

Final, summer 2013

5.

✓✓✓) The debt will help raise the value of the firm

✓✓✓ ⇒ the debt helps resolve S1H-mgt conflict

✓✓ ⇒ cash used for debt service

✓✓✓ ⇒ mgt can't waste it on empire building

✓✓ ⇒ mgt tends to want a larger-than-optimal firm since higher pay, perks, prestige + power

✓✓ ⇒ mgt can't pursue costly diversification w/ excess cash

⇒ the threat of bankruptcy gives (mgt an incentive to work harder)

✓✓ ⇒ problem ⇒ mgt bears the cost of hard work but shares the benefit w/ S1H.

✓✓ ⇒ additional creditors also help monitor mgt

⇒ Debt may signal that mgt is confident in the firm's future

✓✓✓ ⇒ value of firm's stock + bonds rise to reflect this confidence

Scale: 26 = 75
24 = 74
22 = 72
20 = 70
18 = 68
16 = 66
14 = 64
12 = 62
10 = 60
8 = 58
6 = 54
4 = 50
0+ = 35