Andreas Krause

Signalling through raising debt

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Uncertain investment outcomes

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Manager remuneration

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▶ Managers of high-value companies obtain the high remuneration in time period 1 if they take on high debt

▶ $\Pi_M^H = \begin{cases} \gamma V_H & \text{if} \quad V_H > D^* \end{cases}$

- Managers of high-value companies obtain the high remuneration in time period 1 if they take on high debt and low remuneration if they take on low debt

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- In time period 2 the type is revealed and they receive the low remuneration if they had low debt
- If the low-value company had taken on high debt, it would fail to repay its debt and the manager receives no remuneration
- $\Pi_M^H = \begin{cases} \gamma V_H + 0 & \text{if} \quad V_H > D^* \\ \gamma V_L + \gamma V_L & \text{if} \quad V_H \leq D^* \end{cases}$

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Manager choice of debt level

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- A manager of the low-value company would choose a low debt level if
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► By investigating the debt level, company types can be distinguished

Separation of company types

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