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House Banks in Out-of-court Reorganization: Evidence from Austria

Cover Page Footnote

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House Banks in Out-of-court Reorganization: Evidence from Austria

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ABSTRACT

The main purpose of this article is to study the role of house banks in out-of-court reorganization. Banks are traditionally one of the most important financial resources for firms. Especially in financially difficult times like those we now face due to the coronavirus, it can make a difference whether a bank supports its clients and accompanies firms through a crisis or not. With the help of relationship lending theory, we review the existing literature on this topic. Next, based on empirical findings from Austrian banks, we derive implications for corporate practice. The empirical study covers a sample of 658 firm reorganizations in Austria. The data were collected anonymously by different banks processing the cases in their workout departments between January 2011 and December 2013. Correlation analysis and logistic regression were applied to analyze the data. The findings indicate that house banks, despite their relationship of trust, must be critical in their assessment of reorganization projects due to the danger of zombie lending. The four most important prerequisites for completing an out-of-court reorganization were a new loan, an open and proactive communication policy on the part of the distressed company, management changes, and a financial contribution from existing shareholders. The findings show that bank-supported out-of-court reorganization has a high probability of success. A recommendation to entrepreneurs is to respond rapidly to financial distress and maintain open communication with stakeholders, in particular banks. The findings indicate that the implementation of Directive (EU) 2019/1023 on preventive restructuring frameworks in the European Union is crucial to enable bank-led reorganizations.

Keywords: Reorganization, House bank, Out-of-court, Workout, Relationship Lending

JEL Codes: G21, G34

I. Introduction

A. *Problem Statement*

The potentially devastating societal and economic outcomes of the coronavirus crisis currently threaten the survival of firms on a global scale (Wenzel et al., 2020). Financial crises will be frequent features of business life. Many companies will most likely struggle economically for many years. Failure rates and bankruptcies will therefore increase.

SMEs are predominately funded with the help of banks in addition to equity (Berger and Udell, 1998). These businesses are also very dependent on their house banks since access to alternative funding sources is limited (Elsas and Krahen, 2004). In financial crises, this can lead to higher vulnerability and consequently to higher failure rates of SMEs than of larger companies (Kuecher et al., 2018; Box, 2008). In financial distress, it can make a difference whether a bank supports its clients and accompanies firms through the crisis or not. Despite the fact that banks are willing to help (Couwenberg and Jong, 2006), they also play a key role in the reorganization process and discriminate very well between successful and unsuccessful firms (Huang et al., 2015). Regarding reorganization, companies can choose from an out-of-court reorganization, a workout, or a court-supervised procedure (Gilson, 1991). While an in-court supervised reorganization makes use of the insolvency law framework to remedy a firm's financial distress, an out-of-court reorganization or a so-called workout or out-of-court settlement aims to address the distress before the opening of judicial proceedings or outside of insolvency proceedings and thus serves as an alternative to these, in consultation with creditors. Out-of-court solutions are handled privately, and therefore little is publicly known about the process of an out-of-court reorganization and what determines its success or failure. On the one hand, confidential handling is regarded positively by many creditors and debtors (Garrido, 2012); on the other hand, due to missing or limited legal principles on the process itself (which in most countries is not standardized), its outcome and success is hard to measure (European Commission, 2011). A healthy core of resources (employees, production knowhow, image, infrastructure, finance) forms the basis for a successful reorganization in both forms (Mayr and Mitter, 2015).

Compared to bankruptcy, the workout option has so far been examined to only a limited extent in the existing literature with regard to its course and the resulting success rates (Blazy et al., 2014). Decker (2018) states that most articles in the literature on out-of-court reorganization are focused on the North American experience. Furthermore, she notes that existing studies mainly focus on large, stock-based companies, whereas studies on SMEs' negotiations are limited. In addition to the limited literature on out-of-court reorganization, there is also limited literature

regarding the role of banks in the workout process (Huang et al., 2015). Prior findings regarding the role of banks in out-of-court reorganization confirm that a stable house bank relationship increases the probability of out-of-court settlement (Blazy et al., 2014; Couwenberg and Jong, 2006; Jostarndt and Sautner, 2010; Micucci and Rossi, 2017).

B. Aim of the Study

The main purpose of this article is to study the role of house banks in out-of-court reorganization with a strong focus on SMEs. Banks are traditionally one of the most important financial resources for small- and medium-sized firms. Especially in financially difficult times like those we face now due to the coronavirus, it can make a difference whether a bank supports its clients and accompanies firms through a crisis or not. With the help of relationship lending theory, we review the existing literature. Based on empirical findings from Austrian banks, we derive implications for corporate practice. The remainder of this paper is structured as follows: In the next section, the theoretical background, relationship lending theory, is presented. In the third section, the existing literature is reviewed. The fourth section presents the methodology, followed by the results and the discussion. The paper concludes with the central findings and recommendations for corporate practice.

