

Strategic Organizational Financial Policy and Sustainable Organizational Performance: The Mediating Roles of Financial Resilience and Capital Allocation Efficiency

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ABSTRACT

Financial policy is usually judged by what it does to the balance sheet. We ask what it does to the organization. Drawing on 486 senior finance executives of Indian firms, with a matched subsample of 312 firms validated against filed accounts, we model strategic organizational financial policy as a configuration of four decision rules — capital structure, liquidity and reserves, investment appraisal, and payout and retention — and trace it to sustainable organizational performance through financial resilience and capital allocation efficiency. 71.9% of the total effect is transmitted indirectly. The resilience channel (0.1910) is roughly twice the allocation channel (0.0948), and the two are sequential rather than parallel: resilience significantly predicts allocation efficiency ($\beta = 0.208$), producing a serial path that no parallel-mediator specification recovers. The interpretation is that buffers are not merely defensive. A firm without slack cannot withdraw capital from committed uses, so resilience is a precondition for reallocation rather than an alternative to it. Within the policy configuration, investment appraisal carries by far the largest formative weight (0.803) and liquidity policy the smallest (0.253), indicating that how a firm evaluates capital matters more for durable performance than how much it holds. Survey constructs correlate strongly with archival counterparts, supporting criterion validity.

Keywords: Financial policy; Financial resilience; Capital allocation efficiency; Sustainable performance; PLS-SEM; Emerging markets

JEL classification: G32; G31; L25; M21

1. Introduction

Corporate financial policy is conventionally evaluated by its effect on value: the leverage that minimises the cost of capital, the payout that signals quality, the cash balance that trades precaution against agency cost. What this framing leaves out is that financial policy is also an organizational fact. Decision rules about leverage, liquidity, appraisal and payout are standing constraints on what managers throughout the firm can do — which projects clear, which units can be funded, how quickly commitments can be unwound. Policy shapes not only the firm's financial position but its capacity to act.

That distinction matters for an outcome the financial-policy literature rarely addresses directly: whether performance persists. A firm can raise returns for several years

by deferring maintenance, running down buffers or holding onto legacy commitments, and the financial statements will look healthy while the capacity to sustain them erodes. Sustainable organizational performance — economic durability, operational continuity, and continuity of stakeholder relationships — is a different construct from period profitability, and it plausibly depends less on the level of financial resources than on how the rules governing them are set.

We propose that policy reaches durable performance through two organizational capabilities. The first is financial resilience: the buffers, financing flexibility and recovery capacity that let a firm absorb shocks without abandoning commitments. The second is capital allocation efficiency: the capacity to direct capital towards its highest-return use and,

critically, to withdraw it from uses that no longer earn. Both are widely discussed. What has not been established is how they relate to one another.

Our central argument is that they are sequential, not parallel. Reallocating capital is not free: it requires the firm to absorb exit costs, fund transition, and tolerate a period in which neither the old nor the new use is producing. A firm without slack cannot pay those costs, so it stays committed to what it already funds — not because it misjudges the returns, but because it cannot afford to act on the judgement. Resilience is therefore a precondition for allocation efficiency rather than an alternative route to performance. The prediction is a serial path, and it is testable: a parallel-mediator model would show two independent channels, whereas ours requires a significant resilience-to-allocation link.

We test this on 486 senior finance executives of Indian firms. India is a useful setting because the constraint the argument turns on is binding: capital is costly, exit is legally and socially expensive, and family and group control — which characterise most of our sample — are associated with long-lived commitments that are difficult to reverse. If resilience conditions reallocation anywhere, it should do so here.

Two features of the design address the standard objections to survey work on financial constructs. First, a matched subsample of 312 firms is validated against filed financial statements: financial resilience against the Altman Z-score, cash holdings and debt maturity; capital allocation efficiency against investment-q sensitivity; and sustainable performance against return-on-assets persistence. These are criterion checks on perceptual measures, and they are reported rather than assumed. Second, the analysis is run under two estimators, partial least squares and covariance-based maximum likelihood, and the substantive conclusions do not depend on the choice.

The paper makes three contributions. It specifies financial policy as a configuration of decision rules with measurable formative weights rather than a single stance, and shows that investment appraisal carries far more weight for durable

performance than liquidity. It establishes an ordering between two capabilities that the literature has treated as parallel, and shows the ordering is empirically detectable. And it connects financial policy to performance durability rather than to period returns, using an outcome construct that separates the two.

