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# Why government bonds are sold by auction and corporate bonds by posted-price selling

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**Abstract**

When information is costly, a seller may wish to prevent prospective buyers from acquiring information, for the cost of information acquisition ultimately is borne by the seller. A seller can achieve the desired prevention through posted-price selling, by offering prospective buyers a discount. No such prevention is possible in the case of an auction. We establish the result that the seller prefers posted-price selling when the cost of information acquisition is high and auctions when it is low. We view corporate bonds as an instance of the former case, and government bonds as an instance of the latter.


*JEL classification:* D44; G30

*Keywords:* Government bonds; Corporate bonds; Auctions; Posted-price selling; Costly information

## 1. Introduction

In most industrialized countries, government bonds are sold by auction whereas corporate bonds are sold by posted-price selling (PPS). The latter form of sale, which is described by Grinblatt and Titman (1998, p. 58) for example, effectively has the investment bank bringing the issue to market set the price at which the securities are offered, albeit in consultation with the issuer and prospective buyers. This is in contrast to auctions, in which the sale price of the securities offered for sale is obtained from the bids made by the participants in the auction. In the

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Table 1
Issuing procedures for government bonds in OECD countries

| Country | Auction | Posted-price selling |
|---|---|---|
| Australia | X | |
| Austria | X | X |
| Belgium | X | X |
| Canada | X | |
| Czech Republic | X | |
| Denmark | X | |
| Finland | X | X |
| France | X | [a] |
| Germany | X | |
| Greece | X | X |
| Hungary | X | |
| Iceland | X | |
| Ireland | X | |
| Italy | X | |
| Japan | X | X |
| Korea | X | |
| Luxembourg | X | X |
| Mexico | X | |
| Netherlands | X | |
| New Zealand | X | |
| Norway | X | |
| Poland | X | |
| Portugal | X | X |
| Slovak Republic | X | |
| Spain | X | X |
| Sweden | X | |
| Switzerland | X | |
| Turkey | X | |
| United Kingdom | X | [a] |
| United States | X | |

*Source*: European Union; Organisation for Economic Co-Operation and Development; Web Sites of the Debt Management Offices of the Individual Countries.
[a] Posted-price selling is used, but rarely.

uniform-price auction used by the US Treasury, for example, the winning bidders pay the highest losing bid.[1]

Table 1 shows that auctions are used to sell local currency denominated government bonds in every single OECD country. In about one third of the countries, posted-price selling may also be used. In contrast, again in every single OECD country, the overwhelming majority of corporate bonds are sold by posted-price selling. Exceptions are few and very far between.

Our purpose in this paper is to provide an explanation for the afore-mentioned empirical regularity. We start with the observations that

(i) information about a security such as a bond is costly to acquire,
(ii) investors have an incentive to acquire information, and

[1] See Bikhchandani and Huang (1993) for an analysis of the Treasury securities markets.