The Influence of Macroeconomic Factors on the Success of Reorganizations

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Abstract:

Are two reorganized firms with the same characteristics expected to succeed with the same probability? This paper is based on an idea that even though the companies would be the same, the probability would differ over time, as it would be dependent on more factors that can help us predict the success rate better – and with that, make more rational financial decision whether a firm should be reorganized or whether a liquidation should take place instead.

The vast majority of studies concerning reorganizations focuses on financial characteristics, with models dating tens of years, started most notably with Altman's Z-Score. Other attempts how to improve our ability to analyze companies were also considered – with either different financial metrics, or the use additional factors that could make an influence, such as the company size or age. With these variables, the prediction models are built so that a probability of a success is calculated.

Nevertheless, these approaches share the same shortcomings. They do not consider the environment in which the reorganization takes place. This paper follows other authors, that were mostly focused on predicting the firm survival (which also contains reorganizations, as reorganized companies survive the culling) or bankruptcy. They suggested that macroeconomic factors are usually not used because it is simpler to look at individual companies separately. When they used macroeconomic factors, the accuracy of the prediction models grew.

This is also supported by the fact that a year as a variable in the prediction models of reorganizations increases the accuracy as well. However, such variable does not help us predict the future reorganizations – as it includes a trend but also other factors that are innate to that particular year. With that, it is not possible to correctly say whether there is a change in the success rate of reorganizations.

This paper proposes rationale for the importance of use of the macroeconomic factors, such as GDP, in the models predicting the success of reorganizations. Companies that enter the reorganizations during economic crisis face different environment than companies that do so under the time of peace. The ease of getting financing or interest rates may differ, for example. The trust of shareholders can also be different whether a company is a lone wolf that got misguided or whether the whole industry faces grave issues. On the other hand it may be easier for a company to grow their business when the

crisis ends, while it may be harder to do so when the growth slows down (with the inevitable risk of economic downturn in the horizon).