

BOOK REVIEW: “INNOVATION IN FINANCIAL RESTRUCTURING: FOCUS ON SIGNALS, PROCESSES AND TOOLS”

by
Marco Tutino and Valerio Ranciaro
(Virtus Interpress, 2020)

Stefano Dell’Atti *

* University of Foggia, Foggia, Italy



How to cite this paper: Dell’Atti, S. (2021). Book review: “Innovation in financial restructuring: Focus on signals, processes and tools”. *Risk Governance and Control: Financial Markets & Institutions*, 11(3), 81–84. <https://doi.org/10.22495/rgcv11i3p6>

Copyright © 2021 The Author

This work is licensed under a Creative Commons Attribution 4.0 International License (CC BY 4.0). <https://creativecommons.org/licenses/by/4.0/>

ISSN Online: 2077-4303

ISSN Print: 2077-429X

Received: 10.10.2021

Accepted: 12.11.2021

JEL Classification: G32, G34

DOI: 10.22495/rgcv11i3p6

The topic of financial restructuring has attracted more interest from academic scholars that have provided numerous interpretations. The economic stages during the life of a company can be characterized by the crisis and uncertainty of future perspective, to the detriment of the ability to operate successfully in the chosen competitive environment (Dallocchio et al., 2013). The financial restructuring process implies a change of financial or economic company’s structure to eliminate all the financial crises. Often economic crises lead to also an organizational restructuring aimed at saving the capacity of creating value. Following the sub-prime loan crisis, regulators and operators have started to devote more attention to the financial restructuring process, especially in the banking industry.

This research field appears extremely interesting and the book offers an original approach to financial restructuring management and turnaround process (Opler & Titman, 1994; Routledge & Gadenne, 2000; Fabozzi & Drake, 2008; Chiaramonte & Casu, 2017; Habib, Costa, Huang, Bhuiyan, & Sun, 2020). Specifically, it provides a careful analysis of key effects related to the financial structure and financial distress, profiles of innovation in financial debt, the financial restructuring process and successful implementation. It is useful to identify and analyze in detail signals of financial distress, processes and early warning tools for corporate failures.

The book is organized into four chapters.

Chapter 1 offers an overview of the concepts of shareholder equity and financial debt, the costs of corporate capital and financial distress. The distinction between equity, debt and hybrid instruments lies in the nature of the claims on the firm’s cash flows (Damodaran, 2001). Equity is represented by all the shares of the risk capital of a company and equity investment is direct participation in the business risk (Brealey, Myers, & Allen, 2018; Annibaletti, 2014). Debt is another form of financing made available to the company by third parties that provide money in the form of credit (Ranciaro, 2015). Hybrid financial instruments share some characteristics of debt and some of equity (Forestieri & Tasca, 1994). Debt financing has a very important advantage in the fiscal policy of corporations

because interests paid to bondholders are exempt from corporate taxation (Damodaran, 2014). Many models have been developed to identify the specific benefits and costs of using debt and equity such as the capital asset pricing model and the trade-off theory by Modigliani-Miller (Modigliani & Miller, 1958; Hull, 2012; Brealey et al., 2018). In accordance with the benefits of debt and the cost of distress, the optimal capital structure should be reformulated following the trade-off theory, indeed if the distress costs are significant the optimal leverage for a company may be lower (Harris & Raviv, 1991; Graham & Harvey, 2001; Sherif, 2006; Altman, Hotchkiss, & Wang, 2019).

Chapter 2 analyzes the new standard of financial documentation and market practice in the loan market, the financial covenants and the indicators for the detection of financial distress in the economic context. The Loan Market Association together with the Association of Corporate Treasurers developed a recommended form of syndicated facility agreements aimed to facilitate the negotiation of loan documentation to benefit primary and secondary loan markets (Loan Market Association, 2013; Gadanez, 2004). The authors also analyze the financial covenants that have an important early warning tool and maintain a line of communication between the borrower and the lender (Freudenberg, Imbierowicz, Saunders, & Steffen, 2017). The implication of the covenants is to protect the lender against the borrower taking actions that could have an adverse impact or increase the risk for the lender (Corporate Financial Institute, n.d.). Covenants are tested on a periodical basis (Freudenberg et al., 2017). Addressing asset quality issues is one of the key priorities for the European Central Bank (ECB) banking supervision. The deliberate and sustainable reduction of non-performing loans (NPLs) in banks' balance sheets is beneficial to the economy from both a macroprudential and microprudential perspective (European Central Bank, 2017).

