Exploratory Note 23

Applications and Conflicts

**INTRODUCTION**

Capital structure decision making in small firms is oftentimes very different from what we find in larger firms. This by no means renders the theories considered in the prior two exploratory notes useless, but it is worth noting and discussing the environmental differences. This is the primary subject matter of our final exploratory note of the evening.

**SMALL BUSINESS CAPITAL STRUCTURE DECISION MAKING**

According to finance theory, what should be the primary objective of management? And how do we operationalize this? Does debt help to mitigate the conflict between management and ownership? If so, how?

If we consider capital structure from the standpoint of debt-tradeoff theory (Modigliani and Miller), are the conclusions of this model in line with the primary objective of management discussed above?

But, what about when it comes to small, closely-held firms? Are their objectives the same? Regardless, should they be the same?

Why might smaller, closely-held firms make seemingly suboptimal decisions regarding capital structure? Is debt in such an environment similar in structure to debt in the public markets? If not, why does this matter?

Taking this a step further, small firm entrepreneurs and bankers typically behave less like partners and more like adversaries. Why?

Due to the constraints that they are faced with, small firms often utilize working capital for longer-term investment needs? What are the risks associated with such decision making? Is this behavior observed in larger firms as well?

Do smaller firms have to be careful when it comes to pursuing growth? Why?

**CONCLUSIONS**

What conclusions can we draw regarding the applicability of finance theory to small firm applications?