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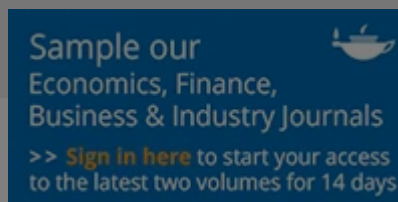
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Credit watch and capital structure

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Abstract

We study the capital structure reactions of firms that have been added to Standard & Poor's (S&P's) CreditWatch list in order to test the role of credit ratings in firm financial decisions. Survey evidence by Graham and Harvey (2001) indicates that Chief Financial

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Notes

¹ Michelsen and Klein ([2012](#)) also examine leverage changes following CreditWatch placements. However, we look at quarterly reactions to a credit watch addition – the quarters of the action and also around the action. Michelsen and Klein look at the financials in the year of a credit watch action. Credit watch actions by definition have a shelf life of 90 days and an examination of the quarters of and around an action may be more revealing.

² We also examine net debt issuance behaviour in the second quarter following the CreditWatch action but do not detect any differential financing behaviour for firms with either ‘positive’ or ‘negative’ placement.

³ Though not reported, we also zero in on BBB firms with a ‘minus’ sub-rating, that is, the firms nearest to losing their investment grade status. For these firms, we find that the ‘negative’ Watch designation is not associated with any significant change in the marginal debt financing. We also examine other broad ratings (AA, A, BB, B, CCC). We find positive, significant coefficients for firms with a ‘negative’ CreditWatch dummy occur for ratings classes A and B. In the case of firms with ‘positive’ Watch placements, we observe significant declines in debt financing in A- and BBB-rating groups suggesting that these firms reduce debt financing at the margin with the prospect of an improved rating in the future. Overall, these results mirror those reported for the full sample of firms. [Capital structure](#)

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