II. Theoretical Background

The availability of external finance for small and medium enterprises (SMEs) is a topic of significant research interest to academics and an important issue to policy makers around the globe (Berger and Udell, 2006). Different lending technologies or concepts therefore play a key role since government policies and national financial structures affect overall credit availability for SMEs (Huang et al., 2015). A lending technology represents a unique combination of primary information sources, screening and underwriting policies/procedures, a loan contract structure, and monitoring strategies/mechanisms. Lending technologies are often categorized into two types: transaction lending, which is based primarily on “hard,” quantitative data, and relationship lending, which is based significantly on “soft,” qualitative information (Berger and Udell, 2006). Relationship lending is primarily dominated by long-term commitments between lenders and borrowers and an informational monopoly by the lender (Elsas and Krahen, 1998). It is further characterized by close monitoring, renegotiability, and implicit long-term contractual agreements (Berlin and Mester, 1998). This relationship can only be ensured due to information production and repeated interactions over a longer period between a firm and its main bank (Elsas, 2005). A common finding is that large institutions have a comparative advantage in transaction lending to SMEs based on hard information, while small

institutions have a comparative advantage in relationship lending based on soft information (Berger and Udell, 1998). Inherent in small business lending is a more pronounced information asymmetry, since small and medium sized companies are more opaque than relatively transparent large firms (Hardee, 2008).

However, relationship lending is not a dominant type of financing because it is also associated with costs (Elsas, 2005). In addition to existing monitoring costs for the lender, the borrower also faces switching costs due to obstacles in changing banks (Berger and Udell, 1998). Such changes become harder because of the information privilege of the main bank, which induces bargaining power due to its special status with respect to the locked-in situation of the lender. Relationship lending is very similar to the definition of the German house bank. We therefore use the terms relationship lending and house bank lending synonymously (Elsas and Krahen, 1998). In addition to Germany, Japan is especially known for the importance of its banking relationships (Hoshi et al., 1990).

According to Blazy et al. (2014), the average duration of a credit relationship between a firm and its main bank is approximately seven years. In addition, the existence of relationship lending is influenced by three determinants: borrower characteristics (e.g., size or quality of the firm, informational opaqueness, access to public debt or equity markets), bank characteristics (e.g., type of bank, such as a savings or cooperative bank versus a private bank), and market characteristics and conditions (e.g., regulation, market structure, competition) (Elsas, 2005). Another variable to assess the presence of a house bank relationship is a firm's number of bank relationships (Elsas and Krahen, 1998). The "exclusivity of a bank relationship is neither a necessary nor a sufficient condition for relationship lending," but it reduces direct competition between various banks and allows unique access to important information (Elsas, 2005). Bank size is another characteristic related to relationship lending, since larger banks are disadvantaged in relationship building with small firms (Berger et al., 2014). This disadvantage occurs because relationship lending is based on soft information collected through the strong exchange of communication between borrower and lender. Large banks have difficulties in processing and transmitting soft information due to long communication channels that increase information loss (Stein, 2002).

A study from Harhoff and Körting (1998) finds that in the German lending market, the intensity of a relationship between a bank and an SME is affected not only by the length of the relationship and the number of the SME's credit providers but also by mutual trust because trust improves the firm's access to financing and reduces borrowing costs. Therefore, social interaction between a bank consultant and an entrepreneur is very important to stabilize the relationship; furthermore, this leads in a next step to lower interest rates, lower collateral requirements and an increase in

credit availability (Hirsch et al., 2018). Trust also has a positive effect on transaction costs, which are lowered, and helps economic interactions run more smoothly and for a longer time. Finally, trust helps prevent firms from switching banks (Hirsch et al., 2018).

Different lending technologies require different means of collecting information on the part of the bank. On the one hand, banks can collect information with transactional lending (hard facts) and, on the other hand, with relationship lending (soft facts). While relationship lending is based on “proprietary information collected, in particular, by the loan officer through repeated interaction with the firm over time” (Micucci and Rossi, 2017, p.343), transactional lending is mostly based on the evaluation of the firm’s financial statement.

A common tool for banks to collect information is to monitor the client, which is a more or less automatic process, starting even before credit is granted and continuing after the credit is approved and paid to the client. Due to this continuous process of gathering and analyzing information over the entire life cycle of the firm-bank relationship, monitoring costs can be reduced, and early warnings can be detected to allow for quick intervention in periods of distress (Micucci and Rossi, 2017). Furthermore, monitoring increases the chance of renegotiation options in case of distress (Berlin and Mester, 1992). Another advantage of monitoring is to reduce moral hazard behavior on the part of clients, which is a key factor in cases of financial difficulty (Micucci and Rossi, 2017). According to Inoue et al. (2008) there is a need for monitoring and mediation by bank supervisors to react in a timely manner when a company falls into distress. Relationship lending and banking represents an approach to monitoring debtor firms and thereby reducing information asymmetries (Huang et al., 2015). However, “relationship strength and its consequences may be greater when banking markets are less competitive, because firms have fewer potential alternatives in the future event that their main bank tightens contract terms dramatically” (Berger et al., 2014, p.267).

