effects of financial constraint by surveying US, Europe, and Asian financial executives. Besides, Bancel and Mittoo (2014) survey the gap between theory and practice of corporate valuation among European experts.

This study is comparable to earlier studies in the Nepalese environment, but it differs in terms of its focus and scope. This study focuses primarily on the viewpoints of Nepalese managers when it comes to making finance decisions, in contrast to (Campello et al., 2010) who investigated many aspects impacting financing decisions utilizing several constraint criteria. A previous study in corporate finance examines how various frictions in raising external financing can produce financial constraint for corporations. In essence, companies that are financially constrained due to low revenue, small scale, and youthfulness encounter several market challenges, rendering them unable to secure the necessary financing for their potential endeavours. Research scholars have hypothesized that these constraints may have a considerable impact on a corporate financing decision (e.g. Campello et al., 2010; Hennessy & Whited, 2007). Faff et al. (2016) show that companies facing limited market access and enduring financial constraints tend to build up cash reserves for future business opportunities. Their finding unveils that 85% of companies prioritize unwavering commitment to robust liquidity management within the domain of corporate finance.

Researchers (Bellone et al. 2010; Jin et al. 2019; Pergelova & Angulo-Ruiz, 2014) among others frequently seek a gauge of the severity of financial constraints to delve into how it shapes a firm's performance. The fluctuation in stock prices following a firm's announcement of changes in leverage might be linked to the pursuit of an ideal or desired capital structure (Titman & Tsyplakov, 2007). Besides, Kim and Li (2021) demonstrate the pivotal role of social factors in shaping corporate policies, while Carrizosa et al. (2022) unveil that government tax policies directly impact the financing decisions of firms.

As suggested by Modigliani and Miller (1958), while decisions related to leverage might be considered unimportant, the

data they convey regarding a firm's investment outlook could lead security holders to reassess their expectations for the firm's future. Primarily, the firm operates in a condition where it encounters minimal or no obstacles when raising funds for ventures with a positive net present value. These firms do not experience issues related to asymmetric information. For unconstrained firms, investment decisions are independent of financing, with external financing driven solely by the availability of profitable opportunities. Conversely, profitable firms prefer to use internal funds for external financing to minimize investment banking fees. Conversely, financially constraint firm faces higher financing cost either because of asymmetric information or some cost related to agency. Myers and Majluf (1984) suggest that financially constrained firms exhibit an even stronger inverse correlation between internal profit and external financing compared to unconstrained firms. This finding aligns with the conclusions drawn by Pradhan and Kurmi (2004). Subedi (2017) also emphasizes the heavy reliance of firms on their internal funds to finance their investment opportunities. Silwal (2018) conducted a study which revealed that constrained firms tend to rely heavily on cash flows and cash holdings for funding abnormally large investments, while relying relatively less on debt capital.

Eighty-nine percent of managers reported that they use leverage to some extent when making their firms' financing choices (Scott & Johnson, 1982). They further evinced that the respondents expressed an overwhelming preference for book value ratios. However, Frank and Goyal (2009) reported that market value measures are a major aspect of financing decisions. Pinegar and Wilbricht (1989) identified that the most important item affecting corporate leverage decision is management's desire for financial flexibility. The study also indicates that 69% of the surveyed firms utilized the times interest-earned ratio, whereas only 56% employed the long-term debt to net worth ratio. The result was surprising that the debt ratio (total debt/total assets) was used so rarely by these respondents. Graham and Harvey (2001) claim that financial flexibility is highly valued by 59% of the respondents for making leverage decisions. Furthermore, they argue that the window of opportunity holds utmost significance for firms experiencing informational asymmetries. When the stock price increases, these firms are inclined to raise capital by issuing equity rather than opting for debt.

Moreover, the study conducted by Campello et al. (2010) involving chief financial officers from 39 countries, uncovered that companies facing financial constraints tend to extensively utilize cash, rely heavily on lines of credit due to apprehensions about potential future restrictions imposed by their banks, and allocated a larger proportion of assets to finance their business operations. Besides, the findings indicate that over half of the respondents admitted to postponing their intended investments. Moreover, financial difficulties among firms, leading to an inability to borrow externally, resulted in many firms refraining from pursuing otherwise attractive investment

opportunities. Internal funds gain significant importance when other funding options are not available to mitigate potential project risks. During periods of financial constraint, firms frequently rely on their cash holdings to secure external financing. Reflecting this perspective, Kim et al. (1998) noted that companies facing greater uncertainties in securing external funding tend to stockpile more cash.

In Nepal, the application of these insights remains uncertain due to the study's lack of consideration for the current dynamics within the country. This research gap highlights the necessity for a study concentrating on Nepalese non-financial firms. The proposed research attempts to expand on previous research findings by investigating aspects of capital structure and financial constraints specific to Nepal. It particularly focuses on identifying the perceptions and behaviours of financial executives regarding their approach to financing decisions in both financially constrained and unconstrained firms.

Our findings offer valuable insights for financial executives, shedding light not only on how they typically address their financing needs in response to the capital market but also on how capital structure theories can aid in comprehending the determinants of their financial value. Moreover, financial executives grasp the concept of market barriers that impede the acquisition of additional financing for their potential projects. Academicians stand to benefit by gaining an understanding of the present and prospective trajectories of capital structure and financial constraints, directing their focus in research. Additionally, policymakers can glean insights from this study regarding the proxies that influence financing decisions in the context of Nepal.

