

A Study of Factors Influencing Corporate Debt Default

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Abstract. With the global debt rate rising at a high speed in recent years, the risk of corporate debt default has also increased gradually, in order to explore the influencing factors of corporate debt default and let enterprises better avoid the risk of debt default. This paper discusses the impact of corporate debt default from internal and external, macro and micro levels, from the aspects of corporate investment and financing strategy, management's investment preference, corporate governance structure, corporate strategic positioning and the differences between the same industry, external macroeconomic environment, national policies and international exchange rate impact, and the degree of opening up of the capital market to the outside world. Corporate debt can be influenced by several factors, and a clear understanding of the relationships and mechanisms between the factors will help to propose feasible debt reduction programs that will lead to more robust corporate development.

Keywords: Risk of debt default; Influencing factors; Synthesis of research.

1. Introduction

As the global economy is growing at a rapid pace, the global debt ratio is also increasing every year. According to the International Monetary Fund (IMF), global public debt has tripled since the mid-1970s, reaching 92 percent of global GDP (just over \$91 trillion) at the end of 2022. Private sector debt has also tripled to 146% of global GDP (nearly \$144 trillion). And total global debt in 2022 even reaches 238% of global GDP, totaling \$235 trillion, \$200 billion above 2021 levels. Generally speaking, the risk of corporate debt default refers to the risk or crisis that an enterprise cannot operate normally or even fall into closure or bankruptcy due to its inability to repay debts such as bank loans, upstream suppliers' payments and corporate bonds in full when they are due. Corporate debt default will affect the development of the enterprise itself and the normal operating capacity of financial institutions, increase the cost of financing for other enterprises, and aggravate the overall refinancing risk of the market. In this era of extremely high debt ratios, corporate debt defaults are likely to have a dramatic impact on the external economic environment, with serious consequences for both financial institutions and the enterprises themselves. In this paper, we will sort out the existing literature on debt default and give a corresponding summary.

2. Internal Factors

2.1. The Strategies for Corporate Investment and Financing

According to relevant information and literature, a considerable number of enterprises that have defaulted on their debts have had a period of strategic aggressive expansion with debt financing as the fulcrum and rapid mergers and acquisitions as the main approaches. The strategic aggressive expansion path focuses on the balance of growth, profitability and risk.

Liu and Guo found that the behavior of "short-term lending and long-term investment" is a very common way for listed enterprises in China, and after several tests, it is concluded that "short-term lending and long-term investment" significantly increases the risk of debt default of enterprises through three ways: increasing the degree of over-investment, increasing the cost of debt and financing, and decreasing the profitability of enterprises [1]. The strategically aggressive firms have a strong preference for "short-term lending and long-term investment" behavior.

Guo and Zhang found that strategic aggressiveness is the main cause of corporate debt default [2]. Strategic aggressiveness increases the risk of corporate debt default by negatively affecting investment efficiency, and also positively affects asset-financial indebtedness (short-term lending and long-term investment) to increase the risk of corporate debt default. Such enterprises tend to over-invest but the return sometimes does not meet expectations, in the form of debt financing to support the abnormal expansion, and such aggressive expansion is very easy to break the vulnerable balance of growth, profitability and risk, resulting in corporate earnings do not meet expectations, resulting in a corporate debt default.

2.2. Management's Investment Preferences

Firm management is the direct decision-maker in capital restructuring and investment strategy development. Various literature shows that various characteristics of managers affect their investment preferences, which in turn affects the firm's investment risk. Qian and Liang argue that managers' investment preferences are related to managers' age. They believe that with the growth of age and experience, managers will have a more rational understanding of investment and M&A behavior, but due to their concern for their own career stability, their own reputation and interests, they will make more conservative investment decisions in case of unexpected events resulting in corporate debt default [3]. On the contrary, young business managers have more energy and enterprising spirit, they are willing to make more innovative and risky decisions [4], which is a double-edged sword for the development of the enterprise, which may improve the enterprise's income and increase the risk of corporate debt default. He spotted that there are significant differences between women's and men's attitudes toward risk, women's decision-making process shows a more obvious risk aversion tendency, and female executives' risk aversion makes it easy to overestimate the negative return on investment, more concerned about the loss of investment, and thus more conservative in investment decisions, while male executives tend to be more focused on the positive returns of the business and are more confident in the growth of the business[5].

2.3. The Governance Structure of the Enterprise

The governance structure of an enterprise is the highest power distribution and supervision framework of an enterprise, and several studies in the literature have pointed out that the governance structure of an enterprise is closely related to the formulation of investment decisions of an enterprise, which will indirectly affect the debt-servicing capacity of an enterprise, and thus affect the risk of default of an enterprise.

