

CEO Incentives and the Cost of Debt

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Motivated by concerns that option compensation might lead to excessive risk-taking, this paper examines the relations between CEO option incentives and the cost of debt. Unlike related prior research, this paper uses the sensitivities of CEO stock option portfolios to stock price and stock return volatility to measure incentives. The results show that yield spreads on new debt issues are higher for firms with CEO stock option portfolios more sensitive to stock return volatility, but lower for firms with CEO stock option portfolios more sensitive to share price. A sample firm at the median level of each of the option sensitivities enjoys a net 37 basis point reduction in the yield spread on a new debt issue. From a debtholders' perspective, CEO option compensation is not perceived to be associated with increased risk-seeking.