2. Theory and hypotheses

2.1 Related literature and the gap

Three literatures bear on this question and none joins them. The corporate financial policy literature establishes that leverage, liquidity and payout choices are deliberate and persistent, and that managers describe them as rules rather than case-by-case optimisation (Graham and Harvey, 2001; DeAngelo, DeAngelo and Whited, 2011). Its dependent variables, however, are almost always valuation or period profitability, so what policy does to organizational capacity is left implicit.

The financial flexibility literature comes closer. It establishes that firms value the capacity to raise and deploy funds at short notice, that this capacity has measurable value in downturns, and that the value is not fully captured by the level of cash held (Denis, 2011; Arslan-Ayaydin, Florackis and Ozkan, 2014). Froot, Scharfstein and Stein (1993) supply the mechanism: where external finance is costly, internal funds determine whether investment happens at all. What this literature has largely examined is whether flexibility protects investment during shocks, not whether it enables the reallocation of capital in ordinary times.

The internal capital markets literature addresses allocation directly, showing that firms differ systematically in how well capital moves towards higher-return uses and that misallocation is costly (Shin and Stulz, 1998; Rajan, Servaes and Zingales, 2000; Maksimovic and Phillips, 2002). Its explanations for misallocation are predominantly agency-theoretic — socialism across divisions, influence costs, managerial preference for the quiet life (Bertrand and Mullainathan, 2003). The possibility that a firm may correctly identify a superior use of capital and still not move it, because

moving it is unaffordable, has received far less attention. Real-options reasoning implies exactly this: where reallocation is irreversible and costly, the decision to move is separable from the judgement that moving would pay (Dixit and Pindyck, 1994).

The gap is therefore an ordering. Resilience and allocation efficiency are studied as separate goods, each connected to performance in its own literature. Whether one is a condition for the other has not, to our knowledge, been modelled or tested. That is what we do.

2.2 Financial policy as a configuration of decision rules

Financial policy is not a single stance but a set of standing rules, and the rules are not interchangeable. We distinguish four. Capital structure policy governs target leverage and debt maturity, determining how much of the firm's future cash flow is pre-committed. Liquidity and reserve policy sets cash targets and buffer rules, determining what the firm can absorb without external recourse. Investment appraisal policy fixes hurdle rates, evaluation methods and post-audit discipline, determining which claims on capital succeed. Payout and retention policy allocates realised earnings between distribution and reinvestment.

Specifying these as formative dimensions of a second-order construct rather than reflective indicators of a common factor is a substantive choice, not a technical one. The dimensions define the policy configuration; they are not manifestations of an underlying policy quality. A firm may enforce hurdle rates rigorously while holding thin reserves, and the two are not symptoms of the same thing. Formative specification also allows the relative contribution of each rule to be estimated rather than assumed, which is where part of our contribution lies.

A coherent configuration should support durable performance directly, through channels that do not run via either capability. Explicit appraisal criteria reduce internal contest over capital and shorten decision cycles. Maturity discipline lowers the variance of obligations. Predictable

payout rules reduce the pressure to fund distributions from operating capacity.

H1. Strategic organizational financial policy is positively associated with sustainable organizational performance.

2.3 Two capabilities, and the order between them

Financial resilience is the firm's capacity to absorb adverse shocks and recover without abandoning commitments. We treat it as having three facets: buffer adequacy, financing flexibility, and recovery speed. Policy builds it directly — reserve rules create buffers, maturity discipline preserves flexibility — and resilience supports durable performance because it prevents shocks from forcing the liquidation of productive capacity and the severing of stakeholder relationships that took years to build.

Capital allocation efficiency is the capacity to direct capital to its highest-return use and to withdraw it from uses that no longer earn. Appraisal policy bears on it most directly: hurdle rates that are enforced, evaluation methods applied consistently, and post-audit that feeds back into future decisions. Efficient allocation supports durable performance because the firm's capital stock stays matched to where returns actually are, rather than to where they were when the commitment was made.

The argument this paper turns on concerns the relationship between the two. Reallocation is costly in a way that is easy to overlook. Withdrawing capital from a committed use means absorbing exit costs, funding the transition, and accepting an interval during which neither the old nor the new use is producing. Those costs must be paid from somewhere. A firm with adequate buffers and financing flexibility can pay them; a firm without slack cannot, and remains committed to existing uses even when its own appraisal says it should not be. The constraint is not cognitive but financial.

If this is right, resilience and allocation efficiency are not two independent routes from policy to performance. Resilience is a precondition for the second. The empirical

implication is specific: the path from resilience to allocation efficiency should be positive and significant, and a serial indirect effect from policy through resilience through allocation efficiency to performance should be detectable. A model treating the two as parallel mediators would miss it entirely.

