The choice of types of debt

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Abstract

This study investigates whether large non-financial corporations with access to multiple debt markets engage in market timing. Existing empirical evidence shows that the debt structure of large rated firms in the U.S. have a more dispersed structure of debt securities compared to unrated firms. While the concentration of debt structure in unrated firms can be explained by the lack of access to alternative sources of financing, the heterogeneity of debt structure in rated firms remains a debatable issue. Although information asymmetry and agency costs of different types of debt, the two most cited theories in the capital structure literature, are two important considerations for the choice of debt, I argue in this research that large companies with a credit rating have another motive to choose to borrow from more than one type of debt, namely market timing. This is because these firms face lower information costs relative to unrated firms. More importantly, as long as issuers can choose between at least two alternative sources of financing, it is reasonable to expect them to choose the market where their issue is most over-priced.

Key words: financial markets, bank lending, bonds, market timing.

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