

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

by

Marco Tutino and Valerio Ranciaro
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An Italian hackneyed phrase states “*tra il dire ed il fare c’è di mezzo il mare*” (something like a sea separates human actions from human assertions). Probably such a phrase inspired the two Italian Authors of “*Innovation in Financial Restructuring. Focus on signals, process and tools*”. In fact, the book attempts to match together the “assertions” on the capital structure theory with the “actions” of the financial practices in restructuring processes. The actual implementation process is often at the bottom of the (un)successful ending of the restructuring effort. Indeed, it is the separating “sea”: although you are a good swimmer, it can be a bit wider it may appear from the coast. Why?

The capital structure theory is a patchwork, evolving from seminal proposals by Modigliani and Miller (1958) toward the current bigger picture as depicted in Chapter 1 of the book. The most recent pieces of knowledge add some qualitative (patches) approaches to the core ones, which had a more quantitative focus, namely the impact of leverage over the cost of capital. Accordingly, we all got aware that the weighted average cost of capital (WACC) is determined through components (i.e., cost of debt and cost of equity) which embed some original risk premia. This makes the relationships among leverage and WACC a non-regular one; in fact, they are filtered (sometimes: boosted) by other components of the firm making more and more complex the actual cobweb, therefore its investigation. Agency costs are emblematic examples of the above. The agency relationship may either bias the value creation processes by suggesting a reduction of leverage; or they may push superior efficiency boosting the operating returns of the firm and sustaining above normal leverages as Ross, Westerfield, Jaffe, and Jordan (2015) describe. Corporate governance is another cornerstone. The bootstrap effects it may ignite depend on the nature of the stakeholders using the corporate governance framework of that specific company as Mantovani and Moscato (2020) demonstrate. The patchwork makes difficult to deal with a sound process of financial restructuring, accordingly a definitive coding of the financial practices to adopt. This is why associations and independent bodies make a continuous effort to update the standards, thus producing a continuous-time flow of updates, as explained in Chapter two of the book.

The Authors provide their best effort to give the most up-to-date picture of the state of the art and they are very honest to declare the potential obsolescence of their description. In fact, any passionate about economic history knows that rigidity in standards is the biggest pitfall behind their efficacy. This was the emblematic case of Bretton-Woods agreements, which teaches next-to-nothing to the Basel Agreement designers. Just like the case of upgrades for any operating system into our laptops, they are always released once a sad experience took place...for the users! Similarly, the Basel Agreements receive core updates only AFTER a financial disaster takes place with the previous release. Indeed, the Authors warn us about this possibility when giving a detailed description of the L.M.A. standards. At the best of my knowledge, two other critical elements contribute to the complexity of the puzzle. On one side, you should consider the impact of firm-specific (idiosyncratic) risks over leverage. On the other side, you should be aware that debt maturity matters.

We know the story: systematic risk is at the bottom of the most scientifically accredited (and used in practice) financial models, e.g., the CAPM. Betas are therefore the very basement of the pricing of capital investment instruments, including debt. If you investigate carefully the most recent pieces of the theoretical patchwork on capital structure (e.g., bankruptcy costs, agency costs, personal taxation, intangibles contribution, pecking orders, etc.) they are chiefly based on firm-specific items. Therefore, the trade-off effect as greatly synthesized by Tutino and Ranciano is really a balancing puzzle among the systematic and the firm-specific riskiness over the leverage decisions. As an example: while the tax-shield of debt contributes to corporate value through systematic risk, the probability of default is a very firm-specific element of risk although it (negatively) contributes to such a value as well. Maybe missing the distinction between these two different clusters of risk into the coding of the best practices is at the very bottom of their accelerated obsolescence. My personal suggestion to the Authors is to contribute more on this topic in the forthcoming editions of the book.

Debt maturity is another “dark side of the moon” of capital structure theory that was partly investigated during last decade by Rey, Tuccillo, and Roberto (2020); Rashid, Islam, and Nuryanah (2014); Wolfe (2008). In fact, the standard practice is based on the duration matching principle...and its pitfalls! Since mid-nineties, Leland and Toft (1996) proposed an interesting approach based on the “endogenous-bankruptcy”. According to this approach, the cashflow mismatches over time may ignite default given a common set of economic background. Supposing that the shareholders may have an anticipated controlling capability over the company (as compared to debt capital investors) because of their superior information set over the company, this may lead to unexpected behaviours. In fact, when the long-term persistency of the corporate performance declines, they could decide to interrupt the hedging of mismatched cash flows and ignite default. Such default is endogenous and sometimes it can be even a crime. To prevent endogenous bankruptcy, you may design the debt maturity to prevent mismatching. Similarly, debt maturity re-design can be a fantastic tool to produce more effective results of any financial restructuring process. A more detailed explanation of the above concept is summarized by Mantovani (2015). My personal suggestion to the Authors is to consider more the proposal of Leland and Toft (1996) into forthcoming editions for paragraphs 2.3 and 3.3 which already give a very innovative contribution to the standard practice.

One of the most innovative parts of the book is focusing on the control of the post-restructuring phase. In fact, this is

a topic where experts in law are writing the more, while business economists tend to be absent. In my personal opinion, the spreading of short-termism from financial markets to managerial practices (The Economist, February 16th, 2017) is at the basis of the reduced contribution by business economists, although is a lemma, only, of a deeper problem in the knowledge in business economics: the lacking knowledge about the drivers of the persistency in corporate performance and the (consequent) low-awareness of its contribution to business economics. The Italian School on Business Economics has a long tradition of research on that topic, provided the relief given by its founder, Gino Zappa, who conceived the “ordine economico” concept (economic orderliness) at the root of his proposal of the business economics (“Economia Aziendale”). Maybe this helps to understand why the two Italian Authors of the book make a big effort to give some insights on this topic which are clearly a direct consequence of their applied research experience. I must honestly say that this is the most innovative and outstanding part of the book, with extensions also into Chapter 4 describing a case history as an application. The most recent revisions of the value-based approach based either on the sharing of value among stakeholders (Porter & Cramer, 2011) restored the seminal work by Fruhan (1979) who initially suggested that the persistency of value creation process were determined even by ways value is distributed among the stakeholders. The case discussed in Chapter 4 of the book is a clear proof of the great contribution that this approach may give to financial restructuring.

As a conclusion, my opinion is that *Innovation in Financial Restructuring* is a must be read book, meaningless the different theoretical perspectives you may have. In fact, the tentative to cross the see dividing theory and practice in this topic is the most distinguishing and innovative characteristic of the book. Such a characteristic makes the book useful both for academicians and practitioners, by opening a wide use for pedagogical purposes. The continuous evolution of the subject will oblige the Authors to propose new editions with updates in the forthcoming years. Indeed, this is normal for this kind of topics and that is why I try to give my suggestions on this path.

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