Determinants of the call option on corporate bonds ★

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Abstract

A number of hypotheses have been proposed as explanations of the call feature in corporate bonds. Using a large sample of callable and noncallable corporate bonds issued during the period 1977–1986, this paper simultaneously examines the empirical validity of five hypotheses that have been offered to explain the call option. The evidence provides no support for the hypotheses that the call option provides managerial flexibility or tax advantages. There is mixed support for agency cost explanations of the corporate call feature. The call feature is found to be highly correlated with the level of interest rates and the maturity of debt issues. That is, the call feature is found to be more likely during periods of higher interest rates and for longer maturity bonds.
Does the choice between fixed price and make whole call provisions reflect differential agency costs?
2017, Journal of Corporate Finance

Callable bonds, reinvestment risk, and credit rating improvements: Role of the call premium

Citation Excerpt:
...For example, the call provision can mitigate underinvestment for firms with growth options (Bodie and Taggart, 1978) and address agency issues due to informational asymmetry and managerial risk incentives (Barnea, Haugen, and Senbet, 1980). The call provision signals better prospects (Robbins and Schatzberg, 1986; Ederington and Stock, 2002), enables the firm to reduce financial leverage or remove restrictive covenants (Vu, 1986), and mitigates interest rate risk (Kish and Livingston, 1992). The call protection period affords flexibility to mitigate underinvestment (Thatcher, 1985)....

The issuance of callable bonds under information asymmetry
2013, Journal of Empirical Finance

Callable risky perpetual debt with protection period
2010, European Journal of Operational Research

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