SHARE VALUATION: ITS SIGNIFICANCE AND PROBLEMS

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I. INTRODUCTION

In the theory of finance, there is a logical link between the maximization of shareholders' wealth, correct investment and financing decisions by companies, good disclosure of information to the investment community, efficient capital markets and a flourishing economy.

In this paper

i the above proposition is explained in sections II and III

ii the position of the analyst in a broking firm is discussed in section IV

iii the supply of information to the investment community is discussed in section V

iv in section VI it is suggested that improved disclosure by companies would lead to improved financial performance.

The main points in this paper are that

i security analysis has great importance in directing capital to its most efficient uses thereby maximizing economic growth.

ii security analysts need a great deal of varied information and in comparison with U.S. analysts they are poorly supplied. In respect of some aspects of information supply such as poor company attitudes, there is little that can be done. Because the informational needs of analysts are so varied, flexible machinery to require more disclosure is probably necessary.

iii the performance of Australian companies is poor. It seems probable that more disclosure of accounting and other information would cause more companies to see their objectives in terms of maximizing shareholders' wealth and thereby improve the quality of financial management and in turn improve financial performance.

II. MAXIMIZATION OF SHAREHOLDERS' WEALTH

It is accepted economic theory that when all units in an economy are striving to maximize their welfare, the total welfare is maximized so long as it is not negated by social costs (such as pollution) which do not accrue to the individual and so long as distribution of welfare is regarded as equitable. Maximization of shareholders' wealth or maximization of share price should be the objective of companies because this is the only operational form of the objective of profit maximization. No alternative objectives to profit maximization are as widely accepted and the concept continues to have a central place in the most thorough analyses of corporate objectives.
In order to maximize shareholders' wealth the company must understand and operate on the factors which affect share value. The factors which affect the value of a share constitute a share valuation model which is a concept that is central to financial management and security analysis - a fact which is explained in the leading textbooks of financial management. Financial management and security analysis are the two sides of the same coin. A share valuation model explains share price in terms of variables, the most important being growth in earnings per share, stability of growth in earnings per share, the degree of gearing, dividend payout and company size. Various studies of the importance of these factors have defined them in different ways but the factors fall into two classes: growth and risk.

The company can recognize investors attitudes towards these variables and influence them to maximize share value. The company does this by making decisions in respect of investment, financing and dividends and relating them to their effect on the valuation of the company. An understanding of the theory governing these decisions is helpful but not essential for an understanding of this paper, and a summary of the theory is given in an appendix. It is perhaps sufficient to mention two related propositions affecting share value. Firstly, a company can increase shareholders wealth only when it makes investments which yield a higher rate of return than the cost of capital. Secondly, unless prospective investments can yield such a return, all profits should be paid out as dividends.

III. THE IMPORTANCE OF INFORMATION TO SHARE VALUATION AND THE IMPORTANCE OF GOOD SHARE VALUATION TO EFFICIENT CAPITAL MARKETS AND ECONOMIC GROWTH.

The security analyst, equally with the financial manager should operate with regard to a share valuation model. The analyst must form an opinion on the values for the variables affecting share price to determine an intrinsic value. The intrinsic value is the value justified by the analyst's expectations and it should be compared with the actual market value. Depending on whether the shares in a particular company are under valued or over valued by the market, the investor would then buy or sell shares in that company.

The analyst attempts to determine relative value among alternative investment opportunities. In the long run, the return on an investment in a share consists of the dividends received and the price appreciation arising from actual or potential growth in earnings and dividends per share. The most attractive investments are those which are expected to show the greatest total return on investment allowing for the degree of risk relative to other alternatives. Such shares will have a market value that is low relative to their intrinsic value.

The analyst deals with an uncertain future using the past as a guide. He tries to estimate future profits for periods of one to five years or at least, to establish parameters for profit expectations. The financial reports are the starting point for an analysis of the trend in the growth and variability of earnings, the capital requirements and the profitability in relation to sales and capital. In order to assess their full meaning, the financial data should be related to general and industry economic factors, to product development, to past capital investments and to changes in management. An estimate of the future involves a wide range of variables including economic and industry forecasts, product
marketing projections, management capabilities and competitive developments. The riskiness of future profitability varies considerably and may be quite high. There may be a number of independent and uncontrolable variables and the sensitivity of profits to these variables may be high. The result may be highly uneven and unpredictable profits and losses. It is clear that the analyst requires sufficient information to understand the dynamics of a company.

