On the modelling of Debt Maturity and Endogenous Default: A caveat

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Abstract. We focus on structural models in corporate finance with roll-over debt structures in the vein of Leland (1994) and Leland and Toft (1996). We show that, without ex ante pre commitment, the optimal bankruptcy in these models is not defined by the first time such that the firm's assets reaches a sufficiently low positive threshold that must be optimally determined. We characterize the optimal bankruptcy policy and explain why the existing literature have considered sub-optimal bankruptcy policies.

Keywords Optimal stopping time. Hitting time. Nash Equilibrium.