Finance: a field of interest

Veteran financial researcher and frequent author **Professor H Kent Baker** discusses the origins of his passion for the subject, as well as some of the exciting results and unorthodox methods that have led to his prominence in the field

Could you introduce your professional background, and explain what prompted your interest in finance, particularly in the behaviour of investors and corporate managers?

My interest in finance was largely generated as a result of taking my first course in finance as an undergraduate at Georgetown University, USA. The subject simply fascinated me, and from that point forward I knew I wanted be in the finance field. While in the MBA programme at the University of Maryland, I decided I wanted to be a professor and researcher in finance. What a wonderful life – helping others learn a captivating subject and adding to knowledge in finance through research. Being an academic would also give me the freedom and flexibility to pursue my interests and satisfy my curiosity.

What are your major research goals?

Throughout my academic career, my major research goal has been to contribute significantly to the finance literature by helping to bridge the gap between theory and practice among academics and practitioners. I've written dozens of articles trying to identify and explain these gaps, mainly in corporate finance and primarily using survey research. My peers recognize me as one of the leading survey researchers in the field. I have published more survey-based articles in peer-reviewed academic journals than perhaps any other finance academic. Additionally, I co-authored a book, *Survey Research in Corporate Finance – Bridging the Gap between Theory and Practice* (Oxford University Press, 2011).

Throughout your career, you have written papers about an enormous range of subjects relating to finance. Are there benefits from having a broad spectrum of expertize?

Academics often have a narrow focus. Many are highly knowledgeable about a very limited area. While this has

advantages, I find that limiting my attention to a single area over long periods can be boring. My diversity of research interests in such areas as finance, accounting, management, and education stems largely from my educational background, which reflects a diversity of degrees and designations. Specifically, I have a BSBA in Management from Georgetown University, an MBA and DBA in Finance from the University of Maryland, an MEd in Educational Administration, an MS in Quantitative Methods, an MA in Training and Career Development, a PhD in Educational Administration and Organizational Development, and a PhD in Counselling and Student Development from American University. I also hold Chartered Financial Analysts (CFA) and Chartered Management Accountant (CMA) designations. Thus, the major benefit of having a range of areas of expertise is to keep constantly engaged.

You have established yourself as one of the leading academics in the area of survey research. Why do you approach finance in this way?

My interest in survey research resulted from two pragmatic factors. First, this methodology is a highly appropriate way to identify gaps between theory and practice. That is, surveys can produce data that are unavailable from other sources. Hence, survey research has been the favourite methodology for achieving one of my primary research goals. Second, although today an abundance of databases are available, few (if any) financial databases were readily accessible for conducting research on topics that interested me when I started my academic career more than 40 years ago. Thus, by both design and necessity, I relied on obtaining primary data because secondary data were either unavailable or expensive.

You have taken on consultancy and training roles for a large number of organizations, including the Central Intelligence Agency (CIA), several US departments and the American Bankers Association. How does your expertize help bring benefits to these organizations?

My services as a consultant or trainer have benefited the organizations in different ways depending on the nature of the relationship. In some instances, for example, I have worked as an organizational development consultant helping managers cope with conflicts, improve interpersonal relationships and communication, and alter the organization's culture. In other instances, I've provided specific management training on leadership, conflict styles, time and stress management, constructive discipline, and many other areas. Additionally, I have helped literally thousands of candidates prepare to take the CFA examination. In short, the benefits that I bring vary from client to client depending on the purpose of the engagement.

Survey successes

Innovative work in the field of finance has been taking place at American University's **Kogod School of Business** in Washington, DC, focusing on achieving new results using survey methods – a way of working that has not become popular in finance until recently

THE PRACTICAL VALUE of studies in finance should be immediately apparent, even to outsiders. In recent years, the financial behaviour of corporations and governments has come under increasing scrutiny – especially as this conduct, or misconduct, has driven crashes and crises affecting the entire globe. While most people recognize the profound impact of financial decision making on their lives, some consider financial research as being unexciting.

In fact, the truth is far removed from this impression. The study of finance includes the study of human behaviour, which is an exciting topic. Finance has evolved over time as have the assumptions about economic behaviour. For example, traditional finance assumes that people behave rationally and predictably, whereas behavioural finance recognizes that this is not always the case. When all aspects of finance are considered, the field is not only of practical importance, but also of significant intellectual interest.

THEORY AND PRACTICE

Reconciling the rigidity of some financial models with the unpredictability of investors' actual economic choices – or bridging theoretical and practical approaches to finance – has been a persistent problem in the field. Since the mid-20th Century, the emphasis has shifted away from the normative assumptions of 'traditional finance' and toward a more behavioural approach that can cope with the cognitive and emotional biases that financial decision makers often encounter in practice. The problem of aligning the two aspects of finance requires new thinking and methodologies.

