

Callable Bonds: A Risk-Reducing Signalling Mechanism

EDWARD HENRY ROBBINS, JOHN D. SCHATZBERG

First published: September 1986

<https://doi.org/10.1111/j.1540-6261.1986.tb04558.x>

Citations: 42

ABSTRACT

The theory of financial economics has failed to distinguish advantages of callable bonds from those of short-term debt. This paper shows that either type of borrowing can signal a firm's better prospects but that short-term debt does so at the cost of weakened risk-sharing with capital markets. By issuing either equity or long-term, non-callable debt, a firm with poor investment opportunities will not pool its prospects with those of a better firm. But equity produces superior risk-sharing. Perhaps this explains the almost complete absence of long-term, non-callable bonds from observed corporate capital structures.

REFERENCES

- 1 V. A. Aivazian and J. L. Callen. "Future Investment Opportunities and the Value of the Call Provision on a Bond: Comment." *The Journal of Finance* 35 (September 1980), 1051-54.

[Web of Science®](#) | [Google Scholar](#)

- 2 A. Barnea, R. A. Haugen, and L. W. Senbet. "A Rationale for Debt Maturity Structure and Call Provisions in the Agency Theory Framework." *The Journal of Finance* 35 (December 1980), 1223-34.

[Web of Science®](#) | [Google Scholar](#)

- 3 Z. Bodie and B. M. Friedman. "Interest Rate Uncertainty and Value of Call Bond Protection." *Journal of Political Economy* 86 (February 1978), 19-34.

[Web of Science®](#) | [Google Scholar](#)

- 4 Z. Bodie and R. A. Taggart, Jr. "Future Investment Opportunities and the Value of the Call Provision on a Bond." *The Journal of Finance* 33 (September 1978), 1187-1200.

[Web of Science®](#) | [Google Scholar](#)

- 5 Z. Bodie and R. A. Taggart, Jr. "Future Investment Opportunities and the Value of Call Provision on a Bond: Reply." *The Journal of Finance* 35 (September 1980), 1055-56.

6 I. E. Brick and B. A. Wallingford. "The Relative Tax Benefits of Alternative Call Features in Corporate Debt." *Journal of Financial and Quantitative Analysis* 20 (March 1985), 85–105.

7 D. Galai and R. W. Masulis. "The Option Pricing Model and the Risk Factor of Stock." *Journal of Financial Economics* 3 (January–March 1976), 53–81.

8 M. Harris and A. Raviv. "A Sequential Signalling Model of Convertible Debt Call Policy." *The Journal of Finance* 40 (December 1985), 1263–81.

9 B. Holmstrom. "Moral Hazard and Observability." *Bell Journal of Economics* 10 (Spring 1979), 74–91.

10 J. E. Ingersoll, Jr. "A Contingent Claims Valuation of Convertible Securities." *Journal of Financial Economics* 4 (May 1977), 289–322.

11 J. E. Ingersoll, Jr. "An Examination of Corporate Call Policies on Convertible Securities." *The Journal of Finance* 32 (May 1977), 463–78.

12 J. F. Jaffe. "Special Information and Insider Trading." *Journal of Business* 43 (July 1974), 410–28.

13 M. C. Jensen and W. H. Meckling. "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure." *Journal of Financial Economics* 3 (October 1976), 305–60.

14 R. A. Lambert. "Long-Term Contracts and Moral Hazard." *Bell Journal of Economics* 14 (Autumn 1983), 441–52.

15 H. Leland and D. Pyle. "Informational Asymmetries, Financial Structure, and Financial Intermediation." *The Journal of Finance* 32 (May 1977), 371–88.

[Web of Science®](#) | [Google Scholar](#) |

16 W. Marshall and J. Yawitz. "Optimal Terms of the Call Provision on a Corporate Bond." *Journal of Financial Research* 3 (Summer 1980), 202–11.

[Google Scholar](#) |

17 S. C. Myers. "Discussion." *The Journal of Finance* 26 (May 1971), 538–39.

[Google Scholar](#) |

18 S. C. Myers. "Determinants of Corporate Borrowing." *Journal of Financial Economics* 5 (November 1977), 147–76.

[Web of Science®](#) | [Google Scholar](#) |

19 J. W. Pratt. "Risk Aversion in the Small and in the Large." *Econometrica* 32 (January–April 1964), 122–36.

[Web of Science®](#) | [Google Scholar](#) |

20 G. Pye. "The Value of the Call Option on a Bond." *Journal of Political Economy* 74 (April 1966), 200–5.

[Web of Science®](#) | [Google Scholar](#) |

21 S. A. Ross. "The Economic Theory of Agency: The Principal's Problem." *American Economic Review* 63 (May 1973), 134–39.

[Web of Science®](#) | [Google Scholar](#) |

22 S. A. Ross. "The Determination of Financial Structure: The Incentive-Signalling Approach." *Bell Journal of Economics* 8 (Spring 1977), 23–40.

[Google Scholar](#) |

23 J. Yawitz and J. Anderson. "The Effect of Refunding on Shareholder Wealth." *The Journal of Finance* 32 (December 1977), 1738–46.

[Web of Science®](#) | [Google Scholar](#) |

ABOUT WILEY ONLINE LIBRARY

[Privacy Policy](#)

[Terms of Use](#)

[About Cookies](#)

[Manage Cookies](#)

[Accessibility](#)

[Wiley Research DE&I Statement and Publishing Policies](#)

[Developing World Access](#)

HELP & SUPPORT

[Contact Us](#)

[Training and Support](#)

[DMCA & Reporting Piracy](#)

OPPORTUNITIES

[Subscription Agents](#)

[Advertisers & Corporate Partners](#)

CONNECT WITH WILEY

[The Wiley Network](#)

[Wiley Press Room](#)