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Convertible Bond Design and Capital Investment: The Role of Call Provisions

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ABSTRACT

If firms issue convertible securities to facilitate sequential investment, the securities should be engineered to give sufficient flexibility to accommodate timing of follow-on investment. We examine call provisions in convertible bonds and argue that firms with investment options expected to expire sooner (later) will offer weaker (stronger) call protection. We find that issues with weak or no call protection are offered by firms that invest greater amounts soon after issuance than those issuing convertibles with strong protection. Moreover, capital expenditure levels during the 5-year period following issuance are inversely related to the length of call-protection periods.

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