The remainder of this paper is structured as follows: Section 2 comprises data and methodology. Section 3 describes the analysis and presentation. Section 4 provides conclusion and managerial implications along with scope for future research.

RESEARCH METHODS

Research in the realm of large corporate financing endeavours to understand decision-making processes and optimization strategies through the analysis of historical data. However, relying solely on archival data presents challenges as it predominantly reflects past occurrences, making it difficult to discern pre-existing corporate strategies and investigate underlying economic assumptions and market dynamics. To gain deeper insights into managerial behaviours regarding corporate financing practices, we employed a questionnaire survey aimed at industry practitioners. The primary data pool for this research consisted of financial executives actively involved in seeking funding for their prospective ventures. Previous surveys have consistently indicated the involvement of either the Chief Executive Officer (CEO) or the Chief Financial Officer (CFO) in corporate financing decisions.

Building upon this understanding, we developed a comprehensive questionnaire grounded in a thorough

review of previous literature by Graham and Harvey (2001), Bancel and Mittoo (2004, 2014), Faff et al. (2016), and Graham (2022). This initial questionnaire was distributed among respective stakeholders (academics and practitioners) to gather feedback. After incorporating their suggestions, we made minor adjustments to the original documents. The revised questionnaire was then distributed to financial decision-makers within non-financial firms, aligning with the objectives of our study.

We identified potential respondents using the business directory and website of the Federation of Nepalese Chambers of Commerce and Industry (FNCCI). This criterion was established on the premise that firms with capital exceeding Rs 10 million actively pursue new financing avenues to foster growth. This provision is stipulated in the Company Act 2063 in Nepal, which mandates that to qualify as a public company, a minimum capital of Rs 10 million is required. Therefore, relying on the data obtained from FNCCI, our study population comprised a total of 950 firms spanning diverse sectors including manufacturing, trading, hydro, tourism, and others. We deleted 52 firms because of the non-availability of their email addresses. Our final mailing group contains 898 firms.

The questionnaire, along with the cover letter, was emailed to all these firms associated with the FNCCI in Nepal in July 2023. A subsequent email was sent in October 2023. In the cover letter, we emphasized our preference for one response from each firm, ideally from the chief executive or financial officer. We took measures to ensure that our final sample did not contain any duplicated responses. Our sample comprised 198 respondents, resulting in a response rate of 22.05%. Notably, this rate surpasses those observed in recent analogous surveys carried out in the United States - 9 percent (Graham & Harvey, 2001), and Australia - 12.5 percent (Faff et al., 2016). It seems that the data were sufficient to identify the measures in capital structure and financial constraint survey.

The survey asks financial executives a few financing questions: Do companies have a financing hierarchy? If so then which source they prefer to use first, second and so on. What factors impact the level of debt financing? Equity financing? Do firms have difficulty in financing accessibility? If so then what are the reasons? Do businesses resort to selling off assets to acquire funding? To evaluate these inquiries, we utilized diverse question formats, such as ranking alternative choices, binary selections, and closed-ended responses using a 5-point Likert scale. This facilitated quantitative analysis of the answers. The Likert point 1 indicates very important and 5 to the unimportant. The descriptive research design was employed to attain the research objectives.

DATA ANALYSIS AND DISCUSSION

This section presents data analysis and discusses their results.

Demographic Profile

Table 1 displays the demographic composition of respondents, indicating that a majority were employed in manufacturing sectors, comprising 120 individuals (60.61%), while the remaining 78 (39.39%) worked in non-manufacturing sectors. Regarding firm age, the data reveals that 148 (74.75%) respondents noted their business organizations as matured, with over 10 years of establishment, whereas 50 (25.24%) respondents expressed their firms as relatively young, with less than 10 years of age.

In terms of level of debt, 128 respondents (64.65%) reported their firms having a higher debt ratio, while 70 (35.35%) indicated their organizations used less than 50 percent debt. Concerning job positions, 120 respondents currently serve as Chief Financial Officers (CFOs), while the remaining 78 held positions of CEOs or company owners. Moreover, the table highlights that 102 (51.51%) of respondents reported paying zero or less than 5% dividend, and 53.54% of firms were classified as small, with turnovers below Rs 500 million. Furthermore, respondents were queried about financial constraints, with 51.52 percent acknowledging their firms' struggles with financial issues at certain times, while the rest declared their companies as financially unconstrained. Overall, the findings suggest that the surveyed firms tend to be small, exhibit lower payout ratios, maintain high leverage, are younger in age, and self-report financial constraints, encountering

Table 1

Demographics for survey companies

This table provides insights into the demographic profile of respondents' firms in 2023, including firm type, maturity, level of debt usage, decision makers' positions, payout ratios, firm sizes, and self-declared financial constraints, based on responses from 198 financial executives.