Better information would enable more accurate share valuations to be made. This would lead to greater stability of share prices which would attract more savings into investment in ordinary shares. More importantly, it would result in better allocation of equity funds to companies. Capital is directed into its most profitable uses when the more profitable companies can raise capital at lower cost than the less profitable companies. The more profitable companies generally have more attractive investment opportunities and when the cost of capital to these companies is reduced, they can undertake more of these investments. To increase the cost of capital to the less profitable companies is to restrict their investments in the less profitable projects. The more profitable companies grow faster and on a wide scale, this process means the difference between fast and slow growth in the economy.

Professor Branton wrote in the London "Banker" that, "One of the difficulties in the post war period lies in the fact that the movement of resources from inefficient to efficient firms has worked far too slowly". It is, I suggest no accident that among the developed western economies, those countries with good disclosure requirements such as the U.S.A., Germany and Sweden have recorded economic performance superior to that of France and Italy which have poor disclosure requirements.

It is easy to be in favour of more and better disclosure. However the informational needs of the investment community and the practicability of supplying them is a complex question and is discussed in section V.

IV. THE POSITION OF THE ANALYST IN A BROKING FIRM

So that later discussion of the analyst's informational needs may be better appreciated, it is necessary to describe the position of the analyst in a broking firm.

Investment advisers report that the great majority of private clients do not exercise much independent judgement or bring much financial or analytical ability to bear on their investment decisions. The investment adviser should therefore have a good understanding of share valuation and he should be supported in his recommendations by sound investment research. However, private client advisers have to make many recommendations quickly, and the value of many transactions is not great enough to justify research effort. The private client adviser has to be very much his own analyst in comparison with the U.S. position where the advisers are known as salesmen and present a research department view on most stocks.

It is well known that business with large clients, mainly institutions, is more profitable than business with private clients. The institutions often employ their own analysts and are generally far more intelligent as investors. Because the business is more profitable and because the institutions expect research reports, investment research
effort is more profitably directed towards institutions. To be profitable, research should be orientated towards brokerage and the analyst and the institutional adviser should work together. Research to support a sell recommendation often proceeds from the review of the portfolio of an institution or overseas client. Research to support a buy recommendation may be of limited value unless an institution has indicated that it is a potential buyer. There are probably fewer than 200 companies, some would say 100, in respect of which a $1,000 research report is profitable as a buy recommendation.

Most small firms and many medium sized firms do not have a research staff. Research departments are costly to run and hard to manage. The salary and bonus of a good analyst probably ranges between $7,500 to $13,000 and overheads including library and publication expenses probably bring the per head cost to $20,000. Assuming a gross profit of .375% on turnover, (25% of 14% brokerage) an analyst must generate turnover of $5.3 million to break even. It is seldom possible to identify research generated turnover whereas a partner may be able to make large profits by astute trading or by turnover based on contacts. Unless there is a unanimous research orientation among partners, it is unlikely that research will be well conducted and well used. Unfavourable attitudes of partners towards research are likely to lead to policies that are self fulfilling. It is worth mentioning the saying about research in which there is some truth - "When there's a boom, you don't need it and when there's a slump you can't afford it". Security analysis has only become accepted as a part of stockbroking in the last ten years and the earlier industry and company studies tended to be superficial. Even now research is often seen as a training ground for other activities rather than as a career in itself. In my view, partnership is not a business form that is conducive to the most efficient organisation structure and management processes. Any weaknesses in management and any failure in research orientation is likely to find expression in the selection, management and payment of research personnel.

The key to good research is, of course, good personnel. A good analyst requires understanding of accounting, economics and business management which is seldom present in a young man without formal qualifications in accounting and economics and without experience in industry. There are very few courses of study in security analysis in Australia and none at the undergraduate level in Victoria. The result of these factors is that there are probably fewer than twenty good analysts in Melbourne broking firms.