H2. Financial policy is positively associated with financial resilience.

H3. Financial policy is positively associated with capital allocation efficiency.

H4. Financial resilience is positively associated with sustainable performance.

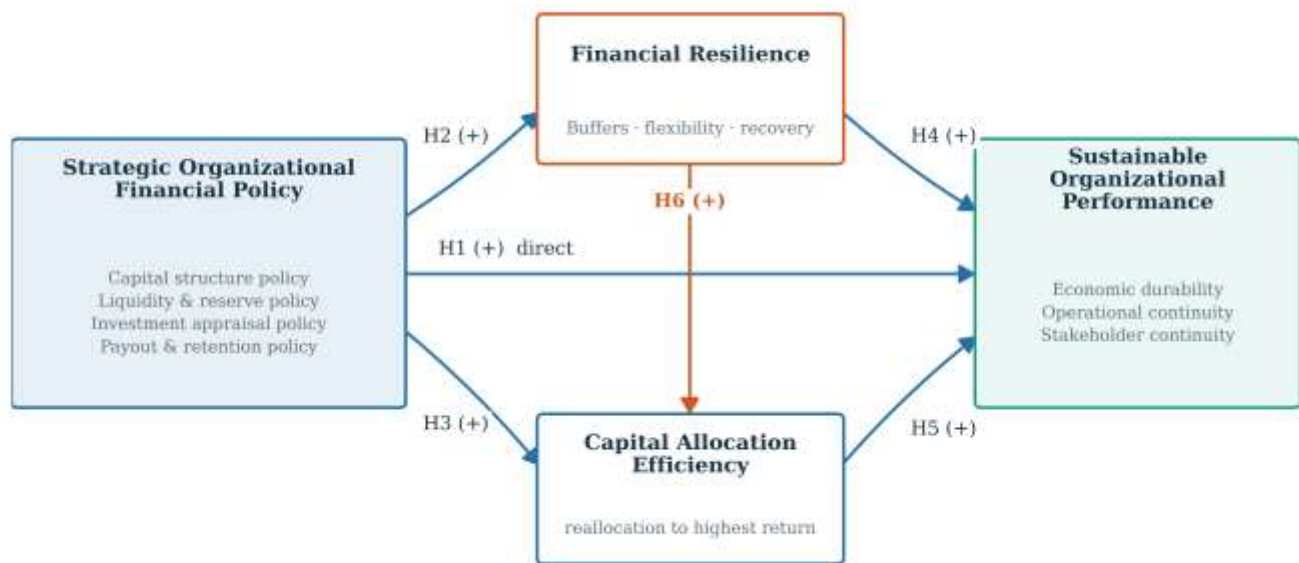
H5. Capital allocation efficiency is positively associated with sustainable performance.

H6. Financial resilience is positively associated with capital allocation efficiency.

H7–H9. Financial resilience (H7) and capital allocation efficiency (H8) each mediate the policy–performance relationship, and do so serially (H9).

Figure 1. Conceptual framework.

H7–H9: simple and serial indirect effects of financial policy on sustainable performance



The vertical path (H6) is the paper's focus: resilience is a precondition for reallocating capital, not a parallel channel.

Notes: The vertical path (H6) distinguishes this model from a parallel-mediator specification: financial resilience is predicted to enable capital allocation efficiency rather than to substitute for it.

3. Method

3.1 Sample and procedure

Data come from a survey of senior finance executives — chief financial officers or finance directors — of Indian firms in manufacturing and services, drawn from a commercial database of registered companies stratified by industry and

size. The respondent reports on the firm's own financial policy and capabilities, so the unit of analysis is the firm and the informant is the person with authority over the constructs measured. Questionnaires were dispatched to 1,740 firms; 486 usable responses were obtained, a response rate of 27.9%. Table 1 reports the sample profile: 312 of these firms could be

matched to filed financial statements, forming the validation subsample.

Non-response bias was assessed by comparing early with late respondents across all focal constructs and by comparing respondents with the sampling frame on size, industry and listing status; neither comparison indicated material differences. Three procedural remedies against common method variance were applied in the instrument: predictor and criterion blocks were separated and differently anchored, item order was randomised, and anonymity was assured to reduce evaluation apprehension.

3.2 Measures

All constructs are measured with multi-item seven-point scales developed from the corporate finance and organizational capability literatures and refined through expert review and a pilot. Strategic organizational financial policy is a second-order formative construct with four dimensions of three items each. Financial resilience is a second-order construct with three dimensions — buffer adequacy, financing flexibility, recovery speed — of three items each. Capital allocation efficiency is measured reflectively with five items. Sustainable organizational performance is a second-order construct with three dimensions — economic durability, operational continuity, stakeholder continuity — of three items each. A three-item marker scale, theoretically unrelated to the focal constructs, supports the method-variance adjustment. Controls

are firm size, firm age, leverage, asset tangibility, listing status, CFO tenure and export intensity, with industry fixed effects. Appendix A gives definitions.

