



BONDHOLDER REACTION TO INCREASES IN LEVERAGE

John Simpson  
Federal Trade Commission  
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convertible debt would be used only where bondholders have little information regarding a firm's riskiness or where the shareholder-bondholder agency problem is especially severe.

In a previous study, Mikkelson (1980) used a probit model to test whether the offer of debt with options privileges was correlated with a set of regressors that proxied for the severity of the shareholder-bondholder agency problem. Mikkelson found a statistically significant positive relationship between the offer of debt with options privileges and the maturity length of a debt issue, the leverage of the firm (debt/equity or debt/assets), and the growth opportunities of the firm (measured as the growth rate of assets). The size of the debt issue (issue size/equity or issue size/assets) was negatively correlated with the offer of debt with options privileges, but this relationship was not statistically significant. Mikkelson argued that these results generally support the agency explanation for convertible debt.

### III Empirical Results

In this section, a probit model is used to test whether the probability that a firm issues convertible debentures rather than straight debentures is related to both past changes in the firm's debt/assets ratio and the firm's present characteristics. Thus, whereas Mikkelson's model examines the present characteristics of the firm, this model examines both the firm's present characteristics and its past behavior. In this model an observation is an issue of debentures by a nonfinancial, nonutility firm between Jan. 1, 1980 and Dec. 21, 1987. To be























