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Corporate failures and the denomination of corporate bonds: Evidence from emerging Asian economies over two financial crises ☆

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ABSTRACT

Using a novel financial data-set which covers an extensive time period between 1995 to 2012, we test for the impact of currency denomination of bonds on Asian firms' survival probabilities. Our data span two financial crises: the 1997–98 Asian crisis and the 2007–09 global financial crisis. We find that during the former crisis firms with foreign currency denominated bonds face a higher probability of failure compared to firms with domestic bonds. On the other extreme, we find no notable differences between the 2007–09 financial crisis and tranquil times for both domestic and foreign issuers.

1. Introduction

It is generally accepted that during hard times lenders are more likely to withhold funds and interrupt lines of credit to less creditworthy firms forcing some of them to fail. The recent global financial crisis and the ensuing recession have spurred renewed interest in the relationship between access to capital markets and the incidence of corporate failures. Becker and Ivashina (2014) find evidence of substitution from loans to bonds at times characterized by contraction in bank lending supply and tight monetary policy. In the context of emerging market economies, Bolton and Freixas (2008) argue that bond financing, as a form of long-term finance, does not expose firms to the risks of bank runs and systemic crises. While

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bank-financed firms are fully exposed to the risk of bank loans, bond-financed firms are shielded from the adverse effects of a financial crisis and therefore are more likely to survive. In the Asian region, one lesson learned from the Asian crisis in 1997–98 suggests that providing access to well-developed bond markets could mitigate the negative effects of a financial crisis. Asia is potentially more prone to the adverse effects of foreign loan dependence due to the low level of corporate debt securities outstanding. Asian countries have been aware of this weakness since 1997 and have sought to develop their financial markets.

Since the 1997–98 Asian financial crisis, policymakers in the region have taken several steps to develop and strengthen their bond markets. One of the most well known regional initiatives was to establish an Asian Bond Fund to purchase dollar and local currency government bond issues (see Packer and Remolona, 2012). In particular, the ASEAN countries have co-ordinated the issue and trading of sovereign and quasi-sovereign bonds since 2003. They have also improved the infrastructure as part of a wider Asian Bond Market Initiative (ABMI) to create a more integrated regional market.

In this paper we assess the role of bond finance, considering the currency denomination of bonds, in firm survival during extreme economic events. Our data spans the 1997–98 crisis as well as the 2007–09 crisis and hence it provides a natural experiment to explore the impact of currency denomination of bonds over two different financial crises. This paper seeks to determine whether the beneficial impact of bond finance on firm survival holds when we distinguish between firms with foreign and domestic bonds during the Asian crisis and the recent global financial crisis.

Our work is related to two different strands of literature. First, we build on the empirical and theoretical literature that looks at the importance of financial status and borrowing constraints on firms' survival chances and concludes that firms in bad financial shape are more likely to fail (see Zingales, 1998; Bunn and Redwood, 2003; Clementi and Hopenhayn, 2006; Bridges and Guariglia, 2008). Our work moves this literature forward by examining the role of bond currency denomination. In addition, the present study differentiates the effects of domestic and foreign bond finance across crises and tranquil periods. This contribution speaks directly to the literature which has emphasized the important role of macroeconomic environment in survival (see Alvarez and Görg, 2009; Bhattcharjee et al., 2009).[1]

A second related line of work is the literature on the emerging economies financial development. According to Turner (2012), the development of the domestic corporate bond market will help firms to better endure financial crises and avoid currency mismatches. There is also significant evidence that firms increased cash stocks in Asia as a precautionary motive to ensure investment and growth (Guariglia and Mizen, 2012). The progress of development in Asia, especially for corporate bonds, has been rapid and steady since 2005, although it is lacking in terms of depth and liquidity compared to Western counterparts (Genberg and Sulstarova, 2008; Packer and Remolona, 2012; Mizen and Tsoukas, 2014). In our study we find that access to domestic bond finance is one factor that could ameliorate emerging markets crises and protect firms against failures. Hence, the promotion of deep and liquid regional bond markets should be at the top of the policymakers' agenda.

The remainder of the paper is laid out as follows. Section two illustrates the empirical specifications and the econometric methodology. In Section three we present a descriptive analysis of our data. Section four presents the empirical evidence. Section five concludes the paper.

2. Theoretical background and hypotheses

The theoretical rationale for expecting an effect from firms' financial position on their survival prospects is well documented in Clementi and Hopenhayn (2006). In their model borrowing constraints affect firm survival and this generates a role for capital structure in an asymmetric information setup. In our empirical analysis we take on board these predictions and we also consider the impact of access to bond markets on corporate failures. One basic premise of this study is that access to bond finance is associated with the establishment of reputation in the market. Companies with bond issues can directly tap the capital markets and therefore may be able to replace bank funding with funds directly raised on financial markets. In light of the above discussion, our first testable hypothesis is as follows:

Hypothesis 1. Access to a corporate bond market reduces firms' probability of bankruptcy.

Our motivation to examine the impact of currency denomination of bonds on corporate failures stems from the fact that foreign currency liabilities played a crucial role in amplifying the adverse effects of several crises in emerging markets (Bordo et al., 2010). The idea of foreign debt exposure is central in the above paper since the authors argue that in the face of a sudden and large depreciation of exchange rates, reliance on foreign debt will make private and public debt default more likely. One plausible question is whether being a bond issuer in Asia was more of an advantage in attenuating failure hazards given that many firms were relying on bonds denominated in foreign currency when the Asian crisis burst in 1997. Therefore, we consider the following testable hypothesis:

Hypothesis 2. The currency denomination of a bond can have an (positive or negative) impact on firms' probability of bankruptcy.

[1] Alvarez and Görg (2009) offer evidence from Latin America and Bhattcharjee et al. (2009) from the UK showing that changes in the macroeconomic environment may interact with relevant firm and industry features in amplifying exit hazards.

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