Characteristics	Category	N	% of responses
Industry	Manufacturing	120	60.61
	Non-Manufacturing	78	39.39
Firm age	Less than 10	50	25.25
	=> 10 years	148	74.75
Leverage	Less than 50%	70	35.35
	=> 50%	128	64.65
Position	CFO	120	60.61
	CEO/Owner	78	39.39
Payout	Less than 5%	102	51.52
	=> 5%	96	48.48
Size	Less than Rs 500m	106	53.54
	=> Rs 500m	92	46.46
Self-declared type	Constraint	102	51.52
	Unconstraint	96	48.48

Table 2

Financial executives' preference over financing alternatives

The table shows the distribution of responses across various ranks, with ranking priorities ranging from 1 (most preferred) to 6 (least preferred). Composite mean rankings are determined by assigning scores from 1 to 6, reflecting preferences from highest to lowest. The table includes the percentage of responses, the total number of respondents, composite mean scores, and their corresponding ranks. A lower composite mean signifies the most favored financing option, while a higher mean score denotes the least preferred financing type among Nepalese non-financial firms. "Imp" and "v.imp" stand for important and very important, respectively.

Types of financing	Percentage of response within each rank[a]								
	% imp or v imp	1	2	3	4	5	6	Mean	Rank
Internal equity	92%	65.70	26.30	8.10	0.00	0.00	0.00	1.43	1
External equity	64%	17.20	46.50	33.30	2.00	1.00	0.00	2.23	2
Straight debt financing	43%	14.10	29.30	54.50	1.00	1.00	0.00	2.45	3
Straight preferred stock financing	4%	1.00	3.00	63.60	15.20	17.20	0.00	3.45	4
Convertible debt financing	3%	0.00	3.00	0.00	17.20	67.70	12.10	4.86	5
Convertible preferred stock financing	0%	0.00	0.00	3.00	14.10	16.20	66.70	5.45	6

a. These estimates are based on 198 responses of non-financial firms. A score of 0 is assigned when a source is not ranked.

Note: From survey 2023

financial challenges at various points in their operations.

Financing Policy

The pecking order theory goes on the assumption that financing costs increase when there is asymmetric information. Based on this theory, financing comes from different sources such as internal equity, debt, and new common stock. Companies utilize capital from these funds by first giving preference to internal equity as their primary source of financing, followed by debt. If additional funds are required, the last resort is obtaining new common stock. This theory postulates that business firms employ funding based on hierarchical order.

Typically, external funds are less favoured due to the existence of informational asymmetries between management and investors, suggesting that external funds are undervalued relative to the extent of this asymmetry (Graham & Harvey, 2001; Myers & Majluf, 1984). According to this theory, companies do not aim for a particular debt ratio; instead, they resort to external financing only when internal financing proves to be inadequate (Graham & Harvey, 2001). Furthermore, within firmly established management frameworks, internal profits would accumulate as unrestricted cash flow, while seeking external financing would be avoided to mitigate additional burdens and the potential dilution of monitoring and

control through unwanted oversight. The preference to employ internal funds for investment projects could either reflect a desire to reduce cost (flotation/bankruptcy) or to protect from dilution of control. To examine the priority rank of funding in Nepalese enterprises, managers were asked to rank different types of financing on a scale of 1 (first choice) to 6 (last choice) and the responses received are shown in Table 2.

As shown in Table 2, financial executives assigned first choice to retained earnings (rating 1.43, 92 percent), the second choice surprisingly to external equity (rating 2.23, 64 percent), third choice to debt financing (rating 2.45, 43 percent) and least choice to convertible preferred stock financing. The result reveals that Nepalese financial executives seem to follow hierarchy theory but not on same principle of pecking order theory, rather they prefer internal equity to external equity and finally debt. Managers tend to favor external equity over debt because equity carries less obligation compared to debt. This finding aligns with (Chen, 2004), suggesting that firms aim to evade unwanted monitoring and complications from creditors.

Which factors drive debt decision?

To examine the internal attributes affecting debt financing, a question was asked to the financial executives, which included various debt decision factors. It comprises ten statements altogether to know the information regarding leverage decision. The factors included in this questionnaire were review outcome of (Bancel & Mittoo, 2004; Graham & Harvey, 2001), and among other evidence. Specifically, high payout firms are regarded as financially unconstrained, whereas low payout, small, young, and low-rated firms are deemed financially constrained (Almeida & Campello, 2010). This intuition aligns with the notion that financially constrained firms exhibit significantly lower payout, as evidenced by (Cleary, 2006; Fazzari et al., 1988) and among others in the financial constraint literature.

Taking this into account, respondents from lower-paying firms were asked about factors that could potentially influence debt financing, and responses obtained are shown in Table 3. One of the most contentious issues regarding capital structure revolves around whether firms maintain target debt ratios. As per the trade-off theory, firms establish an ideal debt ratio by weighing the advantages and disadvantages of debt, as illustrated by Scott Jr (1976). This theory suggests that the benefit of utilizing debt lies in the tax advantage gained through interest deductibility, as proposed by Modigliani and Miller (1963). Conversely, the drawbacks associated with debt include financial distress costs and personal tax obligations for bondholders upon receiving interest income. Table 3 illustrates that financial flexibility emerges as the most significant factor followed by insufficient internal funds and tax advantages from interest deductibility in debt financing. The percentage of respondents indicating very important or important for these factors are 74.20, 71.70 and

