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The International Zero-Leverage Phenomenon

by

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Abstract

Extreme debt conservatism is an international phenomenon which has increased over time. While only 5% of the firms in our international sample maintained a zero-leverage policy in 1989, this fraction rose to roughly 15% by 2010. The increasing prevalence of zero-leverage firms is related to the different IPO waves and the accompanying changes in industry composition. In addition, we attribute the higher propensity to maintain a zero-leverage policy throughout all size and age groups to the increasing asset volatility during our sample period. Country-specific factors also affect extreme debt conservatism. Countries with a market-oriented financial system, higher creditor protection, and a classical tax system exhibit the highest percentage of zero-leverage firms. Analyzing the supply-side of firms' financing choices, we show that only a small number of profitable firms with high payout ratios deliberately maintain zero-leverage. In contrast, most zero-leverage firms are constrained by their debt capacity; they tend to be smaller, riskier, and less profitable, and they are the most active equity issuers. With respect to the demand-side of financing choices, we document that firms which follow a zero-leverage policy only for a short period of time seek financial flexibility. After abandoning zero-leverage, these mostly unconstrained firms jump to higher leverage ratios, make higher investments, and reduce their cash holdings by a larger amount compared to constrained zero-leverage firms, which remain debt-free for longer periods of time.

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