Creditor Rights and Capital Structure: Evidence from International Data

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Abstract

Using data from 51 countries, we document evidence that creditor protection is an important country-level determinant of corporate capital structure. Specifically, strong creditor rights are associated with low levels of long-term debt. This pattern is robust to controlling for key firm characteristics (e.g., firm size, profitability, asset tangibility and growth opportunities) as well as various country-level factors (e.g., legal origin, financial market development and per capital GDP). In contrast, the effect of shareholder rights on leverage is relatively weak. The observed negative relation between creditor rights and leverage is not consistent with the view that strong creditor protection would induce lenders to provide credit to firms at favorable terms and thereby result in high corporate leverage. Rather, our results support the alternative view that strong creditor protection discourages managers (and existing owners) from making long-term cash flow commitment to service debt because of the high likelihood of losing control upon financial distress.

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