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How firms use corporate bond markets under financial globalization

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ABSTRACT

This paper studies how firms from developed and developing countries have used domestic and international corporate bond markets since the 1990s. We find that debt issues in domestic and international markets have different characteristics. International issues tend to be larger, of shorter maturity, denominated in foreign currency, include more fixed rate contracts, and entail lower yields. These patterns persist even when analyzing issues by firms from countries with more developed domestic markets and higher financial integration and when comparing issues conducted by the same firm in different markets. These findings are consistent with the existence of frictions that segment domestic and international corporate bond markets and with these markets providing distinct financial services.

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1. Introduction

Financial globalization has transformed corporate finance since the early 1990s. Firms from both developed and developing countries increasingly raise capital through debt and equity issues outside their domestic markets and list their securities in major financial centers. For example, the total amount raised by firms through security issues in foreign markets grew more than three-fold in real terms between 1991 and 2013, reaching about one trillion U.S. dollars at the end of the period and accounting for almost 40% of the total amount raised in capital markets. Though corporate bond issuance in foreign markets declined during the global financial crisis of 2008, it rebounded rapidly afterwards, prompting concerns about the exposure of emerging market firms to currency mismatches and potential changes in international investor sentiment (Avdjiev et al., 2014; IADB, 2014; IMF, 2014; The Economist, 2014a,b).

Although a large literature has examined the internationalization of equity markets, we still know surprisingly little about how firms use the biggest component of domestic and international capital markets: corporate bond markets.[1] Over the period from 1991 to 2013, bond issues accounted for almost 80% of all capital raised by firms through bond and equity issues around the

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[1] The literature on equity market internationalization is rather large and has focused in particular on why firms list their shares in foreign stock exchanges. For theoretical arguments on why firms choose to list shares abroad, see, for example, Black (1974), Solnik (1974), Stapleton and Subrahmanyam (1977), Errunza and Losq (1985), Alexander et al. (1987), Domowitz et al. (1998), Stulz (1999), and Coffee (2002). For empirical analyses of the motivations for cross-listings in foreign stock exchanges, see, among many others, Pagano et al. (2001, 2002), Reese and Weisbach (2002), Ljungqvist et al. (2003), Doidge et al. (2004), and Gozzi et al. (2008). Other papers study the effects of financial globalization from an aggregate perspective; see, for example, Levine and Zervos (1998), Edison et al. (2002), and Bekaert et al. (2005, 2006).

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world and for more than 90% of all capital raised by firms in markets outside their home country.[2] Thus, by focusing on equity markets, most of the literature ignores a large fraction of corporate capital raising activity in domestic and international markets. Moreover, we still do not know the answers to basic questions about corporate bond markets, such as: do firms issue bonds with different characteristics in domestic and international markets? Or, do they issue bonds with similar price and non-price characteristics when tapping investors in different locations? If market frictions make it costly for investors and firms to access some markets, then the resulting market segmentation might induce firms to use domestic and international markets to issue bonds, likely with different attributes.

In this paper, we assemble a unique database on corporate debt issues and analyze how firms use corporate bond markets under financial globalization. We test whether firms systematically issue bonds in domestic and international markets with different non-price characteristics (size, maturity, currency denomination, and type of rate), and whether yields on bond issues by the same firm differ across domestic and foreign markets. While some practitioner articles and international finance textbooks (e.g., Bekaert and Hodrick, 2012) have noted differences in the characteristics of bonds issued in domestic and international markets, they do not assess whether these differences are systematic, and whether any potential differences arise because of differences between the firms that issue in these markets or because of differences between the markets themselves. Thus, we construct and analyze a new dataset that includes information on major characteristics of 143,948 corporate bond issues in domestic and international markets conducted by 18,219 firms from 101 countries (or, more precisely, economies) over the period from 1991 to 2013.