	% imp or very imp	Mean	Respondents: Sorted Criteria													
			Size		Industry		Position		Firm age		Leverage		Payout		Constraint	
			Small	Large	MT	HHO	CFO	NCFO	<10 yrs	> =10 yrs	< 50%	>=50%	< 5 %	>=5 %	FC	NFC
Financial flexibility	74.2	2.01	1.92	2.12	1.85	2.10	2.02	2.01	1.86	2.06	2.02	2.00	1.95	2.07	1.99	2.02
Insufficient internal fund	71.7	2.13	2.17	2.08	2.19	2.09	2.17	2.12	2.20	2.10	2.22	2.03	2.17	2.08	2.14	2.08
Tax advantage of interest deductibility	59.6	2.36	2.68	2.00***	2.64	2.20***	2.48	2.33	2.98	2.22***	2.28	2.45	2.70	2.01***	2.72	1.98***
Volatility of the firm's earnings and cash flow	57.1	2.42	2.58	2.25*	2.41	2.44	2.52	2.40	2.50	2.40	2.29	2.57*	2.94	1.88***	2.87	1.92***
We limit debt so that suppliers/customers are not worried	39.4	3.04	3.06	3.01	3.22	2.93	3.10	3.02	3.10	3.01	2.80	3.28***	3.38	2.67***	3.33	2.66***
Issuing debt gives investor better signal	37.1	2.97	2.93	3.02	2.86	3.04	2.71	3.04*	3.06	2.95	2.96	2.99	2.74	3.23***	2.74	3.27
Size of the firm	36.9	2.98	3.01	2.96	3.12	2.91	3.17	2.94	3.10	1.95	3.15	2.81**	2.89	3.08	2.90	3.08
Asset tangibility	32.3	2.99	2.90	3.11	3.04	2.95	2.98	3.00	2.92	3.02	3.13	2.86	2.75	3.25***	2.77	3.22***
Growth opportunity of the firm	27.8	3.28	3.39	3.16	3.28	3.30	3.62	3.19**	2.90	3.41***	3.15	3.47	3.44	3.11*	3.45	3.07**
Management attitude	17.7	3.61	3.87	3.32***	3.74	3.54	3.52	3.63	3.78	3.55	3.42	3.81***	3.96	3.24***	3.95	3.24

Respondents are asked to rank on a scale from 1 (very important) to 5 (least important). The table presents the overall mean and the percentage of respondents who assigned ranks of 1 and 2 (very important). ***,**,* denotes a significant difference at 1%, 5%, and 10% level respectively. MT, HHO and CFO indicate that manufacturing & trading, hotel, hydro & other (non-manufacturing) and chief financial officer respectively.

59.60 respectively. The survey findings support the conclusions drawn by Faff et al. (2016), indicating that most Nepalese firms also aim to circumvent financial difficulties posed by lenders.

Furthermore, the lower rating of 2.08 for high payout firms suggests that they rely more on debt in cases of insufficient internal funds compared to less payout firms, which received a rating of 2.17. Financial flexibility emerges as a more critical factor for small firms (mean rating 1.92 vs. 2.12 for large firms). However, insufficient internal funds and the tax advantage of interest deductibility are deemed more important by respondents from large firms, hotels, hydro companies, non-chief financial officer (NCFO) positions, young firms, and firms with low payout policies regarding debt policy factors.

Respondents from non-manufacturing sectors (mean rating 2.09 vs. 2.19), NCFO positions (mean rating 2.12 vs. 2.20), firms with over 50% leverage (mean rating 2.03 vs. 2.22), and respondents from low-paying firms (mean rating 2.01 vs. 2.70) consider tax advantages of interest deductibility as the second and third most important factors in debt financing. The views of respondents from less paying and non-paying firms significantly differ at the 1% level of significance.

Contrary to prior literature, notably, tax advantages emerged as significant for large firms, hotel & hydro industries, more established firms, low-leverage firms, unconstrained firms, and high payout firms. Intriguingly, this result contradicts Faff et al. (2016) findings, which suggest that tax advantages on debt were not deemed important for debt financing. Our research implies that the lower cost associated with debt financing in Nepal, in comparison to equity financing, might contribute to these results. Additionally, investors in Nepal could decrease their personal tax liability on interest income by investing their surplus in the long-term financing of high-net-worth firms. In the investigation on whether a company's size affects its choice of debt financing, it is observed that this factor has a moderate impact on debt decisions, scoring 2.98 (37%) as shown in Table 3. Moreover, it appears that companies with lower pay (average rating of 2.89 compared to 3.04) and financial constraints (2.90 compared to 3.08) consider size a significant factor in their financing choices.

The table displays the percentage of responses for each rank within a priority ranking system, ranging from 1 (very important) to 5 (least important). Composite mean rankings are calculated using scores from 1 to 5, indicating the rating from most important to least important factors. A smaller composite mean signifies the most important factors, while the highest mean score designates the least important factors in debt financing for Nepalese non-financial firms. (Based on survey responses to the question: Has your firm paid dividends of less than 5%? If yes, what factors influence the firm's decision about leverage? "Imp" and "v.imp" stand for important and very important, respectively.

Table 4
Factors affecting equity financing

The table reveals the percentage of managers indicating very important and important, mean of overall sample and sub samples of non-financial firms based on their priority factors on equity financing decision. The ten factors are presented in the order of their importance that is retrieved from a survey questionnaire of 198 financial executives.