Nevertheless, if relationship lending becomes exaggerated, it can result in so-called zombie lending or evergreening (Micucci and Rossi, 2017). This can happen when banks try to cover or at least postpone loan losses. They therefore might decide to sustain inefficient firms (Micucci and Rossi, 2017). Banks are at risk of postponing loan losses when the liquidation value of firms is higher than their ongoing concern value. What the literature describes as zombie lending can be basically understood as lending that keeps borrowers artificially alive through the extension of new credit. For instance, the strong relationship ties in Japan have been cited in the literature as an example of the perverse incentives for banks to continue lending to weak firms that can arise under relationship lending (Caballero et al., 2008).

House banks or main banks also play a key role in the reorganization of distressed companies. They might, for example, support a private workout plan or negotiate with other lending banks and the distressed firm (Blazy et al., 2014). Existing cross-country evidence shows that firms that maintain relationships with banks and banks themselves may behave differently in such relationships with regard to workout decisions (Ongena and Smith, 2000; Mian, 2006). Some banks may decide to restructure their loans to financially distressed firms, while others may not. Reasons for accompanying a firm through distress might be the close relationship between a firm and a bank and mutual trust.

III. Literature Review and Development of Hypotheses

Previous research confirms that banks play a decisive role in both the choice for an out-of-court restructuring and its success (e.g., Goto and Uchida, 2012; Blazy et al., 2014). Elsas and Krahnén (2002) and Huang et al. (2013) find in their research that a stable house bank relationship increases the probability of an out-of-court settlement. The study of Elsas and Krahnén (2002) uses a data sample of five German banks for the period 1992 to 1996 and focuses on medium-sized companies. According to the results, house banks have more collateral than arm's length banks, which are essentially subsidiary banks that have less information about the borrowing company. In reorganization, house banks and banks with more securities for outstanding loans support out-of-court restructuring more often than other banks. High collateral improves the bank's negotiating position not only vis-à-vis the debtor company but also vis-à-vis other creditors. This good negotiating position thus has a positive effect on the bank's decision to support an out-of-court restructuring. In the survey undertaken by Huang et al., (2013), which focuses on Taiwanese listed companies, a connection between the number of banks and the decision over the form of restructuring is identified, in addition to the influence of the intensity of the banking relationship: a lower number of bank relationships reduced information asymmetries and coordination problems and thus increased the probability of an out-of-court restructuring. Couwenberg and Jong (2006) also confirm the role of the bank with regard to the decision on the form of reorganization: banks support companies in an out-of-court reorganization when the banks hold a high share of the total debt and thus risk or when they expect a high probability of success of the restructuring.

H1: A strong relationship between a firm and its main bank (house bank) increases the likelihood of successfully completing a workout.

Findings from Taiwanese listed firms facing severe financial distress indicate that bank relationships (relationship lending) significantly reduce the risk of filing for

bankruptcy but increase the probability of deb renegotiation (out-of-court settlement) (Huang et al., 2013). According to (Dahiya et al., 2003), prior banking relationships are valuable for lenders. On average, abnormal returns to banks upon the announcement of a borrower's financial distress are significantly and negatively related to the existence of a prior past borrowing relationship with that borrower. This means that banks are more willing to help economically successful firms or at least companies with a higher chance of success. Couwenberg and Jong (2006) confirm the role of the bank in regard to deciding over the form of restructuring: banks support companies in an out-of-court reorganization when the banks hold a high share of the total debt and thus risk or when they expect a high probability of success of the restructuring. The size of the financing bank also plays an important role in reorganization. Berger et al. (2014) suggest that small banks are better able to form strong relationships. Due to their size, they have a large advantage in achieving closeness to the customer compared to big banks (Decker, 2018). Small banks typically engage in relationship lending. Smaller banks collect soft information through personal interaction between firm owners and bank loan officers (Hardee, 2008).

H2: Small banks are more successful in reorganizing firms.

H2A: Relationship lending is more common in small banks.

H2B: Relationship lending is important across the bank size distribution and contributes to a successful reorganization.

Extensive cooperation between a main bank and a firm leads to the growth of the relationship (Huang et al., 2013). A stable and long-term relationship contributes to easier negotiations between the two: The longer the duration of the relationship between a firm and its main bank, the more information is available and the better are the possible market predictions. Another positive aspect of this relationship characteristic is the reduction of information asymmetry and hold-out problems (Gilson, 1991). Couwenberg and Jong (2006) indicate that banks have a powerful say in the restructuring activities of firms. Distressed companies are handed over to workout departments of banks (Kent, 1997). Large banks, in particular, have separate departments with workout experts to manage such cases (Couwenberg and Jong, 2006). We therefore propose that banks guide firms in their restructuring effort and that their assistance is of crucial importance for the success of the restructuring.