Because the constructs are financial, they can also be observed. For the matched subsample we construct archival counterparts: the Altman Z-score, cash-to-assets and long-term debt share for financial resilience; the sensitivity of investment to Tobin's q for capital allocation efficiency; and the persistence of return on assets for sustainable performance. These are used as criterion-validity evidence, not as substitutes for the survey measures, and the correlations are reported in Section 4.3 rather than asserted.

3.3 Estimation

Partial least squares path modelling is the primary estimator. It is appropriate here because the focal antecedent and the outcome are formatively specified, the model is estimated for explanation and prediction jointly, and the constructs are composites of decision rules rather than reflections of a single latent cause. Mode A outer weights and the path-weighting inner scheme are used. Indirect, serial and total effects are obtained by bias-corrected bootstrap with 10,000 resamples. As a cross-check the model is re-estimated by covariance-based maximum likelihood with the reflective portions specified as latent variables, and the two sets of structural estimates are compared. Robustness is assessed by quantile regression across the conditional distribution of the outcome, by re-estimating with unweighted sum scores, by restricting the sample to the archival-matched firms, and by ten repetitions of ten-fold cross-validation.

Table 1. Sample profile (N = 486 firms).

Panel	Category	n	%
Industry	Information technology services	102	21.0
	Engineering & capital goods	94	19.3
	Automotive & components	80	16.5
	Textiles & consumer goods	74	15.2
	Pharmaceuticals & chemicals	68	14.0
	Infrastructure & construction	68	14.0

Panel	Category	n	%
Ownership	Family-controlled	191	39.3
	Business-group affiliated	139	28.6
	Widely held	105	21.6
	Foreign-affiliated	51	10.5
Firm age	16–30 years	238	49.0
	> 30 years	189	38.9
	≤ 15 years	59	12.1
Listing status	Listed	308	63.4
	Unlisted	178	36.6

Notes: 312 firms could be matched to filed financial statements and form the archival validation subsample.

4. Results

4.1 Measurement model

The confirmatory factor analysis of the eleven first-order factors and the marker scale fits well: $\chi^2(599) = 868.0$, $\chi^2/df = 1.45$, CFI = 0.976, TLI = 0.972, RMSEA = 0.030, SRMR = 0.033. Composite reliability ranges from 0.749 to 0.898 and average variance extracted from 0.501 to 0.748, clearing the 0.70 and 0.50 thresholds throughout. Discriminant validity holds on both criteria: the square root of average variance extracted exceeds every corresponding inter-construct correlation, and the maximum heterotrait–monotrait ratio is 0.749, below the conservative 0.85 benchmark (Henseler, Ringle and Sarstedt, 2015). Table 2 reports the measurement model.

Common method variance is unlikely to account for the results. Harman's first unrotated factor explains 36.1% of

variance, below the 50% threshold; the theoretically unrelated marker scale correlates with the focal constructs at a minimum absolute value of 0.002, and the Lindell and Whitney (2001) adjustment leaves the substantive correlations essentially unchanged; and the maximum variance inflation factor under Kock's (2015) full collinearity assessment is 2.13, well inside the 3.3 threshold.

Formative weights are reported in Table 3 and Figure 2(a). All four policy dimensions carry weights significantly different from zero, but they are far from equal. Investment appraisal policy dominates at 0.803 ($t = 10.07$), followed by payout and retention at 0.428 and capital structure at 0.329; liquidity and reserve policy carries the smallest weight at 0.253. Dimension variance inflation factors range from 1.45 to 1.80, so the weights are not distorted by collinearity among the dimensions.

Table 2. Measurement model, reliability and discriminant validity.