Equity financing factors	Survey question: What factors affect your firms' equity financing decisions? [a]													
	% Imp & V imp	Mean	Size		Industry type		Executive		By Firm age		Respondent age		By Liquidity	
			Small	Large	MT	HHO	CFO	NCFO	<5	>=5	<30	>=30	<2	>=2
Increase market to book ratio	85.9	1.71	1.57	1.87**	1.86	1.62**	1.69	1.71	1.80	1.68	1.49	1.78	1.80	1.64
Earnings price dilution	80.8	1.87	1.94	1.78	1.89	1.85	1.98	1.84	1.97	1.56**	2.10	1.79*	1.82	1.91
Issue stock while stock price getting high	74.7	1.90	1.74	2.09**	1.35	1.92	1.71	1.95	2.00	1.86	2.35	1.75***	1.91	1.89
The amount by the stock is UV /OV by the market	52.6	2.68	2.72	2.63	2.51	2.77	2.19	2.81	3.12	2.53	3.31	2.47**	3.03	2.39**
Sufficiency funds from profits to fund new project	52.5	2.55	2.43	2.67	2.49	2.59	2.79	2.48	3.00	2.88	2.39	2.60	2.42	2.65
Stock is least risky source of fund	42.5	2.69	2.53	2.87***	2.65	2.71	2.50	2.74	2.48	2.57	2.69	2.68	2.60	2.75
Capital gain tax faced by investors relative to tax on dividend	39.4	2.99	3.13	2.87	3.28	2.83***	3.45	2.87***	3.36	2.86**	3.00	2.99	3.01	2.99
Inability to obtain funds from debt, preferred stock, and other source	37.3	2.85	2.74	2.98	2.73	2.92	2.95	2.82	3.04	2.78	2.53	2.95**	2.76	2.92
Maintaining target debt-equity ratio	35.4	2.91	3.06	2.74**	2.88	2.91	3.02	2.88	2.56	2.73	2.84	2.93	2.83	2.97
Common stock is lower cost of financing for the firm	33.4	3.26	3.28	3.24	3.55	3.10**	3.21	3.28	3.32	3.24	3.45	3.20	3.32	3.22

*a Respondents are asked to rate on a scale of 1 (most important) to 5 (unimportant). The independent sample t-tests are conducted to see the group mean differences. ***.**,* symbolizes a significant difference at the 1%, 5%, and 10% level respectively. MT-Manufacturing and Trading firms, HHO-Hotel, Hydro and Others, CFO-Chief Financial officer, and NCFO-Non-Chief Financial officer, UV-undervalued, OV- Overvalued.*

What factors drive equity financing decision?

To examine the equity financing policy, financial executives were asked to rank each factor on a scale from 1 (most important) to 5 (least important) and their responses are shown in Table 4. The "increase market to book ratio" (85.9%) emerges as the most significant factor influencing equity financing decisions, followed by earning price dilution (80.8%). It is evident that many general finance textbooks underscore the significance of the market to book ratio, suggesting that as market prices rise, firms tend to issue equity to raise capital. Similarly, finance textbooks also assert that earnings per share (EPS) will not be diluted if a firm receives the required rate on equity issuance. More preciously, if the firm secures external financing through debt, there will be a boost in net income owing to its lower cost, while the number of shares remains unchanged, leading to an upturn in earnings per share (EPS).

Nonetheless, this strategy renders the firm more leverage and prone to risk, and under such circumstances, the stock price might not see an increase despite the elevated EPS. Financial executives generally agree that the issuance of common stock results in the dilution of earnings per share (EPS), as indicated by studies conducted by (Bancel & Mittoo, 2004; Graham & Harvey, 2001). Nepalese financial executives also share a similar belief that equity issuance is supported to some extent, with a mean rating of 1.87. There is no significant difference in the opinion on the importance of EPS dilution as a common equity policy among various respondent groups, except for the views of the group based on firm age and the age of the respondents, where mean ratings differ (1.56 vs. 1.97 and 1.79 vs. 2.10, respectively).

The view of financial executives based on different classification is similar except the size (small-1.74 vs Large 2.09) and age of the respondent (young-2.35 vs older 1.75). The cause may be the large firm is already established and these firms may not require additional financing. Approximately 53% of financial executives consider the degree of stock overvaluation or undervaluation to be important when issuing equity (mean rating of 2.68). Firms tend to avoid issuing common stock if they believe it is undervalued. This behavior supports the pecking order model of financing hierarchy, where firms prefer internal financing over issuing undervalued equity. Conversely, if executives believe their stock is overvalued, they are more likely to issue common stock, suggesting that managerial optimism may drive this pecking order-like behavior (Heaton, 2002).

Cross Country Analysis

Table 5 provides a comparative examination of financial factors impacting debt financing decisions globally. Notably, financial flexibility ranks highest in Nepal, with the tax advantage of interest deductibility following closely in second place in Nepal and fourth place elsewhere, except for the USA, where it ranks fifth. Earning volatility ranks

second in the UK and the Netherlands, fourth in Europe, third in the USA, and fourth in Nepal.

