

The Shadow Costs of Short-Term Debt Financing and Corporate Policies

(joint with Santiago Moreno, in progress)

Abstract

This paper studies the impact of rollover risk, inherent to short-term debt financing, on the optimal capital structure and cash management policies of a financial firm. Consistent with recent empirical evidence, our model shows that rollover risk related to short-term financing amplifies the costs of long-term debt, and the management takes these "shadow" costs into account when choosing the firm's liability structure. Given that corporate liability structure and cash management policies are jointly determined, the adverse impact of short-term debt financing on the costs of long-term debt can be tempered via conservative cash management policy. Our preliminary results suggest that highly profitable firms build larger cash reserves, bear lower costs of long-term debt and exhibit lower short-term to total debt ratios as compared to less profitable ones.