Few agents of change have been more active in this area than H Kent Baker, University Professor of Finance at American University's Kogod School of Business. A prolific contributor to the academic literature and frequent author of books and textbooks, Baker has been studying finance for more than 40 years – and has always been a proponent of less traditional methods. "I was doing research in behavioural finance long before the field of behavioural finance became popular," he remarks, and his ambitious goal to bridge the gap between theory and practice has also set his work apart from that of most of his contemporaries.

BEST BEHAVIOUR

Behavioural finance is a useful alternative to traditional finance in that it helps to explain some of the more interesting and counterintuitive decisions that investors make, emphasizing the multifaceted and situational nature of risk. Most people, for example, are loss averse – they tend to place more significance on the risk of losing money than the chance of an equivalent gain, skewing their financial behaviour. Another well-known bias is the sunk cost fallacy, whereby investors will continue to escalate investment despite poor returns because of their existing commitment. The field of behavioural finance recognizes these anomalies and the constraints that limit purely rational financial decisions in the real world.

> *Baker's widely read papers have covered topics from dividend policy and stock splits to mergers and ethics, using surveys to shed new light on the subjects*

The behavioural approach has gained ground in recent decades, but obstacles remain toward synthesizing traditional and behavioural finance in a useful way that can inform both theory and practice. One fundamental issue is that of data collection; historically, data in the field of financial research have come from secondary sources such as financial databases. Reliance on this form of data has become ingrained in the finance field.

PRIMARY DATA

Secondary data, however, are sometimes ill suited to the needs of researchers in behavioural finance. Over the course of his career, Baker has therefore carved out a niche as one of the leading financial researchers who rely on survey data. Surveys are a useful method for discovering new information in finance because they can provide data unavailable from traditional sources and can therefore suggest fresh avenues of research. Challenges such as generalizing results and the potential of non-response biases notwithstanding, survey data could be valuable in answering questions in many areas including financial management, investor behaviour, and financial education.

Despite the potential, this route has not been an easy one for Baker. "Survey research still has sceptics in finance and is sometimes looked down on in academic circles," he admits – and work employing this methodology does not often appear in the top finance journals. During the last 40 years or so, however, Baker has proven himself the exception to the rule; his widely read papers have covered topics from dividend policy and stock splits to mergers and ethics, using surveys to shed new light on the subjects. The geographical scope of these studies has also been broad, taking in the responses of participants in the US, the UK, Australia, Canada, Indonesia, Japan, Norway, Singapore, South Africa, Switzerland, and Thailand.

PAYING DIVIDENDS

With such a broad body of published research over a lengthy career, picking highlights is a challenge – but one area of particular success has been Baker's work on cash dividends in the US. Cash dividends are payouts that companies make to shareholders to reflect profits. The survey research conducted in this area demonstrates that the key determinants of dividend policy have changed little over the last 50 years. Of these, some of the most prominent and consistently identified factors are the pattern of past dividends, stability of earnings or cash flows, and the level of current and expected future earnings.

The set of common factors identified by surveys has inherent value, as Baker notes, however, "What may be important for one firm may be much less so or unimportant to another". An implication of this diversity is that accurately predicting dividend behaviour with a single 'one-size-fits-all' model has been challenging.

TURNING THE PAGE

Baker and his co-authors summarize the results of numerous surveys in their 2011 book *Survey Research in Corporate Finance – Bridging the Gap between Theory and Practice*. Although he still focuses his research on identifying gaps between theory and practice, he devotes himself increasingly to developing and editing books. "I have a comparative advantage relative to many of my colleagues; I have decades of experience in finance, strong organizational and editing skills, and enjoy the entrepreneurial activity of publishing books," he explains. Baker has already published more than 25 volumes and is working toward completing the remaining books in the 10-book *Financial Markets and Investments* series with Oxford University Press – a rare achievement.

SURVEY RESEARCH

RESEARCH INTERESTS

- Corporate finance
- Financial Markets and Investments
- Accounting
- Management
- Education

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PROFESSOR H KENT BAKER, is a University Professor of Finance in the Kogod School of Business at American University, where he served as the Chair of the Department of Finance and Real Estate for 11 years and headed the Finance Center of Excellence for eight years. Before joining the faculty at American University, he held both faculty and administrative positions in the business schools at Georgetown University and the University of Maryland. Baker is the past president of the Southern Finance Association and has served on several boards of directors. He has been the Dean of the Executive Management Institute since 1981.