What Drives Corporate Funding Spreads of Oil Companies: Evidence from the Integrated, Upstream and Downstream Industries

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Highlights:

- We analyse the determinants of corporate funding spreads using credit default swaps of the world's largest oil companies in the integrated, upstream and downstream, industry over the 2007-2020 period covering the 2008 financial crisis, oil plunge crisis and Covid-19 pandemic
- Oil companies operating in the upstream industry have the largest magnitude to oil price shocks and their CDS spread compared with firms operating in the integrated and downstream industries.
- The largest magnitude to downstream companies CDS spreads was observed during the Covid-19 pandemic
- The integrated firms have a similar trend with the upstream firms concerning oil price shocks and CDS spreads, but the magnitude of responses is much smaller. However, we did not find any significant impacts on the CDS spreads of firms that operate in the downstream industry.
- The practical implications of this research can be highlighted as: i. provides opportunities to exploit arbitrage in the derivative markets on CDS referenced entities between upstream and downstream companies under oil price shocks and thereby increasing overall price efficiency, ii. provides debt investors and issuers with more precision in evaluating debt funding spreads between companies that operate in the upstream and downstream industries and therefore more accuracy around pricing, book building and launching of new debt instruments and ii. it points to oil price shocks as a major contributor exacerbating systematic risk for oil companies with exposure to debt capital in the upstream industry and thus impacting equity values.

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