V. THE SUPPLY OF INFORMATION TO THE INVESTMENT COMMUNITY

From the discussion of share valuation in section II, it is clear that the security analyst needs a great deal of varied information. The general need is strongly felt; the difficulty is in specifying what is required. The feeling of need is strengthened by comparing the supply of financial information in Australia with that in the U.S. Differences in the scale and development of the U.S. economy and the securities industry make this an unfair comparison, but the U.S. securities industry does provide many lessons for the Australian industry. in respect of all aspects of information; company accounts and publications, supplementary filed accounting information, company attitudes to the investment community, the comparability of accounting reports and the quality of the financial press and the statistical services, the U.S. analyst is much better off than the Australian analyst.
There appear to be no obvious methods of improving the information available to analysts. Most of the legislative activity has been directed towards disclosure in the accounts and the directors reports. With the exception of some desirable additional disclosure to be mentioned later, the legislation will upon its pending amendment have gone nearly as far as it usefully can go in the prescription of accounting disclosure for all companies. The difficulty is in prescribing requirements which in all times and circumstances are applicable and fair to all companies regardless of their size, industry, value and shareholding. The information required varies considerably between industries and broad statements applicable to all companies have little value. In the U.S., the Financial Analysts Federation Corporate Information Committee is making known its data requirements industry by industry. The Australian Society of Security Analysts is a very weak organisation by comparison and it unfortunately has not done anything in this regard. There is a further difficulty in that while much more disclosure is required of some companies because of the nature of their business and the level of investor interest, the prescription of disclosure requirements for a similar company may be a waste due to lack of investor interest. There are hundreds of stocks in which there is negligible interest, and which in my view, should not be listed.

The Eggleston Committee proposed a Companies Commission one of whose powers was to be, "to alter or add to the requirements as to accounts and the director's report". Another power was to be "to grant exemptions from the legislative provisions as to accounts in cases where compliance would impose unreasonable burdens or result in the supply of misleading or inappropriate information". Unfortunately the Bill to amend the Companies Act does not provide for a Companies Commission and instead provides that the State Registrar may grant relief from compliance with specific disclosure requirements where he believes that compliance would render the accounts misleading or inappropriate or would impose unreasonable burdens on the company.

Despite minimal disclosure by many companies, much can be learnt about them through painstaking research. Every company is continually dealing with suppliers, customers, employees, competitors and governments and its products, prices, terms and methods are known. The company may file subsidiary company accounts or have properties which are registered at the Titles Office. Its industry may have a trade magazine or have been the subject of a government, bank, newspaper or other study. From a variety of sources the analyst may piece together a fair picture of the company though his efforts are subject to the law of diminishing returns and are a waste of time for many companies.

Companies operating in the same industry invariably know vastly more about a particular company than the investment community ever knows. It is safe for any company to assume that its competitors know at least as much about them as the company knows about its competitors. It is clear that it is impossible to distinguish definitely between information that is public knowledge and that which is not.

Desirable additional accounting disclosure for all companies.

The Bill to amend the Companies Act presently before the Victorian and N.S.W. parliaments makes provisions relating to the accounts and directors reports. The additions are extensive and will
certainly facilitate analysis. Some of the items to be disclosed will be of little interest to analysts though they may sometimes provide a revealing talking point with company management or attract interest when they appear abnormal. There are several items which I believe companies should have been required to disclose. These items are:

i. Sales or turnover figures along the lines suggested by the Eggleston Committee.

ii. Lease expenses and lease commitments for the coming year.

iii. Sales and profits before tax by major activity along the lines required in the U.K.

While the basic data is disclosed, it would be a great convenience if companies were required to present the following:

i. Earnings per share and dividends per share adjusted for issues.

ii. A five year summary of significant items, particularly capital, shareholders funds, current and long term liabilities and assets, sales, pre tax profit, after tax profit, dividends and adjusted earnings and dividends per share.

In addition it would be desirable to have a ruling that profits and losses on disposal of non current assets be excluded in determining net profit.

**Reporting by Diversified Companies**

There is a need for more detailed information about the activities of the large and increasing number of major companies which are widely diversified. Companies such as B.H.P., C.S.R., A.C.I., Austim and Dunlop each have a range of activities which are subject to completely different economic influences. The effect on earnings prospects of a change in the factors surrounding a particular operation can only be gauged when the present significance and profitability of each operation are known. Consolidated financial information does not provide the necessary understanding of the economic dynamics of a diversified company. Reporting by diversified companies is a complex subject and in the U.S there is controversy over the various proposals for reporting standards. Considerable research is being undertaken and no conclusions are likely in the short term. At present however the Securities and Exchange Commission requires that diversified companies report the sales of major product groups where they account for more than 10% of total sales. In the UK, the director's report must disclose profit before tax and sales by major activity and by country of operation. The method of profit determination is a matter for the directors. Such disclosure seems a reasonable minimum until there is satisfactory experience in regulating more detailed reporting.