The main finding of this paper is that debt issues in domestic and international bond markets have different characteristics. In particular, international bond issues tend to be larger, denominated in foreign currency, and involve more fixed interest rate contracts. Moreover, firms from developed countries tend to issue shorter-term bonds in foreign markets. These differences are not driven by differences between those firms that raise debt abroad and those that issue securities at home. Indeed, we find that the differences between bond issues at home and abroad remain after controlling for time-varying country-specific factors and firm-level fixed effects, and when analyzing only those firms that actively issue debt both in domestic and international markets. In other words, issues conducted abroad by a given firm are different from those conducted in the domestic market by the same firm, suggesting that firms use domestic and international markets to issue bonds with distinct attributes. These findings hold for firms from more financially integrated countries, for which one might expect the differences between domestic and international markets to be smaller, or even non-existent. We also find that, although the global financial crisis had a significant effect on issuance activity in both domestic and international corporate bonds markets, most of the differences we find between issues abroad and at home remain when considering the period after 2008. Moreover, we find that issues abroad tend to entail lower yields than issues at home denominated in the same currency, after conditioning on different bond characteristics, country-year dummies, and firm-level fixed effects, and when analyzing firms that issue debt both at home and abroad. Thus, our findings suggest that the same, large firms that issue debt in domestic and international markets seem to face different borrowing costs when issuing in these two different places.

To provide a more complete characterization of the process of internationalization of corporate bond markets, we also present new evidence regarding the main characteristics of those firms that issue debt abroad, and how they differ from those that only issue debt at home. To do this, we match our data on corporate bond issues in domestic and international markets with data on annual firm-level balance sheet information for publicly listed firms.[3] We find that firms that issue debt abroad are significantly larger and more leveraged than those firms that only issue debt at home. Among firms from developing countries, we also find that those issuing bonds in foreign markets tend to be older and less profitable than those that only issue bonds in domestic markets. However, as mentioned above, these differences across firms do not account for the differences that we find between debt issues at home and abroad, as the differences in bond characteristics across markets remain when we analyze issues conducted by the same firm across different markets.

The patterns documented in this paper provide information about the functioning of domestic and foreign markets under globalization. Our finding that issues abroad are different from domestic issues, even when comparing issues conducted by the same firm, is consistent with (1) market segmentation and (2) markets offering distinct financial services.[4] In a world with perfectly integrated markets, the location where firms issue securities is irrelevant, but various frictions might segment markets (Japelli and Pagano, 2010). For example, regulations and taxes might hinder the ability of investors to purchase securities outside their home market (Lewis, 1999; Karolyi and Stulz, 2003; Cameron et al., 2007), and information asymmetries between foreign and domestic investors might induce them to price similar assets differently (Bae et al., 2008). In this context, investors with different preferences, investment horizons, and/or abilities to diversify risk could dominate particular markets, so that securities with distinct traits are offered in different locations (Kim and Stulz, 1988). Securities might also differ across markets if market makers in different locations specialize in securities with particular characteristics (Pagano and von Thadden, 2004). Our findings that the non-price attributes of bonds differ across markets and that bond yields do not fully converge across borders are consistent with arguments that stress the role of frictions in segmenting financial markets.

The results in this paper also inform the study and practice of corporate finance. Our finding that corporations issue bonds with different characteristics in domestic and international markets suggests that corporate financing decisions among firms with access to international markets involves a set of choices about the location and characteristics of bond issues. This finding might also help account for the finding from previous studies that firms issue securities in both domestic and foreign markets (Gozzi et al., 2010). Moreover, if having access to international markets allows firms to issue a broader range of securities, it could also affect their capital structure. Furthermore, our finding that debt issues in domestic and international markets are different might explain why the literature tends to find that access to foreign financing is related to changes in firms' capital structure (Pagano

[2] The value of debt issues is not directly comparable to that of equity issues because equity issues have no maturity, while debt issues must be repaid. Part of the proceeds from debt issues is typically used to repay maturing debt and, therefore, only a fraction of debt issues can be considered new financing. Henderson et al. (2006) try to adjust the data on debt issues to take this fact into account and conclude that, even with these adjustments, international debt issues constitute a much larger source of new capital than international equity issues at the aggregate level.

[3] Our focus on publicly listed firms provides us with a relatively homogeneous group of firms that (vis-à-vis non-listed firms) are large, have already met listing requirements, and are formal corporations that can raise external financing.

[4] A parallel literature argues that foreign and domestic banks offer different types of financing. See, for example, Mian (2006), Berger et al. (2008), and Giannetti and Ongena (2012).

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