New York, NY – July 7, 2004 – Shareholder control can have contrasting effects on bond yields depending on the takeover vulnerability of a firm, according to a newly completed study conducted by one current and two former New York University Stern School of Business PhD students, Chenyang Wei, Martijn Cremers and Vinay Nair, respectively. Funded by the NYU Center for Law & Business, their research shows that shareholder control is associated with lower yields if the firm is protected from takeovers and higher yields if the firm is exposed to takeovers. In fact, the difference in bond yields due to the firm’s takeover vulnerability can be as high as 93 basis points. The research also suggests that to ensure high-yields for bondholders a firm with high-debt should protect itself from takeovers while a firm with low-debt should not employ takeover defenses. This is the first paper to date that proves shareholders’ rights can have divergent and economically important effects on bondholders.

In contrast to the majority of research published on the effects of shareholder control on bondholders, this study focused on yields, ratings and long-run bond returns, rather than analyzing bondholder wealth changes. To test their hypothesis, Cremers, Nair and Wei studied seven years of public bond statistics with an average of 2,500 issues per year and combined these figures with [public] data on shareholder ownership for the same time
period. Using the collective data, they were able to analyze how different corporate
governance mechanisms interact to affect bond returns, yields and ratings.

“We were interested in conducting this research because, to date, there is no evidence on
the magnitude of the effect of shareholder governance on bondholders,” said Vinay Nair,
NYU Stern PhD 2004 graduate and current professor at the Wharton School at the
University of Pennsylvania. “Our research has great implications for corporate
governance, suggesting that the use of different corporate governance mechanisms, such
as shareholder monitoring and takeover vulnerability, depend on a firm's capital structure
and that bond-pricing models should account for shareholder control.”

These results also have important implications for bond rating agencies that are still
debating whether corporate governance impacts bondholders. The results show that a
portfolio that buys bonds from firms with strong shareholder control and high takeover
vulnerability and shorts bonds from firms with neither high shareholder control nor
takeover vulnerability generates an abnormal return of up to 1.3%. This abnormal return
is higher for firms that are small and have low leverage and can be as high as 2.5%.
Finally, the research shows that bond ratings appear to incorporate a similar effect of
shareholder control on bondholders.

A working paper of this study can be found at:

About the NYU Center for Law and Business

Established in the fall of 1997, the NYU Center for Law and Business is as a joint
venture of the Leonard N. Stern School of Business and the NYU School of Law. One of
the Center's primary goals is to facilitate professional interaction and joint scholarly work
between faculty at the two schools who share an interest in the structure, regulation and
function of the market economy. These interactions are encouraged through the Center's
support of seminars, conferences and research. Courses are designed to bring law
students and M.B.A. students into one classroom so that different perspectives on
transaction-orientated problems can be shared. These innovative, jointly taught courses
focus on mergers and acquisitions, the public raising of capital, and private contract negotiations. The Center also provides support to business and law professionals engaged in furthering the Center's research, teaching and learning agenda.

About NYU Stern

Situated in the heart of NYC’s Greenwich Village, NYU Stern maximizes its location through partnerships with business and its leaders from Wall Street, Silicon Alley and the entertainment and media industry to provide a value-added, “real world” business education. NYU Stern embodies a diversified learning environment exemplified in its approach to teaching, which blends business theory with experiential learning. For additional information on New York University Stern School of Business, visit www.stern.nyu.edu.