Roll pioneered "The Hubris Hypothesis of Corporate Takeovers" in 1986. Psychological studies have shown that overconfident people believe that they have more control over the development of things than they do so they have over-optimistic psychological expectations of certain events in the future. Management with a high degree of managerial autonomy and a considerable amount of "authoritarian" decision-making tends to be full of optimism about the company's development. Yu found that this psychological characteristic of management in investment decisions will be more inclined to risk, that is, the use of financial leverage to promote the rapid expansion of enterprise scale [6]. From the reality of the outbreak of debt default enterprises in recent years, most of the rapid expansion behavior is driven by high-debt financing. The blind expansion behavior in the irrational state is a major test of the company's capital chain, a little carelessness may make the company's capital chain break, resulting in corporate debt default.

Wang et al. found that in terms of corporate governance when there is a serious agency problem within the firm, it will hurt the value of the firm and increase the risk of debt default [7]. From the perspective of accounting disclosure, the degree of disclosure to the outside world will have a certain impact on the risk of corporate debt default. Lundquist and Vihelmsson found that stable accounting disclosure to the outside world can reduce the likelihood of corporate debt default because disclosure reduces agency problems caused by poor decision-making and operational risks and smoother cash flows for firms [8].

Díez-Esteban et al. found that firms with multiple majority shareholders and decentralized power will have a more conservative attitude towards business operations and financial risks [9], and they prefer to operate their firms in a more stable way with less strategic differences to prevent large fluctuations in their stocks. In addition, Feng and Wen found that companies with multiple major shareholders will cause mutual supervision among shareholders, who will be more concerned about the survival of the enterprise and the long-term development of the enterprise, and reduce its potential investment risk [10]. Therefore, the corporate decisions of companies with multiple major shareholders will be more rational and the development of the company will be more stable, which reduces the risk of debt default in the operation of the company [11].

2.4. The Differences Between the Strategic Positioning of the Companies in the Same Industry

The strategic positioning of an enterprise is a global and long-term planning for the future in order to build core competitiveness and stand out among enterprises in the same industry. And the theory of industrial organization points out that similar enterprises within the same industry face the same survival environment, such as the regulatory system and business environment. Different firms will learn and imitate each other in this natural selection in the market in order to form a set of the most appropriate conventional strategy models that are consistent with the characteristics of the industry [15]. Therefore, the strategies of firms in the same industry tend to converge in the end, which is the conventional strategy model of the firms.

However, some enterprises with unique resources will make strategic adjustments according to their own characteristics in order to obtain excessive profits, to stand out from the industry's conventional strategy model [14,16]. The degree of strategic differentiation has been widely emphasized as an indicator of the deviation of corporate strategy from the industry's conventional strategic model.

Some researchers pointed out that if the degree of corporate strategy differentiation is greater, the degree of volatility of corporate performance is greater, and the surplus sustainability is worse [12-14]. In addition, enterprises adopting the industry's conventional strategy are more likely to be recognized by the government and can obtain part of the resources and policy support from the government, when the degree of corporate strategy difference is large, most enterprises have higher difficulty in adapting to the industry environment, and increase the business risk, which also leads to the reduction of enterprise value, and easy to lead to the volatility of the degree of fluctuation of the operating profit is elevated [17]. Resulting in a decline in the stability of the enterprise's capital chain, if the debt is due, the enterprise's solvency is likely to be insufficient, resulting in debt default.

3. External Factors

3.1. The Uncertainty of Macroeconomic

The external macro-financial environment is the background for enterprises to make venture capital investments, Arellano et al, Zhang and Liu found that financial uncertainty in the macro-environment will affect enterprises' investment decisions [18,19]. Under the condition of financial uncertainty, the financial friction theory states that the uncertainty makes the economic development prospects vague, banks and other financial institutions, in order to avoid the risk of corporate debt default and reduce the possible credit losses, will raise the lending interest rate and the loan collateral threshold of the enterprise. Wang and Song pointed out that a high degree of uncertainty in the external environment will reduce the response of the company's investment to external demand, and uncertainty will increase the value of the real option so that the company's behavior of investing or not will become more prudent, choose to favor the conservative investment strategy, and reduce the level of enterprise's investment, which will cause a certain impact on the profitability of the enterprise [20].

Zhang et al. pointed out that environmental uncertainty will exacerbate the degree of information asymmetry and thus increase the risk of corporate debt default, while the economic downturn period

of corporate investment is more sensitive to financial uncertainty, the asymmetry of information so that the enterprise's investment risk rises, and the investment strategy tends to be more conservative [21]. In an economic downturn, market expectations are generally low, and most investors on an investment behavior of wait-and-see attitude, if the financial uncertainty increases, it is very easy to financial panic, resulting in the difficulty of corporate financing, a decline in profitability and a high possibility of debt default [22].

