

STRATEGIC ACTIONS AND CREDIT SPREADS: AN EMPIRICAL INVESTIGATION*

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ABSTRACT

Do strategic actions of borrowers and lenders have an impact on corporate debt value? Our evidence indicates that they do, though the economic significance of the effect is limited. The possibility of renegotiation on average increases corporate debt spreads by 2-8 basis points due to the threat of strategic default, even though there may be ex-post efficiency gains to renegotiation. The effect of strategic actions increases to up to 40 basis points when bondholders' bargaining position in renegotiation is likely to be weak, including firms with high managerial shareholding, simple debt structures, and high liquidation costs. On balance, although incorporating strategic behavior may improve cross-sectional performance of debt pricing models, it is unlikely to remedy their inability to predict the general level of spreads.

Keywords: Credit spreads; Strategic debt service; Renegotiation; Liquidation costs; Bargaining power

JEL Classification Numbers: G12, G32, G33

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