Discussion of "Repeated Signaling and Firm Dynamics"

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Dynamic Signaling + Costly Bankruptcy

- Infinite horizon

- Privately informed manager

   New private information each period
   Private information becomes public in one period

- Equity and single-period debt

- Capital stock is perfectly reversible $\Rightarrow$ Dynamic wealth

- Analytical solution is not feasible $\Rightarrow$ Numerical Simulation

Restriction on Securities

- Does Exclusion of Long-Term Debt Matter?

  It creates a bias $\Rightarrow$ Adverse selection $\uparrow$

- What about other securities?

  They may also help, but there are issues of tractability

- Single-period debt: An upper bound on the role of adverse selection?

Optimal Security?

- Efficient Equilibrium: High type issues a callable convertible bond, low type issues equity

  Analytical Result: Adverse selection is completely mitigated

- In authors' defense: Callable convertible bonds are not as common $\Rightarrow$ there must be reasons that firms do not choose them

  But then ...

Equilibrium Selection

- Standard issuance games: Informed manager chooses a security and investors subscribe/bid

  Multiple equilibria $\Rightarrow$ Refinement concepts

- Alternative: Maskin and Tirole's (1992) approach

  Informed manager offers menu of allocations

  If investor accepts, principal chooses one of the allocations

  If RSW allocation is interim efficient then RSW allocation is the unique equilibrium outcome [Theorem 1 of Maskin and Tirole (1992)]

  $\Rightarrow$ Least-cost separating equilibrium in a **single stage game**

- This allows

  full use of contracting tools

  justifies restricting attention to the most efficient separating equilibrium of the standard issuance

Equilibrium Analysis

- **Observation**: In an infinite horizon game with random shocks $\Rightarrow$ RSW allocation may fail to be interim efficient at some point

- $\Rightarrow$ Multiple equilibria of the stage game

- What should we do in that case?

  Simulation and calibration restrict attention to separating equilibria although it is inefficient

  Why separation is the focal notion? What about the efficient equilibrium?

- Efficient equilibrium is path dependent

- An infinite sequence of separating equilibrium: An upper bound on the role of adverse selection?