3.2. The Impact of National Policies and International Exchange Rates

In the process of enterprise development and growth, short-term loans and long-term investments have become the choice of many enterprises. However, the risk of debt default under the short loan and long investment is alarming. In recent years, several countries have curbed the risk of debt default through the introduction of appropriate policies. China, for example, China at the end of 2016, the State Council issued the "Opinions on Actively and Steadily Reducing the Leverage Ratio of Enterprises" and the annex "on the market-oriented bank debt and equity conversion of guiding opinions," making it clear that we need to reduce the leverage ratio of enterprises in a market-oriented and rule-of-law-oriented way, to carry out market-oriented debt-to-equity conversion to effectively prevent and resolve debt risks and boost economic transformation and upgrading. Since then China's strict supervision and financial deleveraging kicked off, the credit supply began to step into the tightening cycle, followed by frequent corporate debt defaults, according to which Guo and Zhang found that the corporate strategy of aggressive and credit tightening cycle resonates with the same frequency, in the relevant national policy suppression, the risk of debt defaults of the aggressive type of enterprises surged [2]. However, for other firms, the policy effectively suppressed the default risk of corporate debt, as demonstrated by Wu and Zheng through empirical tests [23].

When the enterprise engages in foreign trade activities, due to the impact of international currency exchange rates, it is very easy to occur due to exchange rate changes that lead to the value of the claim or debt gain or loss of the situation. Li found that because enterprises are used to betting on the unilateral trend of the RMB, often lack of risk-neutral perception of exchange rate fluctuations [24]. Therefore, it is very easy to depreciate the value of the enterprise due to exchange rate fluctuations before it has time to adjust its strategy, which increases the risk of debt default.

3.3. The Impact of National Policies and International Exchange Rates

A capital market with a high degree of openness will attract a large number of foreign institutional investors, who often have high investment experience and ability and are more sensitive to the behavior of the management of an enterprise that is detrimental to the interests of the enterprise. Jia and Wu pointed out that when they find that what the management does will damage the enterprise value, it will often use the trading of shares to convey negative news about the enterprise to the market, bringing the risk of reduced company value and stock decline, thus creating a deterrent effect [25]. Meng et al. found that when the capital market is more open, management will reduce behaviors that harm the value of the firm in order to maintain the value of the firm and avoid being fired, thus helping to reduce the risk of corporate debt default [26]. Chen and Liu found that after the opening of the capital market because foreign investors have stronger information-gathering and analyzing abilities, they tend to attract domestic investors to follow them when choosing investment objects [27]. Chen and Huang found that this leverage effect would urge corporate management to manage the company's image when becoming a target company and actively give up behaviors that are not conducive to enhancing corporate value and performance, thus effectively helping to reduce the risk of corporate debt default [28].

4. Conclusion

This paper discusses the impact of corporate debt default from internal and external, macro and micro levels, focusing on corporate investment and financing strategies, management's investment

preferences, corporate governance structure, corporate strategic positioning and industry differences, external macroeconomic environment, national policies and international exchange rate impacts, and the degree of openness of the capital market to the outside world. From the above review, it can be seen that if the companies want to reduce the risk of corporate debt default, it can start with the power structure and gender ratio of corporate management, the degree of corporate disclosure, the degree of strategic differences, national policies, the degree of openness of the capital market, and, of course, the support of a healthy macroeconomic environment can also significantly reduce the risk of corporate debt default.

Based on the macroeconomic and micro corporate finance perspective, although the above research on corporate debt default has been relatively comprehensive, there are still quite several influencing factors that have not been mentioned due to the lack of in-depth research by the previous researchers, such as the impact of multinational corporations' investment and local people's living habits, cultural differences, familiarity with the national policies, and the impact of the enterprise's internal system, culture and cohesion on the enterprise's revenue earning and debt repayment ability. In the increasingly diversified and open future, the influencing factors of corporate debt defaults will certainly change with the development of the times, and in order to better resolve financial risks and promote social harmony, it is inevitable to dig deeper and study the influencing factors of corporate debt defaults. When people fully understand the influence factors behind corporate debt default, the corporate debt default phenomenon will be greatly reduced, and enterprises and the capital market will grow healthily in an orderly manner. Future research should be based on a broader and more diversified vision, combining the transformation of national policies and social goals at the macro level, and the special and innovative features of enterprises in different industries at the micro level, to discuss the various risks of corporate debt default.

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