Graham & Harvey (2001), Bancel & Mittoo (2004), and Brounen et al. (2006) maintain that contemporary managers universally prioritize these factors, lending support to the tradeoff theory. Tax benefits rank second in Nepal and fourth in other sampled countries, except Australia, while volatility ranks second in the UK and the Netherlands and fourth in Nepal. Larger, dividend-paying firms demonstrate greater financial flexibility on average compared to smaller, less dividend-paying counterparts, indicating a diminished focus on financial flexibility due to reduced information asymmetry. This observation contradicts the pecking order theory but corroborates with the findings of Graham & Harvey (2001) and Brounen et al. (2006). Nonetheless, Nepalese managers place significant emphasis on financial flexibility and the tax advantage of interest deductibility when formulating their debt policy. It is noteworthy that the tax advantage on interest deductibility varies across different financial markets.

Causes Limiting the Use of Bank Loans

The managers were also asked to rank different causes that limit the firm to use bank loan on a scale of 1 (most important) to 5 (unimportant) and the responses received are shown in Table 6. The responses are categorized into four groups to compare the result based on size of the firm, dividend payout, liquidity, and self-declared constraint. Table 6 shows the causes of companies having limited access to bank loans. Several causes may affect the accessibility of loans from banks. When demonstrating the causes of external funding on investment of potential project, executives are permitted to check three of the five possible causes: 'we do need the fund', to avoid paying fees, 'interest rate is too high', 'banking process is too lengthy', and 'to save borrowing capacity for future use based on the study of Campello et al. (2010).

It is observed that the most important cause to limit the use of bank loan is high interest rate with a mean rating of 1.93, banking process is too lengthy with a mean rating 2.12 (68%), and to avoid paying fees with a mean rating 2.12 (44%).

Table 5
Comparative Analysis of Financing Decision: Respondents 'Ranking Factors Affecting Their Leverage Decision

Factors	Cross country financing decision factors: Respondents ranking of factors affecting their debt issuance decision					
	UK	Nederland	Europe (BJK)	Australia (FG)	USA(GH)	Nepal
Financial flexibility	1	1	1	1	1	1
Tax advantage of interest deductibility	4	4	4	NA	5	2
Volatility of earnings	2	2	4	5	3	4

Eighty three percent of the responding firms rated interest cause as one of most important issues in raising debt from Bank. The respondents from small, low-paying, and self-claimed constraint firms believe that interest rates are more significant. Similarly, respondents from high-paying and self-claimed unconstrained groups believe that avoiding paying fees is more significant (row 3, table 6).

In a nutshell, interest rates, banking processes, and avoiding paying fees are key reasons that firms' limit to use loans from banks, which is generally consistent with Campello et al. (2010). This is particularly evident in Nepal, where interest rates are notably high, making it challenging for firms to meet these financial obligations.

Besides, business enterprises in the country continue to grapple with the aftermath of the post-COVID period, struggling to fully restore their operations to pre-pandemic levels. Besides, interest is too high is a contributing factor to companies struggling to thrive and generate employment opportunities. It shows that the constraint on obtaining funds from banks is causing the firm to lose its business prospects. It has compelled companies to either defer their potential projects or liquidate current assets for financing.

Financial Constraints

To explore the answer to the question, whether managers from both financially constrained and unconstrained firms resort on selling existing assets to

Table 6
Causes of Limiting the Use of Bank Loan

The table displays the percentage of respondents indicating most important and important, mean of overall sample and sub samples of non-financial firms based on their priority causes on limiting the use of bank loan. The five causes are shown in the order of their importance that is retrieved from a survey questionnaire of 198 financial executives. Imp and v. imp indicate important and very important.

Causes to limit bank loan	% Imp & V. imp	Overall Mean[a]	Breakdown criteria							
			Size		Payout		Liquidity		Financial constraint	
			Small	Large	Low	High	Low	High	Constraint	Uncon-straint
Interest rate is too high	82.8	1.93	1.77	2.11**	1.78	2.08**	2.01	1.86	1.64	2.27***
Banking process is too lengthy	67.7	2.12	2.11	2.13	2.08	2.17	2.18	2.07	2.06	2.20
To avoid paying fees	43.5	2.75	2.81	2.67	2.92	2.56***	2.66	2.82	2.92	2.59**
To save borrowing capacity for future use	21.3	3.59	3.68	3.48**	3.57	3.60	3.38	3.75	3.58	3.59
We do not need the fund	19.2	3.67	3.94	3.35***	4.08	3.23***	3.72	3.63	4.00	3.35***

*a Respondents are asked to rate on a scale of 1 (most important) to 5 (unimportant). The independent sample t-tests are conducted to see the group mean differences. ***,**,* denotes a significant difference at the 1%, 5%, and 10% respectively.*
Note: From survey 2023

Table 7
Do businesses turn to selling assets to get funding?

The table presents mean comparisons for the proportion of firms indicating that they are presently selling more assets than in the previous year, categorized by group classification. Groups are defined by size, liquidity, payout, and self-declared constraints. Classification 1 is designated as constrained, while classification 2 is labelled as unconstrained for non-financial firms.

