
The Resolution of Claims in Financial Distress the Case of Massey Ferguson: Discussion
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important unanticipated information is not surprising especially if one considers that the expected value of bankruptcy costs impacts shareholder returns significantly. The bankruptcy declaration changes the probability of bankruptcy from some finite number between zero and one to unity.

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DISCUSSION

W. M. TAYLOR*: The financial distress event is complex. It involves resolution or renegotiation of the contracts of the various claimants of the firm. This recontracting game exhibits coalitions and *ex ante* a random number of rounds at random times and with a random completion date. During this period, the market repeatedly adjusts to new information concerning the recontracting and the probability that me-first rules will be violated, as well as about the expected profitability of the firm.

Event studies are usually based on a sample of matched firms. Aharony, Jones and Swary [1] provides a recent example of the use of market data in which control firms were matched with each bankrupt firm to control for possible industry and size effects. Professors Baldwin and Mason have chosen a single case of financial distress and a single reference firm (John Deere). The advantage of focusing on a single case lies in the intensive analysis that it permits. But, a disadvantage lies in the questionable generalizability of any inferences drawn from a single observation of a complex event. The broad results of the Massey-Ferguson case do, however, appear to be consistent with the results of previous studies of samples of bankrupt firms. Overall, the standard deviation of returns increased while the beta declined in the recontracting period.

But, the authors have gone farther than a risk-return analysis. They also address the question of deadweight costs of financial distress by examining Massey-Ferguson's market share over the period of recontracting. A weakness of empirical studies which attempt to measure such deadweight costs is that they are confounded with the effects of factors other than the recontracting among the various classes of claimants. The authors have acknowledged the limitations of their approach and have noted throughout the paper the general confounding of the negative effects of other factors with the effects of the recontracting. For example, the regressions used to test the hypothesis that financial distress affected Massey's marketshare relative to Deere suggest a loss of sales during the

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period. But, there is confounding with other factors such as the decisions of new management. Haugen and Senbet [2], for example, have noted that the willingness of the various suppliers and customers to continue their relationships with the firm may depend on the on-going decline in expected profitability of the firm. This may be particularly true of firms such as Massey-Ferguson in durable goods industries where service and spare parts are of concern.

Following the lead of the authors in examining individual residuals in Figure 3, a particularly large 11 percent decline in price which is not mentioned in the paper occurred in October 6, when the Canadian Government announced its intention to "work closely with firm . . . ". This may be an unobstrusive measure of the credibility of the threat to shareholders of government participation in the recontracting. It was followed by another large decline on October 22 after the Canadian government and the Ontario provincial government reported the extent of their participation in the refinancing plan.

Forty-four "news" items were reported in the press from August 1980 to March 1981. Of these, only six to eight are associated *ex post* with large changes in the residuals computed in Figure 3. Otherwise, the residuals are consistent with market anticipation of the economic impact of the events or that the events had no economic importance to stockholders.

The paper is consistent with previous event studies which indicate types of announcements such as, insider transactions, government intervention or participation, and specific recontracting decisions which can serve as points of interest in a multi-event study of market efficiency, or of shifting valuations of the classes of claims against the firm in the case of financial distress. So, apart from providing a detailed analysis of the Massey-Ferguson case, the value of the paper may lie in its indication of the need for a better theoretical model which makes more explicit the link between market data and recontracting in financial distress. Empirical measurement of deadweight costs from market data requires a method which isolates such costs from the ongoing deterioration of profitability which has led to the need for recontracting or formal bankruptcy.

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