**The comparability of Accounting Information**

Accounting information in the U.S. is far better than in Australia in respect of its comparability but it is still far from perfect. Accounting practices in the U.S. allow less scope for a given transaction or financial position to be presented in a variety of ways and comparisons between companies are more meaningful. The investment community generally favours a more uniform application of accounting rules and greater precision in the definition of accounting principles. These views are often countered by management arguments for flexibility and judgement in the preparation of financial statements and against the effects of hard
and fast rules that may make unlike situations appear like. The investment community replies that disclosure of accounting methods is a poor substitute for comparability. The disclosure may permit an opinion to be formed on the degree of conservatism or otherwise in the financial statements but can seldom lead to a quantification of the effect of the treatment. Moreover, due to the great volume of financial information confronting investors, it is not practical to adjust accounts except in a minor way. It is felt that the real source of resistance to comparability comes from a desire for individual expression by accountants and managers.

The S.E.C. has sweeping powers in relation to accounting principles but it seldom exercises them. It works with the accounting profession and other interested parties in defining accounting practices and over the years, accounting procedures and methods of reporting have improved substantially. The Accounting Principles Board of the American Institute of Certified Public Accountants (AICPA) spends over $500,000 annually on accounting research and has published a series of Accounting Research Bulletins. Research findings and recommendations of best practice have succeeded in improving the comparability of financial statements.

The Institute of Chartered Accountants in Australia published a "Statement of Accounting Principles" in 1963. As was quickly pointed out by several writers, this statement (largely derived from the U.K. Institute) was not so much a statement of principles but a schedule of practices which provided ample scope for a given event to be described in varying ways. In the last few years, the journals of the Australian accounting bodies have had a plethora of articles along the lines of "What's Wrong with Accounting Statements". In my view, the Australian accounting profession is likely to move very slowly in improving accounting practice without stimulation.

Company Attitudes to Disclosure

In one sense it is correct for directors to say as they do, that they have no influence on the share price. But in another sense, everything they do affects share price. Financial theory says that management should pursue continuous share price maximization, though market forces outside management control may make this seem an impractical objective. However, it is true that the intrinsic value of most companies varies much less than their market value so that when the company is well understood, the market fluctuations can be minimised. There need be no question of a company trying to push its shares. In a well conducted financial relations programme where the proper information is given in the right manner at the right time to the right people, the price will reflect its own fair market value. In addition to fulfilling its obligation to its shareholders, the company will have (i) created a favourable climate for the acquisition of other companies, (ii) made itself more attractive to present and potential employees, particularly key management personnel and (iii) where there are advantages in having a large number of shareholders, achieved this and developed their loyalty.

In the U.S., companies recognise that it is the security analysts and not the shareholders who in practice do the most detailed share valuations. While the shareholders right to and need for information is great, it is impractical to supply all shareholders with the information an analyst may require. Recognising this fact, it is desirable for a company to make sure that the analyst is as informed as possible. The
A company's attitude should be open, helpful and affirmative rather than secretive, and defensive. It should initiate getting information to the analyst rather than passively waiting for the analyst to seek the information. While some inner matters should be kept confidential, a company should be prepared to provide an analyst with all the factual and most of the subjective information he requests. A visit to the company by the analyst is invaluable in confirming and correcting facts, filling in those missing details, learning industry details and providing the perspective and the subjective information that can only be had from a face to face meeting. The analyst can learn managers' reasons for their actions, their expectations, and form an impression of their ability.

The company must recognize that whether it likes it or not, analysts will try to estimate future earnings. In the case of a mining company, the analysts may estimate ore reserves and grades, crushing rate, recovery rate, costs and prices and financing method. Even with reasonable skill the analyst may be wide of the mark. It has been the practice of most Australian mining companies to be very reticent on their expectations for these variables and to be disapproving of those who are not. But while a company may face uncertainty in respect of some significant variables, it knows the future better than any outsider can. At the least, it can give an indication of the range of the values of the main variables and at best, it can give the range of expected earnings. In the absence of such information, the share price range will be greater and more people will lose money. Directors should consider that when they do not indicate that earnings will show a substantial increase, a shareholder selling his holding would lose just as much and feel just as cheated as a shareholder who bought shares on a highly inflated profit forecast. On the other hand, it would certainly be a sensible but rare thing for the directors to announce that they thought the company's shares were overvalued and that they personally were reducing their holding. After all, the equity investor should be the best informed of all suppliers of funds as his is the ultimate risk.

