

Going Concern Value Versus Abandonment Option Value in Debt Restructuring Firms

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Abstract:

This paper investigates whether going-concern value or abandonment option value dominates in troubled debt restructuring (TDR) firms, in an attempt to explain the positive excess returns observed in a few studies on TDR samples. Basing the analysis on the shareholders' call and put options on the assets of the firm, this study first predicts the impact of a TDR on the firm's fundamentals and the shareholders' wealth. Then it investigates the financial profiles and asset structures of TDR firms around their restructuring attempts, uses a new methodology to corroborate the positive market reaction results, compares the results with those of a matched sample, and uses a valuation model to examine the explanatory power of their net income and book values. The findings suggest that the financial profiles of debtor firms improve after the TDR attempt, the exit values of their assets are not any higher than those of a matched sample, and the value relevance of NI improves after the restructuring attempt. The evidence supports the positive wealth effects and the prominence of going-concern value in TDR firms.

Keywords: Debt restructuring, financial distress, abandonment option, going concern value, market reaction, value relevance

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