OPTIMAL STRATEGIES IN A RISKY DEBT CONTEXT

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Abstract

The paper analyses structural models for the evaluation of risky debt following H.E. LELAND [2], with an approach of optimal stopping problem (for instance cf. N. EL KAROUI [1]). Moreover we introduce an investment control parameter and we optimize with respect to the failure threshold and coupon rate. With investment, the failure threshold is lower and the rate coupon rises. Finally, we show that the value of the optimal coupon policy decreases and the level of bankruptcy rises if the strict priority rule is removed.

Keywords: corporate debt, optimal capital structure, default, optimal stopping.

References

[1] EL KAROUI N. (1981), *Les Aspects Probabilistes du Contrôle Stochastique*, Lecture Notes in Mathematics 876, p.73-238, Springer-Verlag, Berlin.

[2] LELAND H.E. (1994), "Corporate debt value, bond covenant, and optimal capital structure", The Journal of Finance, 49, 1213-1252.

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