Asymmetries in the Firm's Use of Debt to Changing Market Values

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Abstract

Using a large sample of U.S. firms over the period, 1984 to 2013, this study examines the relation between market and book leverage ratios. Unlike Welch (2004) who contends that changes in market leverage do not induce adjustments in book leverage, we find an asymmetric effect. That is, firms adjust their book leverage relative to market leverage only when the changes in market leverage are due to increases in the value of the firm's equity. No adjustment is observed when firm equity values decrease. We observe a number of interesting differences between those firms that make large and small capital structure adjustments in response to changing equity prices. Our results are consistent with Barclay, Morellec and Smith (2006) who argue that the optimal level of debt decreases in the presence of corporate growth options.

Keywords: market leverage; book leverage; capital structure; adjustment speed

***JEL classification*:** G32; C23

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