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Insolvency Law in Times of Crisis

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The Influence of Macroeconomic Factors on the Success of Reorganizations

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What will we discuss today

- Current state of predicting success of reorganizations
- Reasoning for using macroeconomic factors as addition in these models

Expected return from reorganization = the feasibility indicator of a reorganization

- In most legislatures, a reorganization is feasible only when the expected return from it is greater than in liquidation
- Expected return = Planned returned discounted by risks and interests

What factors we use for success of reorganizations?

- Financial/Accounting information
- Debtor characteristics – age, size
- Length of proceeding

Where did the factors come from?

- Bankruptcy literature
- Company survival literature

Do these companies have the same probability of success?

- Same size, age
- Same accounting information
- Different economic environment

And what about expected return?

Learnings from bankruptcy/survival literature

- Including macroeconomic factors in models improve the accuracy of predictions
- They are seldom used

Why do we act as if environment didn’t matter?

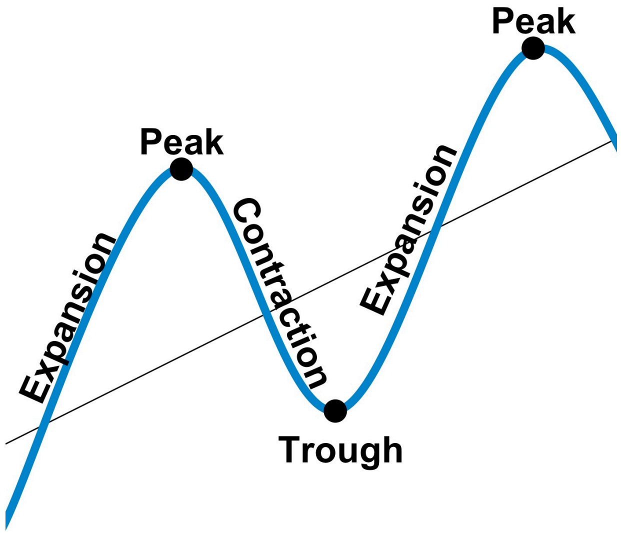
- The ease of analysis
- Environment might already be integrated into debtor
  - More companies file for bankruptcy during crisis
  - More companies reorganize
  - Debtors are in worse shape

Claim

- Including macroeconomic factors (GDP, inflation) improve accuracy of predicting the success of a reorganization

Macroeconomic factors

- Based on Theory of economic cycles
- Unclear what data to use
  - Time point - last quarter? Year? Years?
  - Quarterly or yearly basis?
  - What factor to use (GDP? inflation? Interest rates?)



Ability to finance during crisis

- Differs on company size / means of financing
  - Small companies more dependent on banking system
  - Bigger companies can finance through bonds, lower the dependency on banking after crisis
- Cheaper in crisis (low interest rates)
- Harder to obtain in crisis (bank risk management, trust/fear)

Ability to grow in crisis

- Potentially easier to grow after crisis
  - Easier to grow with the market than gain against competition
  - Survivors may be rewarded by greater share as well

Trust in crisis

- May be diminished on market-level
- Could be bigger on individual debtor-level
- Is there a difference between in perception of a lone wolf going bankrupt or more companies having trouble
    - peer-oriented view

Two approaches

- Country-level factors
  - Ability to finance on the market
  - Crisis subsidies (COVID)
  - Post-crisis law changes
- Industry-level factors
  - Requires knowledge of industry
  - Handles cyclical/acyclical/ neutral industries
  - May not influence financing abilities on the market

Summary

- Macroeconomic factors have been absent in reorganization literature
  - similarly to bankruptcy/survival where they showed its strength
- Including macroeconomic factors may increase prediction accuracy
- **Key reasons:** Financing, Ability to grow, Trust
- **Two approaches:** Country-level, industry-level

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