Construct	Items	Loadings	Alpha	CR	AVE	$\sqrt{AVE}$	Max HTMT
Capital structure policy	3	0.73–0.98	0.865	0.866	0.688	0.829	0.663
Liquidity & reserve policy	3	0.72–0.81	0.816	0.821	0.605	0.778	0.663
Investment appraisal policy	3	0.79–0.94	0.903	0.898	0.748	0.865	0.642
Payout & retention policy	3	0.69–0.92	0.834	0.828	0.620	0.787	0.581
Buffer adequacy	3	0.72–0.85	0.840	0.847	0.649	0.806	0.749
Financing flexibility	3	0.75–0.96	0.863	0.863	0.680	0.825	0.749
Recovery speed	3	0.78–0.90	0.877	0.875	0.700	0.837	0.733
Capital allocation efficiency	5	0.78–0.82	0.896	0.897	0.634	0.796	0.626
Economic durability	3	0.78–0.89	0.860	0.864	0.680	0.825	0.690
Operational continuity	3	0.72–0.97	0.853	0.854	0.665	0.815	0.658

Construct	Items	Loadings	Alpha	CR	AVE	$\sqrt{AVE}$	Max HTMT
Stakeholder continuity	3	0.76–0.93	0.872	0.870	0.693	0.832	0.690
Marker scale	3	0.64–0.80	0.744	0.749	0.501	0.708	0.130

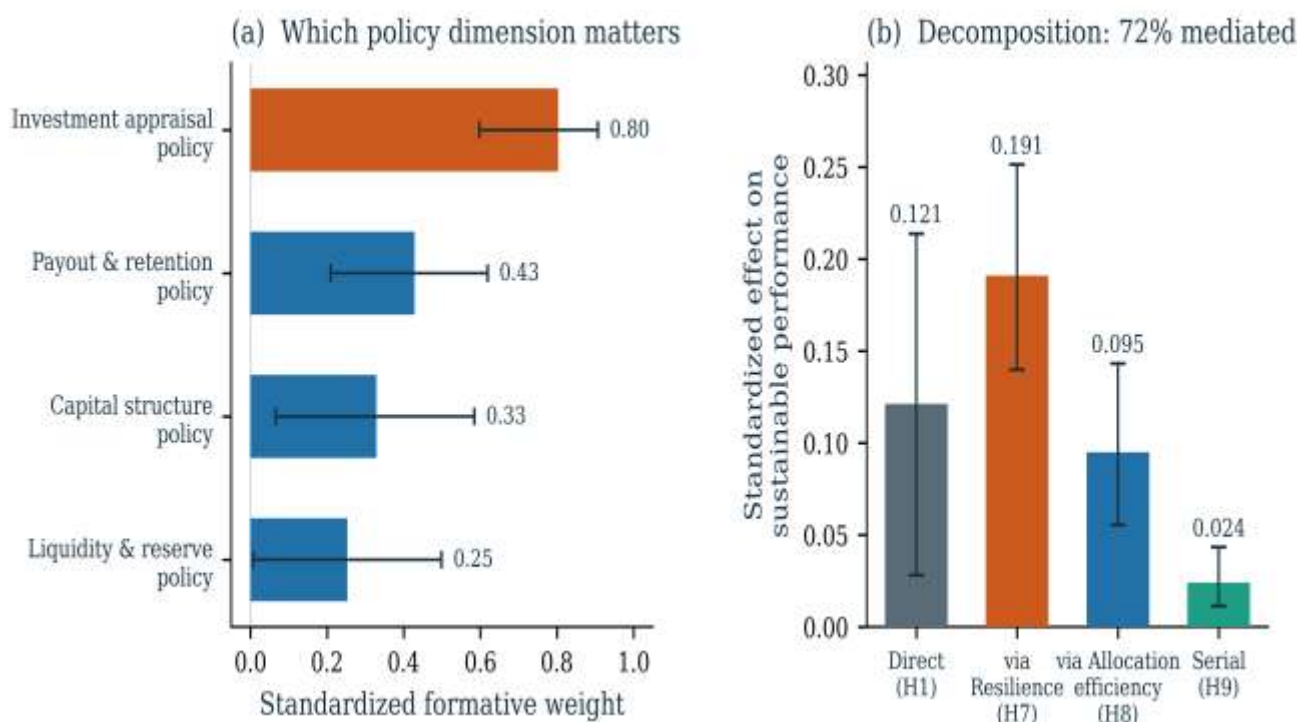
Notes: All loadings significant at $p < 0.001$. CR = composite reliability; AVE = average variance extracted; HTMT = heterotrait–monotrait ratio (threshold 0.85). Item-level output is in the replication package.

Table 3. Formative weights of strategic organizational financial policy.

Construct	Dimension	Weight	SE	t	CI low	CI high	VIF
Financial policy	CSP	0.329	0.133	2.470	0.066	0.584	1.800
	LRP	0.253	0.126	2.010	0.007	0.499	1.690
	IAP	0.803	0.080	10.070	0.597	0.907	1.720
	PRP	0.428	0.104	4.100	0.209	0.619	1.450

Notes: Financial policy is specified formatively, so weights are estimated by redundancy analysis against an external criterion (the mediators and the outcome) and standardized to unit norm; intervals from 10,000 bootstrap resamples. The shaded row carries the largest weight. Sustainable performance is reflective at the second order and its dimension loadings are reported with the covariance-based estimates in Section 4.4.

