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## **INVESTMENT DECISIONS AND FINANCIAL LEVERAGE UNDER A POTENTIAL ENTRY THREAT**

### **Abstract:**

This study examines investment and financing decisions of a pioneering firm and agency costs of debt in the presence of an entry threat by a potential competitor. It demonstrates that the over-investment problem demonstrated by Mauer and Sarkar (2005) remains in the presence of the potential entry threat. In addition, it demonstrates that when the pioneering firm increases leverage, a potential competitor expedites its market entry. Furthermore, high leverage creates the potential for inducing the competitor to enter the market in a downturn and exposing the pioneering firm to a risk of forced bankruptcy. Therefore, the potential entry threat hinders the pioneering firm from debt financing, and thus mitigates agency conflicts between shareholders and bondholders over investment decisions.

### **Keywords:**

Investment; leverage; Agency costs; Entry threats; Real options

**JEL Classification:** G31, G32, G33