H3: A bank with experience in accompanying out-of-court reorganizations is more likely to complete a workout successfully than a bank without that expertise.

The more information a bank has about its client, the better and faster a bank can act and suggest solutions. Collecting soft facts is easier for small banks because the communication channels in a small bank are shorter and more direct and lose less information through the layers of management (Berger et al., 2014). Therefore, banks may have an informational advantage over other stakeholders. This implies that banks are likely better informed about the financial status of their borrowers and thus will be able to take steps to reduce their loan exposures before the news of a borrower's distress becomes public (Dahiya et al., 2003). The better the information and the closer the relationship between a bank and a borrower, the more banks are willing to assist firms and this is the crucial importance to the success of the restructuring (Couwenberg and Jong, 2006). According to Dahiya et al. (2003), banks do not hold out on a restructuring effort, but actively participate by providing new funds, by easing certain conditions (especially extension of principal, a form of “softening”), as well as by tightening others (hasten repayments, additional collateral). If the available collateral does not cover the full amount of liability, then banks remain vulnerable, and in case of distress, a firm might force the bank to forgive part of the principal of a loan (Couwenberg and Jong, 2006).

H4: If a firm receives support from a bank in the form of debt forgiveness or the issuance of new credit, it is more likely to complete a workout successfully.

H4A: House banks are more willing to provide support in the form of debt forgiveness or the issuance of new credit.

H4B: A house bank relationship is important for the availability of options such as debt forgiveness or the issuance of new credit and contributes to a successful reorganization.

It is obvious that distressed companies need the support of external stakeholders, especially banks, that provide financial resources to reverse decline (Decker, 2018). Due to the firms' lending situation, banks gain additional control over distressed firms, and various interests can come into conflict. Therefore, open and proactive communication between the managers of a company and the bank is essential to balance different aspirations and goals. Furthermore, how management communicates with the corporate bank advisor shapes the advisor's impressions (in a positive or negative way) regarding provision of help in a situation of distress. According to Decker (2018), frequent and open communication between the two parties increases the likelihood of stakeholder support and a successful turnaround.

H5: Open and proactive communication between a firm and its bank increases the likelihood of completing a workout successfully.

H5A: Relationship lending is more likely to encourage open and proactive communication between a company and its bank.

H5B: A house bank relationship is important for open and proactive communication and contributes to successful reorganization.

The willingness of a bank to help also depends on the role of managers, that is, whether management is cooperative (Dahiya et al., 2003), and of their knowhow in leading a firm in a crisis. Whereas corporate companies have financial departments with a board of experts, small firms either do not have boards to monitor and control management or boards play a different role, e.g., providing specific knowledge, giving access to a network of relations or perhaps even image-building (Couwenberg and Jong, 2006). According to Blazy et al. (2014), the success of a positive workout depends on whether management is at fault for the distress. Replacement of a leader can be harmful for a firm due to the loss of knowledge and expertise, but it can also be a first step towards a turnaround, especially if the house bank associates the company leader with the failed course of strategic action and the reasons for decline (Decker, 2018). In this situation, a change in management can then be a signal that the distressed company is honestly attempting to avoid failure. Jostarndt and Sautner (2008) emphasize that it is mostly banks, among a firm's various stakeholders, that trigger management turnover. According to Hammann et al. (2009), this effect may be especially important in SMEs where personal relationships and individual responsibilities are essential.

H6: A change in management can increase the likelihood of completing a workout successfully.

H6A: A main bank is likely to encourage a change of management due to mutual trust and information exchange between company and bank.

H6B: House bank status is important for initiating a management change and contributes to a successful reorganization.

Furthermore, studies by Inoue et al. (2010) as well as by Jostarndt and Sautner (2008) identify a positive and significant correlation between the likelihood of a management change and the receipt of new capital when firms are in distress. Couwenberg and Jong (2006) confirm that shareholders are willing to contribute new funds (either equity or debt) in addition to support for management control or the provision of know-how. Prior findings from Mayr and Lixl (2019) indicate that the willingness of banks to support troubled firms is determined not only by their evaluation of the firms' capability of meeting future market requirements but also by the willingness of the entrepreneur to personally contribute to restructuring. In

summary, it can be stated that a financial contribution to the restructuring by existing owners and shareholders can have a positive effect on the outcome of an out-of-court restructuring in two ways: On the one hand, the injection of financial resources can create the necessary slack for the reorganization (Jory and Madura, 2007). On the other hand, this (solidarity-based) financial support can, in the context of negotiations with the company's stakeholders, serve as the decisive factor in securing their consent to the reorganization.

H7: Shareholder contributions can increase the likelihood of completing a workout successfully.

H7A: Shareholders are more willing to invest equity in a company that is in financial distress if it benefits from relationship lending.

H7B: A house bank relationship is important for attracting shareholder contributions and contributes to a successful reorganization.