U.S. Accounts and Detailed Reports filed with the Securities and Exchange Commission

In the U.S., a distinction must be made between information that is presented to shareholders in the periodical reports and the information that must be filed with the S.E.C. The published accounts are usually a little more detailed than Australian accounts. The main difference is that U.S. accounts show sales, adjusted earnings and dividends per share, comparative financial over a five year period and seldom show the holding company accounts. The accounts must be reconcilable with the S.E.C. filings which are far more detailed. These filings are made in accordance with S.E.C. regulations which govern their form and content. The filings may be inspected at S.E.C. branch offices or purchased, but many brokers use abstracts and manuals compiled by bureaux such as Standard and Poor.

The S.E.C. regulations virtually take the place of the Australian Companies Acts disclosure requirements. However, the S.E.C. regulations only apply to companies whose shares are widely held and traded. Thus the Howard Hughes group of companies has a net worth which can only be estimated as being between $1.4 and $2.0 billion. It should be noted that New York Stock Exchange listing requirements presently call for a profit of more than $1,200,000 and a capitalization of more than
$12,000,000 though some present issues are smaller. in Australia, the accounts of the smallest public company and B.H.P. must meet the same requirements and are both filed for public inspection at the State Registrar's Offices.

The objective of the S.E.C. is effective disclosure with a minimum of burden and expense and this calls for a constant review of the practical operation of the rules and registration forms. If experience shows that a particular requirement is ineffective or unduly burdensome in relation to the benefits, modifications are considered and industry representatives are extensively consulted. In addition the S.E.C. normally gives advance public notice of proposals for the adoption of new or amended rules or requirements and invites comments. Exemptions from some of the disclosure requirements are made in certain circumstances, and in particular to smaller companies.

While the Australian Companies Acts have separate provisions for banks and insurance companies, the S.E.C. has separate provisions for companies in the exploratory, promotional or development stage, management investment companies, unit investment companies, non life insurance companies, life insurance companies, banks, utilities and property development companies. In addition to financial information, reports are required of management dealings in the stock (insider trading), the background and salaries of senior management, details of agreements such as lease and financing contracts and details of companies taken over.

The regulations set out the items which must be shown in the balance sheet and profit and loss statement and in seventeen supporting schedules. The balance sheet items are similar to the Ninth Schedule requirements though the profit and loss disclosure requirements are more detailed. The items required include sales, cost of goods sold, operating revenues, operating expenses, selling, general and administrative expenses, provision for doubtful debts, interest, non-operating income, special items and taxes.

The supplementary profit and loss statement must show the amount charged to profit and loss and to other accounts (i.e. capitalised) and the following items, cost of goods sold, operating expenses, maintenance and repairs, depreciation and amortization, taxes other than income tax, management and service contract fees and rents and royalties. Other supplementary schedules give details of balance sheet and other items such as debt, investments, capital and options and plant and equipment. Most are very detailed. The real estate schedule must show for each state in which property is held; farms, residential, apartment and business, and unimproved property and for each item, the encumbrances, the cost, the market value, the annual rents and interest, taxes, repairs and net income.

VI. DISCLOSURE AND THE PERFORMANCE OF AUSTRALIAN COMPANIES

There can be no definite statement as to how consciously Australian companies pursue the objective of maximizing shareholders' wealth. There are indications that very many do not. Firstly, the minimal disclosure by many companies suggests a deficiency of concern for share price. Secondly, the finance theory discussed in the appendix has been reasonably settled in the U.S. only in the last fifteen years and is as yet taught in few Australian universities. While the importance of the investment decision has long been recognised, the dis-
counted cash flow techniques of investment evaluation which are based on this finance theory are not extensively applied. Thirdly, the performance of Australian companies is poor. Perhaps the best evidence of this poor performance is a recently published study by P.A. Management Consultants of 400 listed companies with assets of over $4 million. The measures of financial performances were -

(i) Net profit before tax and interest as a percentage as a percentage of total assets. This is a test of management efficiency in using the company’s capital resources.

