

# Essays in Corporate Distress and Turnaround

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## Abstract

This thesis consists of three essays that examine the effect of director's connections on the financial outcomes of firms going through a period of corporate distress. In Essay 1, I examine the effect of director's connections on (a) distressed firms' likely hood of filing for bankruptcy protection and (b) the time a firm spends under bankruptcy reorganization. I examine these questions in the context of an emerging economy, where the role of connections is likely to be important given that there are severe institutional voids with respect to bankruptcy reorganization. The specific agency that adjudicates bankruptcy cases is the Board of Industrial and Financial Reconstruction (BIFR). I find that connected firms are less likely to file for bankruptcy and are more likely to choose private restructuring during distress. I also find that, in general, board connections are positively related to the time spent in BIFR protection. When I partition the sample into firms that were expelled from protection and those that turned around under BIFR, I find that connections have different effects. Specifically, duration is positively related to connectedness for expelled firms, but negatively related to connections for turnaround firms. My interpretation of these findings is as follows. Suppose we think of turnaround firms as 'good' types, and the expelled firms as 'bad' types. Then, for the good types, connections help them turnaround faster and spend less time under BIFR as a sick firm. Whereas for the bad types, connections slow down their likelihood of exit, and thereby enable them to enjoy the bankruptcy protection a little longer. In Essay 2, I examine the effect of board level connectedness on the turnaround likelihood for a sample of firms going through distress during the period 1998-2014. I find that highly connected firms are more likely to turnaround from distress than are less connected firms. These findings obtain for all my four measures of connectedness, as well as a composite of the four using principal component analysis. I also find that connections have an indirect effect on turnaround likelihood via its effect on certain firm characteristics. Specifically, the effect of profitability, sales growth and investment on turnaround is magnified through connections. To my knowledge, this is the first study on the role of board connections on corporate turnaround. Further, this paper contributes to the understanding of distress resolution in an emerging market where there are institutional voids; my findings confirm that inter-firm mechanisms such as board connections assume importance. Essay 3 examines how stock markets values connected firms going through a period of distress. To test this, I form hedge portfolios by distress and connections, and model their excess returns using the Fama-French model. My results shows that the portfolios of non-connected firms have high positive excess returns (alpha) than connected firms irrespective of whether they are distressed or not. I repeat this exercise for turnaround and failed firms, to find that the divergence in returns between the two reduces with increase in connections. The results support an inverse relationship between excess returns and connectedness. One interpretation of this finding is that connectedness reduces the market perception of firm risk. Additionally, I find that there is no distress anomaly in India.