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Product Market Competition and Debt Choice*

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Abstract

Motivated by prior research on the informational and monitoring role of product market competition, we examine how competitive pressure affects firms' choice between bank debt and public debt. Using a sample of 3,675 U.S. firms over the period 2001–2013, we find that competitive pressure from the product market leads firms to rely less on bank debt financing. In a natural experiment setting, we also find that there is a significant decrease in firm reliance on bank debt after large import tariff reductions. In additional analyses, we show that the effect of competitive pressure on debt choice is more pronounced for firms with greater exposure to competition, higher financial constraints, and weaker governance practices. Moreover, we find that product market competition is associated with long-term maturity debt. Taken together, our study generates the important insight that external governance pressure from the product market acts as an alternate governance mechanism for bank debt monitoring.

Keywords: Product market competition; Import tariffs; Debt structure; Corporate governance.

JEL Classifications: G18; G21 G32

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