IV. Empirical Study

A. Research Method

Scientific research on out-of-court restructuring has so far been characterized by empirical-quantitative methods. Most of the papers identified in the literature review can be classified as quantitative. The predominant use of quantitative research methods in the context of out-of-court restructuring can be justified by the subject of the study. Recent studies mostly deal with listed companies, for which a large amount of publicly available information on restructuring is available due to reporting obligations (e.g., Goto and Uchida, 2012; Huang et al., 2013; Jostarndt and Sautner, 2010).

From a statistical point of view, hypothesis tests of the assumed relationships have mostly been carried out through bivariate and multivariate procedures, in particular regression analyses (e.g., Elsas and Krahnén, 2002; Brunner and Krahnén, 2008; Blazy et al., 2014). The empirical method of the present study is also quantitative. First, the hypotheses were tested by using Fisher's exact test. In addition, logistic regression was applied to build a model estimating the relationship of the dependent variable, namely, the outcome of the reorganization, with the various independent variables referring to the different hypotheses. Logistic regression is one of the structure-testing procedures with the help of which the dependence of a variable of interest on one or more independent variables (influencing factors) is examined. A prerequisite for its use is an idea of the interrelationships between the variables under investigation—in the present case the influence of several independent variables on the outcome (success or failure) of an out-of-court settlement—based on logic or

theoretical considerations. A company was identified as having been successfully restructured out-of-court if a restructuring agreement was concluded with the financing bank and any other creditors and the company continued as a going concern in the existing legal entity in the same or a similar form (Gilson et al., 1990; Jacobs et al., 2012).

B. Sample Description

For the quantitative study, cases of out-of-court restructurings were analyzed within the scope of anonymized data collected at 5 participating banks. The entire data sample contains 920 data records on out-of-court reorganization in Austria. A total of 658 cases where an active reorganization attempt had been made and the reorganization had already been completed were included in the final sample. Taking into account the selection criterion of material insolvency on the part of the affected firms, the participating institutions are fully informed about the cases pending in their workout departments. Possible distortions, which have to be taken into account when interpreting the results, may result from the fact that not all Austrian banks participated in the survey.

With regard to the question of whether the participating banks represent the overall banking market in Austria, the following should be noted: The five banks are among the ten largest banks in Austria, including both banks with a centralized (Raiffeisen Bank International AG, Erste Bank AG, Erste Group Bank AG, Unicredit Bank Austria AG) and decentralized (Raiffeisen Landesbank OOE AG) organizational structure, and thus different levels of credit market access are taken into account. In addition, Raiffeisen Bank International AG and Erste Bank Group are highly internationally active banks, and Raiffeisen Landesbank OÖ AG is a bank that operates predominantly on a regional and national level and is classified as a small bank. Exclusively regional banks are not included in the sample.

C. Descriptives

Table 1 gives an overview of the frequency distribution of the dependent variable (outcome of the reorganization) and several independent variables (various reorganization measures and the type, size and status of the participating bank) that relate to the hypotheses in Chapter 3. The "cases" column shows the respective number of successfully or unsuccessfully reorganized companies in absolute numbers in relation to the respective independent variable. The determined percentages are displayed in the "in %" column and show the relative frequencies of successful and failed cases.

In brief, 409 (62 %) out of the 658 companies were positively restructured and continued to operate, while 249 (38 %) failed to achieve turnaround as a going concern. Out of the 409 successful cases, approximately 33 % received new credit from their own bank to reorganize the firm. More than 70 % of the successfully reorganized firms had open and proactive communication with the bank. In contrast, only approximately 39 % of the unsuccessful reorganizations had open and proactive communication between the firm and the (house) bank.

Table 1: Frequency distribution

Variables	Successful reorganization		Unsuccessful reorganization		Total	
	cases	in %	cases	in %	cases	in %
Outcome of the reorganization	409	62 %	249	38 %	658	100 %
House bank relationship	240	59 %	161	65 %	401	61 %
Small bank	40	10 %	8	3 %	48	7 %
Expert bank	294	72 %	189	76 %	483	73 %
Debt forgiveness	76	19 %	85	34 %	161	24 %
New credit	134	33 %	46	18 %	180	27 %
Open and proactive communication with the bank	298	73 %	98	39 %	396	60 %
Change in management	163	40 %	65	26 %	228	35 %
Contribution from existing shareholders	182	44 %	51	20 %	233	35 %

Table 2 gives an overview of the size of the underlying companies in terms of turnover. Approximately one-quarter are of micro size (up to 2 million €), one-quarter are of small size (up to 10 million €), and one-quarter are of medium size (up to 2 million €), respectively; therefore, in sum, 80 % of the reorganization cases are SMEs.