Constraint criteria	Classification		Difference
	1	2	
By size	2.30	2.28	0.019
	(0.53)	(0.46)	(0.07)
By Liquidity	2.61	2.04	0.577***
	(0.44)	(0.56)	(-0.012)
By Payout	2.18	2.42	-0.24
	(0.51)	(0.48)	(0.03)
By financially Constraint	2.15	2.45	-0.304**
	(0.54)	(0.44)	(0.09)

Executives rated items on a scale of 1 (less), 2 (same), 3 (more), and 4 (not applicable). Means were calculated based on various criteria: size (sales over 500 million for large firms), liquidity (liquidity ratio over 2 for high liquidity), payout (payout ratio over 5 percent for high payout), and constraint (self-declared constraints and unconstraint). Significance levels were indicated by ***, ** for 1% and 5% (two-tailed) tests, respectively.

mitigate their financing requirements in the aftermath of Covid-19 for the current year, the corresponding responses are outlined in Table 7. It exhibits mean comparisons of sample firms reporting whether they sale more existing assets in the current year than recent past across group classification. Firms are categorized as classification 1 for small, less liquid, low payout and self-declared constraint and classification 2 for large, more liquid, high dividend paying and self-declared unconstraint firms. Classification 1 is constraint firm and classification 2 is unconstraint firm. The table reports that an average of 51 percent of the constraint managers observed that they sold more assets than in the recent past.

Exactly 54 percent of constraint financial executives said that they sold more existing assets this year compared to 44 percent of the unconstraint managers. The difference of classification based on liquidity types and self-declared constraint have been found to be significant that different category firms used to sell their assets to imply fund for the future business. Moreover, constrained firms typically exhibit volatile cash flows, inadequate tangible assets, and opacity in information. Consequently, their inability to access the capital market increases firm risk, thereby reducing leverage. The result is in line with Lemmon and Zender (2010), firms encountering challenges in accessing the capital market turn to

selling their tangible assets to meet their financing requirements.

CONCLUSION AND IMPLICATIONS

The survey-based study primarily focused on factors influencing financing decisions, with particular emphasis on the decision criteria for financially constrained firms. These constrained firms, characterized by limited access to external financing, typically consist of younger, less established entities, rendering them more susceptible to external funding challenges. The findings regarding financing hierarchy diverged slightly from traditional pecking order theory. According to the study, financial managers first utilize internal equity and only resort to issuing shares to finance investment opportunities when internal resources are insufficient. If additional capital is needed, they turn to debt issuance. This finding contradicts the study by Myers and Majluf (1984) but aligns with the results of Chen (2008). The reason might be that Nepali investors are traditional, aim to manage funds for the long term, and prefer to avoid potential debt obligations and financial distress. Besides, firms using debt may encounter extensive paperwork and the vested interests of lenders. Key factors influencing debt financing decisions, as identified by financial executives, include financial flexibility and inadequate internal funds. The study also notes that most constrained managers reported an increase in asset sales compared to the recent past. Additionally, high interest rates, lengthy banking processes, and bank fees were identified as prominent barriers hindering firms in their debt financing endeavours.

Managerial implications: In contrast to the conventional pecking order theory, our findings reveal a deviation in financial managers' preferences, showcasing an inclination towards equity financing rather than debt financing. This inclination is grounded in the acknowledgment that opting for equity financing can offer the firm a more sustainable and less onerous source of capital in the long term. The substantial use of debt capital can impose significant financial obligations on the firm, potentially proving unsustainable and impeding its capacity to support upcoming projects. To address financial shortfalls, firms might contemplate an alternative strategy. Instead of turning to market-based debt or equity, it could be judicious to explore divesting existing assets to fulfil financing needs during periods of financial constraints. Financial flexibility appeared to be an influential variable on debt financing decisions indicating that young, small firms may be inclined to avoid distress and unwanted obligations. Therefore, managers should prioritize enhancing financial flexibility to ensure smooth business operations and effectively address any financial shortfalls.

Limitations and Scope for future research: As is widely acknowledged, there are various limitations associated with financial statements and primary questionnaires. However, if researchers believe that personal interviews and

focused group interactions with firm management and potential investors could provide a reflective insight into the current scenario and a clearer understanding of the financing direction, these methods may prove valuable. For example, conducting personal interviews with market players can uncover the primary factors influencing them and the various constraints they face in managing firms with external funds. Therefore, it is suggested that future researchers explore managers' opinions through qualitative research, delving into the potential issues they currently encounter in managing external financing. Furthermore, interviewing money suppliers could shed light on the prerequisites they demand before granting loans to companies. Additionally, the issue of financial constraints for small and medium enterprises is a global concern, particularly acute in Nepalese non-financial firms. There is a gap for future research to delve into such studies for small and medium enterprises.

Funding

The author declares that they have received no financial support for this study.

Conflict of interest

The author did not report any conflict of interest.

REFERENCES

Almeida, H., & Campello, M. (2010). Financing frictions and the substitution between internal and external funds. *Journal of Financial and Quantitative Analysis, 45*(3), 589-622.

Bancel, F., & Mittoo, U. R. (2004). Cross-country determinants of capital structure choice: a survey of European firms. *Financial Management*,*33*(4), 103-132.

Bancel, F., & Mittoo, U. R. (2014). The gap between the theory and practice of corporate valuation: Survey of European experts. *Journal of Applied Corporate Finance, 26*(4), 106-117.

Bellone, F., Musso, P., Nesta, L., & Schiavo, S. (2010). Financial constraints and firm export behaviour. *World Economy, 33*(3), 347-373. https://doi.org/10.1111/j.1467-9701.2010.01259.x

Brounen, D., De Jong, A., & Koedijk, K. (2006). Capital structure policies in Europe: Survey evidence. *Journal of Banking & Finance, 30*(5), 1409-1442.