The dynamics of both the financial restructuring process and the turnaround process are investigated in Chapter 3. A financial restructuring usually takes the form of rescheduling, compromise, conversion of debt to equity or a combination of all three. Restructuring should be distinguished from the turnaround process which is a more pervasive reorganization of both the debtor's financial obligations and operational processes (Lenahan, 2005; Slatter, Lovett, & Barlow, 2006; Agarwal, 2010; Dalocchio et al., 2013). The essential elements of a successful restructuring include the development of a financial and organizational strategy to address the causes of the corporate crisis. A sustainable restructuring can only be achieved if the elements giving rise to the crisis are resolved. Another aspect analyzed concerns the option between restructuring and liquidation which requires an in-depth analysis and which must be carried out in a short time in order not to allow a further aggravation of the state of corporate crisis. The authors examine the ingredients of a successful restructuring agreement and the conversion of a term sheet into a restructuring agreement.

Finally, Chapter 4 examines the elements and phases of the restructuring process, thanks to exploration of the case of BTA Bank in Kazakhstan. BTA defaulted on its obligations in April 2009, resulting in the acceleration of debt held by international creditors as a consequence of bad management, pressure due to the growing number of NPL, including a breach of change of control covenants arising from SK's investment in BTA. By June 2010, the final restructuring plan was presented to the broader creditor group and to the Financial Markets and Financial Organizations (FMSA) and received creditor approval

(BTA Bank, 2010). Since the beginning of 2011, BTA's financial situation deteriorated despite measures undertaken by management. The second restructuring was paramount to preserve the viability of the Bank and to avoid liquidation (BTA Bank, 2012). As it did during the 2009–2010 restructuring process, BTA was committed to treating fairly all creditors concerned by the proposed restructuring ("Bank BTA and Mukhtar Ablayazov", 2015). After successful completion of a rather difficult and scaled restructuring process, BTA Bank focused on the restoration of its former market positions and currently is a stable and sustainable financial institution.

In this work, qualitative and quantitative methods are used simultaneously. The literature review uses regulatory and supervisor reports, books and scientific articles.

The book provides indications that will help academics, regulators and professionals to better manage the financial restructuring and prevent financial crisis. Indeed, this book aims at contributing to literature and the discussion of corporate restructuring and the turnaround process.