Table 2: Turnover of companies in reorganization

Sales	Cases	Percent	Cum. Percent
0 – 2 million €	185	28.3 %	28.3 %

2 – 10 million €	172	26.3 %	54.7 %
10 – 50 million €	164	25.1 %	79.8 %
At least 50 million €	132	20.2 %	100 %

V. Results

In the first step, the bivariate results of a one-sided Fisher's exact test are presented. The significance level for all tests is 5 %. Table 3 shows for each of the main hypotheses (H1 to H7) a short version of the respective hypothesis, the expected influence of the underlying variable on the success of the reorganization (↑ for increasing, ↓ for decreasing) and the one-sided p-value of Fisher's exact test. For some hypotheses (H1 and H4), the result was statistically significant, but the sign was opposite to the expected one; therefore, the column remark shows the direction of the result. The column results sum up whether the hypothesis was confirmed (✓) or rejected (✗).

There are some factors with a significant influence on the outcome of an out-of-court restructuring. In particular, the size of the bank (H2), new credits (H4), an open and proactive communication policy (H5), a change in management (H6) and a capital contribution from existing shareholders (H7) have a significant positive influence on the outcome of corporate restructuring. In contrast, H3, on bank expertise, is not significant.

As the results show, in our sample, a strong relationship with the main bank has no positive effect on the success of the restructuring. Therefore, H1 must be rejected. On the other hand, small banks are more successful in their support than larger ones. H2 can be confirmed. Very surprisingly and contrary to previous findings, the results show that expert banks are not more but in fact less successful in completing a workout than other banks. Therefore, H3 has to be rejected. Regarding the most popular measures in financial reorganization, debt forgiveness and new credit, we only find a significant positive effect for the latter. Debt forgiveness even reduces the probability of completing a workout successfully. Consequently, H4 can only be confirmed for new credit. Regarding internal measures and the communication strategy, we can confirm all the relevant hypotheses (H5 to H7). Open communication increases the probability of a successful negotiation, as do a change in management and a financial contribution from existing owners or shareholders to prove their commitment to the reorganization.

More detailed results show that relationship lending is *less* common in small banks (H2A significant, $p = 0.000$, but with the wrong sign; therefore H2A is not confirmed) and that within the different bank size groups, there is no significant correlation between relationship lending and success (small banks $p = 0.138$, other banks $p = 0.112$).

Table 3: Bivariate results for influence on success

Hypothesis	Expected Influence	p-value	Remark	Result
H1: strong relationship to main bank (house bank)	↑	0.028	↓	×
H2: small banks	↑	0.001		✓
H3: bank with experience (expert bank)	↑	0.149	↓	×
H4: debt forgiveness	↑	0.000	↓	×
H4: new credit	↑	0.000		✓
H5: open and proactive communication	↑	0.000		✓
H6: change in management	↑	0.001		✓
H7: shareholder contribution	↑	0.000		✓

H4 to H7 each had two subhypotheses, one related to the correlation between house bank status and the particular variable of the hypothesis and one related to the variable's influence on success within and outside of house banks:

H4A: House banks are more willing to provide support in the form of debt forgiveness or the issuance of new credit.

H4B: A house bank relationship is important for the availability of options such as debt forgiveness or the issuance of new credit and contributes to a successful reorganization.

H5A: Relationship lending is more likely to encourage open and proactive communication between a company and its bank.

H5B: A house bank relationship is important for open and proactive communication and contributes to successful reorganization.

H6A: A main bank is likely to encourage a change of management due to mutual trust and information exchange between company and bank.

H6B: House bank status is important for initiating a management change and contributes to a successful reorganization.

H7A: Shareholders are more willing to invest equity in a company that is in financial distress if it benefits from relationship lending.

H7B: A house bank relationship is important for attracting shareholder contributions and contributes to a successful reorganization.

Table 4 shows the various results for the correlations between the existence of a house bank relationship and the particular variable of the hypothesis (↑ for increasing, ↓ for decreasing) and the one-sided p-value of Fisher's exact test. For correlations with an unexpected sign, the "Remark" column shows the direction of the result. The "Result" column sums up whether the hypothesis was confirmed (✓) or rejected (×). As the results show, there is no significant positive correlation between house bank status and the probability of a certain reorganization measure being implemented. The only positive, albeit nonsignificant, correlation can be found for the likelihood of receiving a financial contribution from existing shareholders. Therefore, H4A to H7A must be rejected.

Table 4: Bivariate results for influence of house bank status

Hypothesis	Expected Influence	p-value	Remark	Result
H4A: debt forgiveness	↑	0.025	↓	×
H4A: new credit	↑	0.039	↓	×

H5A: open and proactive communication	↑	0.014	↓	×
H6A: change of management	↑	0.000	↓	×
H7A: shareholder contribution	↑	0.390		×

To obtain more insight, hypotheses H4B to H7B are now assessed with data for two subgroups, namely, one group with house banks and the other without house banks. Table 5 shows the results for correlations between the particular variable of the hypothesis and reorganization success for both subgroups separately (↑ for increasing, ↓ for decreasing) and the one-sided p-value of Fisher's exact test. For correlations with an unexpected sign, the "Remark" column shows the direction of the result. The "Result" column sums up whether the hypothesis was confirmed (✓) or rejected (×). As the results show, there are no major differences between house banks and other banks. For both groups, debt forgiveness has a negative influence on the success of the reorganization. For the other measures, there are no large differences between house banks and other banks. Only regarding the change in management variable is there a difference for house banks: House banks are obviously more successful in supporting management change than other banks.