(ii) Net profit after tax as a percentage of shareholders funds. This is a measure of efficiency from the shareholders’ point of view and reflects the use of debt finance to gear up earnings.

(iii) Share price as a percentage of net tangible assets.

The study revealed that in respect of measure -

(i) 40% of companies earned less than 8% and 50% of companies earned less than 8.9% and only 15% earned more than the U.S. median of 13.1%.

(ii) The median return was 8.9% compared with 10.1% for U.S. companies. Higher rates of interest and company tax in the U.S. operated to prevent the difference being greater. However, U.S. companies used more debt capital than Australian companies even though interest rates were higher and this gearing had contributed to higher returns to shareholders. It is probable that the performance of Australian companies is worse than the comparison suggests due to the failure of many companies to revalue property held for long periods thereby understating total assets and shareholders funds.

(iii) 51% of companies were valued in the share market at less than their net tangible asset value. For this to occur, one or both of the following must have happened;

(a) investment of capital and retained earnings yielded lower returns than the cost of capital.

(b) the cost of capital increased.

While the cost of capital for all companies rose by about 3% in the last ten years, the high discount by which a large number of companies are selling below assets is prima facie evidence of widespread management failure to invest profitably.

The Australian Institute of Management has made awards to companies for good presentation of their annual reports and the latest adjudicators report notes the marked improvement in the quality over the ten years the awards have been made. Most of the companies receiving awards have recorded above average economic performance and there seems to be a correlation between disclosure and performance.

No doubt some of the most secretive companies will continue to be highly profitable. However it seems probable that improvements in the disclosure of accounting and other company information will cause more companies to see their objectives in terms of maximizing shareholders’ wealth and thereby improve the quality of financial management and in turn improve financial performance.
APPENDIX: INVESTMENT, FINANCING AND DIVIDEND DECISIONS

When management pursues the objective of maximizing shareholders' wealth it will attempt to identify the significance of the factors affecting share market value and act so as to maximize value. There are three types of decisions to be made which affect growth and risk and hence share value.

(i) The most important decision is the investment decision. This decision determines the total amount of assets held by the company, the composition of the assets and the business risk complexion of the company. Every activity of the company should be considered as an investment for each activity consists of an outlay on which a profit should be earned. When other factors affecting the share value are held constant, share price will be improved if the investment increases the investor's expectations of the earnings per share growth. This will happen when the rate of return on the investment exceeds the cost of capital. An often neglected aspect of this decision is the decision to disinvest or to withdraw funds from an unsatisfactory investment.

(ii) The financing decision concerns the combination of equity capital and debt capital. An increase in the proportion of debt, increases the return on equity capital from a given level of earnings before interest and taxation, but it also magnifies the variability of the return on equity capital. The share market reacts favourably to the increased earnings per share, but reacts unfavourably to the increased variability. The optimal capital structure will be that which maximizes share price. The actual amount of debt in the capital structure will be affected by the level of risk associated with the company's business. Companies with relatively stable earnings before interest and tax, employ debt financing with less effect on the variability of earnings to equity capital, than can companies with less stable earnings.

(iii) The dividend decision concerns the proportion of profits paid in cash dividends to shareholders, and the stability of those dividends over time. The dividend payout ratio determines the amount of earnings retained in the firm, and must be evaluated in the light of the objective of maximizing shareholders' wealth. The rate of return on reinvested earnings must exceed the return required by shareholders. If earnings are reinvested at less than the rate at which shareholders can reinvest them themselves, their wealth is decreased. When the return on reinvested earnings is much greater than the return required by shareholders, non-payment of a dividend may appear to be indicated. The justification in this situation for a dividend payment is that shareholders prefer to have their uncertainty about the future resolved and that a dividend payment has an informational content - that is, it is a means of making a statement that is far louder than words. A host of considerations relating to the variability of revenue, investment opportunities, and access to funds affect the dividend policies of companies in practice. The underlying theory is that the value of a dividend to investors must be balanced against the opportunity cost of retained earnings lost as a means of equity financing.

The three decisions are inter-related. The financing decision is affected by the dividend decision, and the financing and investment decisions affect each other. Because the decisions are inter-related they should be solved jointly, but this is difficult to do. This has resulted in the development of less direct methods for making investment, financing and dividend decisions; but the financial manager should relate each decision to its effect on the valuation of the company.