Campello, M., Graham, J. R., & Harvey, C. R. (2010). The real effects of financial constraints: Evidence from a financial crisis. *Journal of Financial Economics, 97*(3), 470-487.

Carrizosa, R. D., Gaertner, F. B., & Lynch, D. P. (2023). Debt and taxes? The effect of Tax Cuts & Jobs Act of 2017 interest limitations on capital structure. *The Journal of the American Taxation Association*, *45*(2), 35-55.

Chen, J. J. (2004). Determinants of capital structure of Chinese-listed companies. *Journal of Business Research, 57*(12), 1341-1351.

Cleary, S. (2006). International corporate investment and the relationships between financial constraint measures. *Journal of banking & Finance, 30*(5), 1559-1580.

Faff, R. W., Gray, S., & Tan, K. J. K. (2016). A contemporary view of corporate finance theory, empirical evidence and practice. *Australian Journal of Management, 41*(4), 662-686.

Fazzari, S., Hubbard, G., & Petersen, B. (1988). *Financing constraints and corporate investment* (0898-2937). https://doi.org/10.3386/w2387

Frank, M. Z., & Goyal, V. K. (2009). Capital structure decisions: which factors are reliably important? *Financial Management*, *38*(1), 1-37. https://doi.org/10.1111/j.1755-053X.2009.01026.x

Fornell, C., & Larcker, D. F. (1981). *Structural equation models with unobservable variables and measurement error: Algebra and statistics.* Sage Publications.

Graham, J., & Harvey, C. (2001). The theory and practice of corporate finance: Evidence from the field. *Journal of Financial Economics, 60*(2-3), 187-243.

Graham , J. R. (2022). Presidential address: Corporate finance and reality. *The Journal of Finance, 77*(4), 1975-2049.

Hair, J., Anderson, R. E., Tatham, R. L., & Black, W. C. (1998). *Multivariate data analysis.* Prentice-Hall.

Hu Q., & Huang CD (2006), Using the balanced scorecard to achieve sustained IT-business alignment: A case study", Communications of the Association for Information Systems, 17(1), 181-204. https://doi.org/10.17705/1CAIS.01708

Heaton, J. B. (2002). Managerial optimism and corporate finance. *Financial Management*, 33-45. https://doi.org/10.1515/9781400829125-022.

Hennessy, C. A., & Whited, T. M. (2007). How costly is external financing? Evidence from a structural estimation. *The Journal of Finance, 62*(4), 1705-1745.

Jin, M., Zhao, S., & Kumbhakar, S. C. (2019). Financial constraints and firm productivity: Evidence from Chinese manufacturing. *European Journal of Operational Research, 275*(3), 1139-1156.

Kim, C.-S., Mauer, D. C., & Sherman, A. E. (1998). The determinants of corporate liquidity: Theory and evidence. *Journal of Financial and Quantitative Analysis, 33*(3), 335-359.

Kim, S., & Li, Z. (2021). Understanding the impact of ESG practices in corporate finance. *Sustainability, 13*(7), 3746. https://doi.org/10.3390/su13073746.

Lemmon, M. L., & Zender, J. F. (2010). Debt capacity and tests of capital structure theories. *Journal of Financial and Quantitative Analysis, 45*(5), 1161-1187.

Li, S., Ragu-Nathan, B., Ragu-Nathan, T., & Rao, S. S. (2006). The impact of supply chain management practices on competitive advantage and organizational performance. *Omega, 34*(2), 107-124.

Modigliani, F., & Miller, M. H. (1958). The cost of capital, corporation finance and the theory of investment. *The American Economic Review, 48*(3), 261-297.

Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. *Journal of Financial Economics*, *13*(2), 187-221. https://doi.org/10.1016/0304-405X(84)90023-0.

Pergelova, A., & Angulo-Ruiz, F. (2014). The impact of government financial support on the performance of new firms: The role of competitive advantage as an intermediate outcome. *Entrepreneurship & Regional Development, 26*(9-10), 663-705.

Pinegar, J. M., & Wilbricht, L. (1989). What managers think of capital structure theory: A survey. *Financial Management*, *18*(4), 82-91. https://doi.org/10.2307/3665800.

Pradhan, R. S., & Kurmi, M. (2004). A relationship between firm investment and financial status of Nepalese enterprises. *Journal of Management and Development Review*, *1*(1), 9-16.

Scott Jr, J. H. (1976). A theory of optimal capital structure. *The Bell Journal of Economics*,*7*(1), 33-54. https://doi.org/10.2307/3003189

Scott Jr, D. F., & Johnson, D. J. (1982). Financing policies and practices in large corporations. *Financial Management*, 11(2), 51-59. https://doi.org/10.2307/3665024.

Silwal, P. P. (2018). Financial constraint and external financing in Nepalese firms. *The Nepalese Management Review*, 157-170.

Subedi, K. D. (2017). Investment and financing policies of Nepalese enterprises. *Saptagandaki Journal, 8*, 47-55. https://doi.org/10.3126/sj.v8i0.18462

Titman, S., & Tsyplakov, S. (2007). A dynamic model of optimal capital structure. *Review of Finance, 11*(3), 401-451.