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Corporate boards and performance pricing in private debt contracts

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Abstract

We examine the effects of corporate board characteristics on the use of performance pricing in debt contracts. Performance pricing is a recent innovation that plays a role in addressing some debt contracting problems by linking the ex-ante pricing of debt with ex-post firm performance. Results show that debtholders are more likely to use performance pricing in loan contracts for borrower firms with greater board independence and CEOs with higher share ownership, whereas debtholders are less likely to use performance pricing when firms have smaller boards. Debtholders also are more likely to include an interest increasing performance pricing provision in loan contracts when CEOs' incentives are aligned via higher share ownership, but they are less likely to use them in debt contracts when board ownership is lower. Overall, the results suggest debtholders perceive that characteristics associated with effective boards are beneficial and factor them in their contracting decisions. (C) 2017 Elsevier B.V. All rights reserved.

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