REFERENCES

1. Agarwal, O. P. (2010). *Turnaround management with business process re-engineering*. Mumbai, India: Himalaya Publishing House.
2. Altman, E. I., Hotchkiss, E., & Wang, W. (2019). *Corporate financial distress, restructuring, and bankruptcy: Analyze leveraged finance, distressed debt, and bankruptcy* (4th ed.). <https://doi.org/10.1002/9781119541929>
3. Annibaletti, L. (2014). Le ristrutturazioni aziendali. Paper presented at the *Executive Master in Finanza e Mercati*, Luiss Guido Carli, Rome, Italy.
4. Bank BTA and Mukhtar Ablayazov: Nationalization and restructuring. (2015). *Ablayazov*. Retrieved from <http://en.mukhtarablyazov.org/p/37,bank-bta>
5. Brealey, R. A., Myers, S. C., & Allen, F. (2018). *Principles of corporate finance*. New York, NY: McGraw-Hill.
6. BTA Bank. (2010, June 9). *FMSA approves JSC BTA Bank's restructuring plan*. Retrieved from BTA Bank website: <http://bta.kz/en/investor/news/2010/06/09/93/>
7. BTA Bank. (2012, December 24). *BTA Bank announces the successful implementation of the restructuring of U.S.\$11.1 billion of financial indebtedness* [Press release]. Retrieved from BTA Bank website: <http://bta.kz/en/investor/restructuring/>
8. Chiaramonte, L., & Casu, B. (2017). Capital and liquidity ratios and financial distress. Evidence from the European banking industry. *The British Accounting Review*, 49(2), 138–161. <https://doi.org/10.1016/j.bar.2016.04.001>
9. Corporate Financial Institute (CFI). (n.d.). *What are debt covenants?* Retrieved from Corporate Financial Institute website: <https://corporatefinanceinstitute.com/resources/knowledge/finance/debt-covenants/>
10. Dallochio, M., Taveggia, L., Gremmo, D., Alberti, S., Cotogno, M., & Boellis, A. (2013). *Le ristrutturazioni come strumento per tornare al valore*. Milan, Italy: Bocconi University, Centro Ricerche Sostenibilità e Valore.
11. Damodaran, A. (2001). *Corporate finance: Theory and practice* (2nd ed.). Hoboken, NJ: John Wiley & Sons.
12. Damodaran, A. (2014). *Applied corporate finance* (4th ed.). Hoboken, NJ: John Wiley & Sons.
13. European Central Bank. (2017). *Guidance to banks on non-performing loans*. Retrieved from https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf
14. Fabozzi, F. J., & Drake, P. P. (2008). Capital structure decisions in corporate finance. In F. J. Fabozzi (Ed.), *Handbook of finance*. <https://doi.org/10.1002/9780470404324.hof002060>
15. Forestieri, G., & Tasca, R. (1994). *Il mezzanine financing*. Milan, Italy: Egea.
16. Freudenberg, F., Imbierowicz, B., Saunders, A., & Steffen, S. (2017). *Covenant violations and dynamic loan contracting* (NYU Working Paper No. FIN-11-042). <https://doi.org/10.2139/ssrn.1961980>
17. Gadanez, B. (2004). The syndicated loan market: Structure, development and implications. *BIS Quarterly Review*, 4, 75–89. Retrieved from https://www.bis.org/publ/qtrpdf/r_qt0412g.pdf
18. Graham, J. R., & Harvey, C. R. (2001). The theory and practice of corporate finance: Evidence from the field. *Journal of Financial Economics*, 60(2–3), 187–243. [https://doi.org/10.1016/S0304-405X\(01\)00044-7](https://doi.org/10.1016/S0304-405X(01)00044-7)
19. Habib, A., Costa, M. D., Huang, H. J., Bhuiyan, M. B. U., & Sun, L. (2020). Determinants and consequences of financial distress: Review of the empirical literature. *Accounting & Finance*, 60(S1), 1023–1075. <https://doi.org/10.1111/acfi.12400>
20. Harris, M., & Raviv, A. (1991). The theory of capital structure. *The Journal of Finance*, 46(1), 297–355. <https://doi.org/10.1111/j.1540-6261.1991.tb03753.x>
21. Hull, J. C. (2012). *Risk management and financial institutions* (3rd ed.). Hoboken, NJ: John Wiley & Sons.
22. Lenahan, T. (2005). *Turnaround, shutdown and outage management: Effective planning and step-by-step execution of planned maintenance operations*. <https://doi.org/10.1016/B978-0-7506-6787-6.X5000-7>
23. Loan Market Association. (2013). *A loan market association guide: A guide to syndicated loans & leveraged finance transactions*. Retrieved from Loan Market Association website: https://www.lma.eu.com/application/files/1614/7749/3386/LMA_Guide_to_Syndicated_Loans.pdf

24. Modigliani, F., & Miller, M. H. (1958). The cost of capital, corporation finance and the theory of investment. *The American Economic Review*, 48(3), 261-297. Retrieved from https://gvpesquisa.fgv.br/sites/gvpesquisa.fgv.br/files/arquivos/terra_-_the_cost_of_capital_corporation_finance.pdf
25. Opler, T. C., & Titman, S. (1994). Financial distress and corporate performance. *The Journal of Finance*, 49(3), 1015-1040. <https://doi.org/10.1111/j.1540-6261.1994.tb00086.x>
26. Ranciaro, V. (2015). *Financial restructuring*. Paper presented at La Sapienza, Rome.
27. Routledge, J., & Gadenne, D. (2000). Financial distress, reorganization and corporate performance. *Accounting & Finance*, 40(3), 233-260. <https://doi.org/10.1111/1467-629X.00046>
28. Sherif, K. F. (2006). *Financial restructuring in corporations* [PowerPoint slides]. Retrieved from <https://www.slideserve.com/elga/financial-restructuring-in-corporations>
29. Slatter, S., Lovett, D., & Barlow, L. (2006). *Leading corporate turnaround: How leaders fix troubled companies*. San Francisco, CA: Jossey Bass.