Index Membership and Capital Structure: International Evidence*

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ABSTRACT

How much do shocks to the information environment in equity markets matter for debt supply and the financing of firms? We find that the use of debt increases by about two percentage points following exogenous additions of stocks to an index. The leverage response is primarily in public debt markets: Borrowing costs in these markets decrease, while bond liquidity increases. These results suggest that index additions affect leverage because an increase in public information reduces information asymmetries for lenders and increases their willingness to buy information-sensitive debt. Indeed, stocks added to an index are followed by more equity analysts. Overall, we support the view that information production in equity markets spills over into debt markets.

JEL classification: G14, G15, G32

Keywords: index membership, investor awareness, debt supply, capital structure

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