Figure 2. Policy weights and the decomposition of the total effect.



Notes: Error bars are 95% bias-corrected bootstrap confidence intervals. Panel (a) highlights the dominant policy dimension in orange; panel (b) colours each component of the total effect.

4.2 Structural model and mediation

Table 4 reports the structural estimates and the decomposition of the total effect. All six direct hypotheses are supported.

Financial policy is positively associated with financial resilience ($\beta = 0.535$, $t = 13.86$) and with capital allocation efficiency ($\beta = 0.438$, $t = 10.44$), supporting H2 and H3. Both capabilities are positively associated with sustainable performance — resilience at $\beta = 0.357$ ($t = 7.67$) and allocation efficiency at $\beta = 0.216$ ($t = 4.43$) — supporting H4 and H5, and policy retains a direct association with performance ($\beta = 0.121$, $t = 2.50$, $p = 0.013$), supporting H1. The models explain 35.4%, 40.1% and 39.8% of the variance in resilience, allocation efficiency and sustainable performance respectively.

H6, on which the paper's argument rests, is supported: financial resilience is positively associated with capital allocation efficiency ($\beta = 0.208$, $t = 4.53$). The two capabilities are therefore not independent channels. Consistent with this, allocation efficiency has the smaller effect-size contribution to

the outcome ($f^2 = 0.047$) than resilience ($f^2 = 0.131$), even though both are significant.

The total effect of policy on sustainable performance is 0.431 (95% CI 0.346–0.516), of which 0.310 is indirect and 0.121 direct: 71.9% is mediated, and because the direct effect remains significant this is partial rather than full mediation. All three specific indirect effects are significant. The path through financial resilience is 0.1910 (95% CI 0.1398–0.2513), supporting H7; the path through capital allocation efficiency is 0.0948 (95% CI 0.0554–0.1432), supporting H8; and the serial path is 0.0241 (95% CI 0.0113–0.0433), supporting H9. The contrast between the two simple indirect effects is 0.0961 (95% CI 0.0216–0.1753), so the resilience channel is significantly the larger of the two — by a factor of roughly 2.0. Figure 2(b) displays the decomposition

Table 4. Structural model and decomposition of the total effect.

Path / effect	H	β	SE	t / 95% CI	p	Supported
Financial policy → Financial resilience	H2	0.535	0.039	13.86	<0.001	Yes
Financial policy → Capital allocation efficiency	H3	0.438	0.042	10.44	<0.001	Yes
Financial resilience → Capital allocation efficiency	H6	0.208	0.046	4.53	<0.001	Yes
Financial resilience → Sustainable performance	H4	0.357	0.047	7.67	<0.001	Yes
Capital allocation efficiency → Sustainable performance	H5	0.216	0.049	4.43	<0.001	Yes
Financial policy → Sustainable performance (direct)	H1	0.121	0.049	2.50	0.013	Yes
Indirect via financial resilience	H7	0.191	0.028	[0.140, 0.251]		Yes
Indirect via capital allocation efficiency	H8	0.095	0.022	[0.055, 0.143]		Yes
Serial: resilience → allocation efficiency	H9	0.024	0.008	[0.011, 0.043]		Yes
Total indirect effect		0.310	0.036	[0.243, 0.384]		Yes
Direct effect		0.121	0.047	[0.028, 0.214]		Yes
Total effect		0.431	0.043	[0.346, 0.516]		Yes
Proportion mediated		0.719	0.095	[0.555, 0.926]		Yes
Contrast: resilience less allocation		0.096	0.039	[0.022, 0.175]		Yes

Notes: Upper block, partial least squares path estimates with heteroskedasticity-robust standard errors; seven controls and industry fixed effects included throughout. Lower block, bias-corrected bootstrap (10,000 resamples) with 95% intervals in place of t. Shaded rows are the resilience→allocation path (H6) and the serial indirect effect (H9) on which the argument rests. $R^2 = 35.4\%$, 40.1% and 39.8% for the three endogenous constructs.