Table 5: Results for influence on success within/outside house banks

Hypothesis	Expected Influence	p-value	Remark	Result
H4B: debt forgiveness				
within house banks	↑	0.003	↓	×
outside house banks	↑	0.000	↓	×
H4B: new credit				
within house banks	↑	0.002		✓
outside house banks	↑	0.045		✓

H5B:	open and proactive communication			
	within house banks	↑	0.000	✓
	outside house banks	↑	0.000	✓
H6B:	change in management			
	within house banks	↑	0.000	✓
	outside house banks	↑	0.484	×
H7B:	shareholder contribution			
	within house banks	↑	0.000	✓
	outside house banks	↑	0.000	✓

As the very heterogeneous results in Table 3 to Table 5 show, the bivariate correlations are not completely satisfactory in providing a deep and comprehensive insights from the data. Therefore, in the next step, the various influencing factors are modeled by using a logistic regression with regard to the influence on the target variable (successful reorganization). Logistic regression is one of the methods used to examine the dependencies of a variable of interest on one or more independent variables. The method can thus be used to determine the change in the likelihood of an out-of-court reorganization being positively completed if various influencing factors interact.

For variable selection, we used backward selection and a significance level of 10 % to avoid being too careful and excluding too many variables. The pseudo-R squared statistic for the final model was 0.219 (Nagelkerke-R²). To interpret the results of the logistic regression in detail, the odds of the regression coefficients (Odds=EXP (B)) are used instead of the regression coefficient B. Table 6 now shows the final results of the logistic regression, including the regression coefficient B, the p-value, the odds, and a 95 % confidence interval for the odds.

Table 6: Logistic regression – final model

Hypothesis	Regression coefficient B	p-value	Exp(B)	95 % Confidence interval for EXP(B)	
House bank	-.587	.007	.556	.363	.853
Debt forgiveness	-.878	.000	.416	.266	.649
New loan	.412	.084	1.509	.946	2.407
Open and proactive communication	1.146	.000	3.146	2.082	4.756
Shareholder contribution	.669	.002	1.951	1.266	3.008
Constant	.170	.464	1.186		

The final results of the regression show that house bank status ($EXP(B)=0.556$) in our sample does not increase but rather decreases the probability of a successful reorganization. Additionally, debt forgiveness ($EXP(B)=0.416$), an important financial measure in out-of-court reorganization, reduces the likelihood of success. The new loan measure has a positive impact on success. However, since it is significant only at a level of 10 %, this interpretation has to be drawn very cautiously. New loans can increase the likelihood of success by approximately 50 % ($EXP(B) = 1.509$).

An open and proactive communication policy with the bank increases the probability of a successful out-of-court settlement by a factor of three ($EXP(B)=3.146$) and is the strongest factor with the highest odds ratio. A contribution from existing shareholders doubles the probability of a successful restructuring ($EXP(B)=1.951$) and therefore represents the second strongest influencing factor in our regression model.

VI. Discussion and Recommendations

A. Discussion

In general, the findings indicate a high percentage of positive settlements in out-of-court reorganization. Sixty-two percent of the 658 analyzed bank-supported reorganization cases were successful. This confirms prior studies, indicating that

(bank-supported) workouts have high success rates and are more promising than formal reorganizations (Blazy et al., 2014; Couwenberg and Jong, 2006; Franks and Sussman, 2005; Jostarndt and Sautner, 2010). In view of banks' role in the restructuring process, the present results are surprising. We could not identify a positive correlation between house bank status and the success of a reorganization. In contrast to the findings of Huang et al. (2013), a house bank relationship even reduces the probability of a successful reorganization. Consequently, the behavior of the analyzed house banks can be characterized as zombie lending that may artificially keep weak firms alive (Caballero et al., 2008). These new findings add to the existing literature and indicate that house banks, despite their relationship of trust, must be critical in their assessment of reorganization projects. In a similar vein, expert banks also have a reduced probability of a positive reorganization. With regard to the size of the companies studied, mostly SMEs, this may mean that expert banks are more used to working with larger companies. They may lack an understanding of SMEs (Decker, 2018).

Regarding the positive correlation between a small bank size and the success of the reorganization, the results confirm the prior findings of Decker (2018) that small and regional banks are able to positively handle the reorganization of SMEs. With continued consolidation in the financial service industry the number of small banks is shrinking (Hardee, 2008). This can mean that small and medium-sized companies can no longer be given sufficient attention in the reorganization process.

