

Evidence on the External Finance Premium from the US and Emerging Asian Corporate Bond Markets

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Summary

Firm level heterogeneity and its implications for external finance have dominated the research agenda of financial economists over the last few years. Perhaps one of the most recent and promising extensions to this literature takes into account not only heterogeneity at the equity or bank level, but also in bond markets. The continuous development of bond markets in the US and, more importantly, in the emerging Asia raise number of questions about corporate finance. This paper examines the spreads of corporate and government bond yields for international currency denominated bonds in Asian markets versus the much larger and more developed US market, seeking to explain the relationship between the spreads and firm-specific characteristics. This provides an understanding of the determinants of the external finance premium in bond markets, and to the best of our knowledge, this topic has not been explored in the literature.

We approach this issue by looking at two dimensions. First, we compare how the cost of issuing corporate bonds (external premium) responds to firm-level balance sheet information to explore the degree of heterogeneity between firms on the basis of creditworthiness. Second, we examine the excess sensitivity of the premium to financial variables in the 2001-02 recession/credit crunch episode for US firms, and during the 1997-98 crisis for the Asian firms. Our formal econometric analysis shows that balance sheet characteristics are important determinants of the external premium for both the US and Asian markets. When we introduce firm-level heterogeneity we show that financial variables appear to be both statistically and quantitatively more important in the Asian market than in the US. Finally, the premium is more sensitive to firm-level variables during credit crunches, recessions and sudden stops than other periods, with stronger effects for the Asian bond market.