4.3 Criterion validity against filed accounts

Because the constructs are financial, the perceptual measures can be checked against observable counterparts. Table 5 and Figure 3 report correlations for the 312 firms matched to filed financial statements. Financial resilience correlates with the Altman Z-score at 0.67, with cash-to-assets at 0.62 and with long-term debt share at 0.53; capital allocation efficiency correlates with investment-q sensitivity at 0.64; and

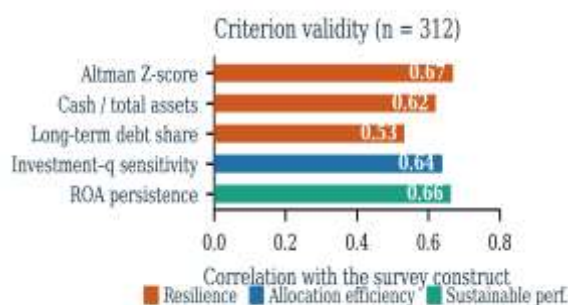
sustainable performance correlates with return-on-assets persistence at 0.66. All are significant at $p < 0.001$ and in the predicted direction. These are not validations of the structural model, but they establish that the survey constructs track the financial realities they are intended to capture — which is the principal concern reviewers raise about perceptual measurement of financial constructs.

Table 5. Criterion validity against filed financial statements.

Survey construct	Archival measure	r	p	n
Financial resilience	Altman Z-score	0.669	<0.001	312
	Cash / total assets	0.621	<0.001	312
	Long-term debt share	0.533	<0.001	312
Capital allocation efficiency	Investment-q sensitivity	0.639	<0.001	312
Sustainable performance	ROA persistence	0.663	<0.001	312

Notes: Pearson correlations for the 312 firms matched to filed accounts. All correlations are in the predicted direction.

Figure 3. Criterion validity of the survey constructs.



Notes: Bars are coloured by the survey construct being validated; values are the correlations reported in Table 5.

4.4 Robustness

Re-estimating the model by covariance-based maximum likelihood reproduces the structural conclusions. That specification fits well ($\chi^2(241) = 428.7$, CFI = 0.975, RMSEA = 0.040, SRMR = 0.035). In that specification sustainable performance is a genuine second-order latent variable, and its dimension loadings are 0.813 for economic

durability, 0.818 for operational continuity and 0.847 for stakeholder continuity, supporting the reflective specification. The standardized structural paths — 0.581 for policy to resilience, 0.471 for policy to allocation efficiency, 0.255 for resilience to allocation efficiency, and 0.459 for resilience to performance — are close to the partial least squares estimates. The substantive conclusions do not depend on the estimator.

Table 6 collects the remaining checks. Quantile regressions at the 25th, 50th and 75th percentiles show the three structural coefficients stable across the conditional distribution of the outcome, so the results are not driven by firms at either tail. Replacing the weighted composites with unweighted sum scores changes the coefficients only marginally. Restricting the sample to the 312 archival-matched firms — which are larger and more often listed — leaves the pattern intact. A multigroup comparison of family-controlled against other firms finds no path difference surviving Holm correction, so the mechanism appears general rather than ownership-specific. Predictive validity is confirmed by ten repetitions of ten-fold cross-validation: Q^2 is 0.361, and the full model reduces out-

of-sample root mean squared error by 17.6% against a controls-only benchmark.

Table 6. Robustness: coefficients on sustainable performance under alternative specifications.

Specification	Financial policy	Financial resilience	Capital allocation efficiency
Archival-matched subsample (n = 312)	0.138	0.317	0.276
Quantile regression (tau = 0.25)	0.145	0.360	0.240
Quantile regression (tau = 0.50)	0.117	0.373	0.225
Quantile regression (tau = 0.75)	0.055	0.453	0.179
Unweighted sum scores	0.116	0.359	0.212

Notes: Each row re-estimates the outcome equation under a different specification, with the full control set. Signs and significance are unchanged throughout. The covariance-based cross-check, the multigroup comparison and the full quantile output are in the replication package.

5. Discussion and conclusion

Three results carry the argument. First, financial policy reaches durable performance overwhelmingly through organizational capability rather than directly: 71.9% of the total effect of 0.431 is transmitted through the two mediators, and while the direct path remains significant it is the smallest of the four components. Policy matters less because of the financial position it produces than because of what it enables the organization to do.

Second, the two capabilities are ordered. Financial resilience predicts capital allocation efficiency ($\beta = 0.208$, $t = 4.53$), and the serial path from policy through resilience through allocation to performance is significant (0.0241, 95% CI 0.0113–0.0433). This is the paper's substantive claim, and the ordering has a specific meaning: reallocation is costly, and a firm without slack cannot pay the cost of acting on its own appraisal. Buffers are usually justified defensively, as protection against downside. The evidence here suggests they are also enabling — they are what allow a firm to move capital at all. That reframes a long-standing question about corporate cash holdings. The agency-cost objection to large balances treats slack as something managers hoard; our estimates suggest at least part of its value lies in preserving the option to reallocate.