Regarding different reorganization measures, the results of the logistic regression show that new loans from the supporting bank, open and proactive communication between the firm and its bank and a financial contribution from existing shareholders significantly increase the probability of a positive reorganization. The findings indicate that the support of banks (with new credit) in combination with other measures makes a reorganization successful. This confirms prior findings from Couwenberg and Jong (2006) and Jostarndt and Sautner (2010). In our sample, the communication between a firm and its bank has the strongest impact on the outcome of the reorganization. Communication takes place face to face but also through the collection of information by the bank via monitoring (Jostarndt and Sautner, 2008; Micucci and Rossi, 2017), which yields an information advantage for the bank over other creditors (Blazy et al., 2014). Transparent and open communication is therefore the key to building trust and enhancing understanding and consequently motivating banks to support firms in distress. According to Decker (2018), trust and information are the basis for a stable lender-borrower relationship. Even though ongoing communication is necessary for a successful workout (Inoue et al., 2008; Micucci and Rossi, 2017), banks must not become negligent in their dealings with customers by artificially keeping weak firms alive.

Since the contribution from shareholders significantly increases the probability of a successful restructuring, we confirm prior results from Couwenberg and Jong (2006) and Jostarndt and Sautner (2008), who refer to the fact that banks guide firms in their restructuring effort. Obviously, owners can encourage banks to provide support through their own contribution, and the scope of reorganization measures is more important than the role or status of the bank. Nonetheless, the bank's willingness to provide support is a decisive factor for success in the restructuring process.

B. Recommendations and Future Research

Based on the empirical findings of this study, the following recommendations for corporate practice can be derived.

Recommendation for entrepreneurs and managing directors of SMEs: An early reaction to financial distress is indispensable for sustainable corporate restructuring. Taking into account the specifics of the individual case, out-of-court restructuring can be a significant restructuring alternative to restructuring in court. Since the legal risks of an out-of-court reorganization are high in the case of failure, the involvement of consultants is strongly recommended for the reorganization review and the subsequent decision-making process.

Recommendation for banks: Competent and active support of out-of-court restructuring serves all involved parties. According to the empirical findings, banks, alongside the firm owners, are the main stakeholders in out-of-court restructurings, especially those of SMEs (Blazy et al., 2014); (Jostarndt and Sautner, 2010). Since debt forgiveness is of only minor importance in out-of-court restructuring, banks are recommended to play an active role in restructuring. This is especially true for small and medium-sized enterprises, which do not receive as much attention from large banks (Hardee, 2008). Compared to formal reorganization, successful out-of-court restructurings lead to higher average satisfaction rates for banks (Franks and Sussman, 2005); (Jostarndt and Sautner, 2010), and banks' financing risk can usually be reduced to a greater extent by active participation than by threats of legal proceedings.

Recommendation for consultants of companies in crisis: Encourage rapid response to corporate crisis and ensure an objective view. In addition to legal advisors, external consultants, including chartered accountants, management consultants and restructuring managers, are regularly employed in crisis management and restructuring. A key task of consultants is to motivate entrepreneurs to react to a corporate crisis in a timely manner and to ensure an objective and holistic view of the initial situation.

Recommendation for legislators: The European Union Directive on "preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt" calls for a reform of national insolvency laws and other company laws to improve the framework conditions for out-of-court restructuring (European Commission, 2019). The objectives include ensuring qualified majorities for the adoption of a restructuring plan and supporting new financing during out-of-court restructuring by providing a "legal priority in payment". This requirement is emphasized on the basis of the empirical findings on the importance of restructuring financing from both banks and firm owners. Particularly in connection with the effects of the corona crisis, the timely implementation of the Directive is of particular importance.

The present work has contributed to the knowledge of the factors influencing successful out-of-court restructuring. When interpreting the present study, however, the context of the investigation must always be taken into account. The results may be significantly influenced by the specific skills and institutional characteristics of the participating banks, such as size and organizational structure. In an international comparison, however, there is still relatively little empirical evidence on the (out-of-court) restructuring of small and medium-sized enterprises. While experience shows that it is difficult to obtain data for SMEs, especially on the development of the asset, capital and liquidity situation from their annual financial statements, follow-up surveys can address these deficits, for example, by directly involving banks' internal company analysis departments. In scientific research on out-of-court restructuring of SMEs, as in the present study, the focus is on the bank perspective through insights into or evaluation of bank files and information. Through qualitative studies, for example, using case studies, this view can be extended to include the perspectives of entrepreneurs, employees and other creditors. However, it should be pointed out in this context that information is usually handled very discreetly by all affected stakeholders regarding financial crises and restructuring. In previous studies, the short-term success of an out-of-court reorganization has usually been measured through the concluding of a reorganization agreement (Blazy et al., 2014); (Jostarndt and Sautner, 2008). However, the sustainable and long-term success of a reorganization can only be assessed after the agreed reorganization measures have been implemented appropriately and taking into account the economic situation of the restructured company (Mayr et al., 2017). Future research projects should therefore assess the long-term success of the reorganization and focus on the international comparison of the results.

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