JOURNAL ARTICLE

Evidence on the Impact of the Agency Costs of Debt on Corporate Debt Policy

Wi Saeng Kim and Eric H. Sorensen

The Journal of Financial and Quantitative Analysis
Vol. 21, No. 2 (Jun., 1986), pp. 131-144 (14 pages)
Published By: Cambridge University Press

https://doi.org/10.2307/2330733
https://www.jstor.org/stable/2330733

JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS VOL. 21, NO. 2, JUNE 1986

Evidence on the Impact of the Agency Costs of Debt on Corporate Debt Policy

Wi Saeng Kim and Eric H. Sorensen*

Abstract

In the last several years, there has been increased theoretical emphasis on the agent-principal problem as it applies to corporate finance. This paper is an attempt to empirically test for the presence of the agency costs and their relation to the debt policy of corporations. We find that firms with higher insider ownership have greater debt ratios than firms with lower insider ownership, which may be explained by the agency costs of debt and/or the agency costs of equity. Other regression results tend to confirm the theoretically optimal relationships put forth by Myers. We find that high-growth firms use less debt rather than more debt, high-operating-risk firms use more debt rather than less debt, and firm size appears to be uncorrelated to the level of debt.

I. Introduction

The introduction of the agency costs of external financing by Jensen and Meckling [16] and Myers [19] represents a substantial theoretical advancement, and provides new hope in explaining corporate financing behavior. The literature addresses two general categories of agency costs due to external financing.[1]

The agency theory described in [16] postulates a single entrepreneur with total control of the firm. The sale of shares to outsiders reduces his or her frac-

York, December 28, 1982.

[1] The rapidly growing literature on the principal-agent problems explores both normative and positive aspects of this potential conflict in decision making. The normative agency theory mainly focuses on the development of optimal contracts between the principal and the agent. The positive theory of agency, instead, is concerned with corporate behavior in the presence of the principal-agent problem (see [15] for references).