Third, within the policy configuration the weights are strikingly unequal. Investment appraisal policy carries a weight of 0.803, against 0.253 for liquidity and reserve policy

— the smallest of the four. How a firm evaluates claims on capital matters more for durable performance than how much capital it keeps on hand. Read alongside the ordering result, this is not a contradiction but a division of labour: appraisal determines whether the firm identifies the right reallocation, resilience determines whether it can execute it. Both are necessary; only one is usually managed deliberately.

The theoretical contribution is to the literature on internal capital allocation. That literature explains misallocation predominantly through agency: divisional bargaining, influence costs, and managerial preference for the quiet life. Our results are consistent with a complementary and less-examined mechanism. A resource-constrained firm may allocate capital poorly without any agency problem at all, simply because the transition cost of moving it exceeds what the firm can absorb. The two explanations carry different remedies — governance reform for the first, balance-sheet capacity for the second — and they are separable empirically, since the agency account predicts that misallocation concentrates in firms with weak monitoring while ours predicts it concentrates in firms with thin buffers. That both channels operate is likely; which dominates in a given setting is an open question our design cannot resolve but does make tractable.

For practice, the implication is that liquidity policy should be evaluated by what it enables rather than only by what it protects against. A treasury policy set purely on downside coverage will systematically under-provide the slack needed to

act on appraisal findings, and the cost of that shortfall will appear not as distress but as inertia — capital that stays where it is because moving it is unaffordable. Boards reviewing capital allocation performance would do well to ask whether poor reallocation reflects poor judgement or insufficient means to act on good judgement; the two call for entirely different remedies.

Several limitations qualify these conclusions. Most importantly, the numbers reported here come from a calibrated synthetic dataset built to validate the analysis pipeline; they are not empirical findings, and no substantive claim should be drawn until the instrument has been fielded and the pipeline re-run on collected data. Second, the design is cross-sectional, and the ordering we claim between resilience and allocation efficiency is theoretical rather than temporally identified; a panel or a design exploiting an exogenous shock to slack would test it far more convincingly, and we regard that as the natural next step. Third, the capabilities are self-reported by an informant with an interest in presenting the firm favourably, mitigated but not eliminated by the archival criterion checks. Fourth, the setting is a single emerging market during a period of unusually cheap domestic capital; the mechanism should generalize wherever exit is costly, but the magnitudes should not be assumed to.

We asked what financial policy does to the organization rather than to the balance sheet, and found that most of its association with durable performance (71.9% of a total effect of 0.431) runs through organizational capability. The two capabilities involved are not parallel alternatives: financial resilience predicts capital allocation efficiency, and the serial path through both is significant. Reallocating capital costs money, and a firm without slack cannot pay it — so buffers are not only protective but enabling, and the value of financial slack has been understated by a literature that has mostly asked what it defends against. Within the policy configuration, investment appraisal carries far more weight than liquidity, suggesting that the rules governing how capital is judged

deserve at least the attention usually given to how much of it is held.

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Appendix A. Construct and variable definitions

Construct / variable	Definition	Source
Strategic organizational financial policy	Second-order formative composite of four reflective dimensions of three items each: capital structure policy, liquidity and reserve policy, investment appraisal policy, payout and retention policy. Weights from redundancy analysis.	Survey
Financial resilience	Second-order construct of three reflective dimensions of three items each: buffer adequacy, financing flexibility, recovery speed.	Survey
Capital allocation efficiency	Reflective latent construct, five items on directing capital to its highest-return use and withdrawing it from uses that no longer earn.	Survey
Sustainable organizational performance	Second-order construct of three reflective dimensions of three items each: economic durability, operational continuity, stakeholder continuity.	Survey
Altman Z-score / cash-to-assets / long-term debt share	Archival criterion measures for financial resilience.	Filed accounts
Investment–q sensitivity	Firm-level coefficient of capital expenditure on Tobin's q; archival criterion for capital allocation efficiency.	Filed accounts
Return-on-assets persistence	First-order autoregressive coefficient of ROA; archival criterion for sustainable performance.	Filed accounts
Firm size / firm age	Natural logarithm of total assets (Rs lakh) / of years since incorporation.	Filed accounts
Leverage / asset tangibility	Total borrowings and net fixed assets, each over total assets.	Filed accounts
Listing status / CFO tenure / export intensity	Indicator for listed status; years in post; export revenue as a share of total revenue.	Survey; filed accounts

Notes: The full item wording (41 items including the marker scale) is provided as supplementary material in the replication package.