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WITH THE ASSISTANCE OF
ELIZABETH T. SIMPSON

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The high level of investor confidence since World War II, and the large and expanding volume of bond financing, raise important questions as to the quality of bond credit in the postwar period. Although our records do not cover this period—and even if they did, a retrospective test of quality could not be undertaken until the market had been subjected to a real test—the record of the past is sufficiently strong to suggest the need for constant review of bond market standards.

W. BRADDOCK HICKMAN, *Corporate Bond Quality and Investor Experience*, 1958

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T. R. A.

January 1966

FOREWORD

Atkinson's study of postwar corporate bonds in the United States is the third report on the business sector to appear in the National Bureau's program of studies in the quality of credit. Albert Wojnilower's *The Quality of Bank Loans* (1962) and Martin Seiden's *The Quality of Trade Credit* (1964) covered the other two major elements of the debt of American business enterprise. Since trade credit, commercial bank loans, and bonded debt constitute the overwhelming proportion of business indebtedness, Atkinson's study rounds out the program's coverage of the business sector. The program has been supported in large part by a grant from the Merrill Foundation for Advancement of Financial Knowledge, Inc.

To the degree that was possible, this study represents an updating of W. Braddock Hickman's volume, *Corporate Bond Quality and Investor Experience*.¹ That Atkinson's study is of moderate length is not because of any decline in the importance of bonds as a source of American business finance. As he shows, corporate bonds have remained a major source of business funds since the war. Two other factors are instead responsible.

First, the resources available for this postwar study were small compared with those devoted to the National Bureau's corporate bond project, on which the Hickman studies rested. Second, the postwar performance of corporate bonds has been so strong that the detailed statistical examination of the relations between the characteristics of bonds and their performance, which comprised a large part of Hickman's study, was not feasible for the postwar period.

Indeed, the postwar years have been so free of bond defaults that one might conclude that no quality problem exists. However, the Hickman study supplies a warning. One of its salient findings was that investor confidence engendered by extended periods of prosperity appears to generate security issues of less than prime quality. Atkinson

¹ Princeton University Press for National Bureau of Economic Research, 1958.

carefully examines the characteristics of postwar bond issues for evidence of such changing "ex ante" quality, covering all of the important variables that Hickman employed.

Atkinson supplements the earlier study in another important respect. Hickman studied bonds in an era when the bulk of them were "public offerings," whereas in the postwar years the placement of securities by direct negotiation between borrower and investor has become of almost equal importance. In the case of industrials, the direct placement (along with its half-sister, the commercial bank term loan) has become the dominant form of corporate long-term financing. By examining the records of the National Association of Insurance Commissioners, which rates a large share of direct placements, and by using the new information gathered by Avery Cohan on the direct placements of life insurance companies, Atkinson has been able to make some judgments regarding the quality of this increasingly important share of corporate debt.²

Hickman included bonds convertible into stock in his study, but did not analyze the influence of this feature on default or market performance. In view of the fact that in postwar years the share of publicly offered bonds containing the convertibility feature has been more substantial than before the war, Atkinson gives specific attention to such securities. Upon re-examining the Hickman data, he found that default experience in prewar periods was considerably poorer for convertible issues than for nonconvertibles. He appraises the prevalence of the convertibility feature in postwar corporate bond issues in the light of this finding.

In these several important respects, therefore, the present study augments our knowledge of the quality characteristics of business debt and its record of performance.

JAMES S. EARLEY, Director
Quality of Credit Studies

² Cohan's own study of the yields and quality of direct placements, undertaken as part of the National Bureau's interest rate study, is in progress.