**Department of Banking and Financial Management**
**University of Piraeus**

# Research Seminar Series

**Thursday, April 30th, 2009**
**Time: 16:00 – 18:00, Room 013**

**Seminar Title**

# "Strategies using Multiple Securities of Distressed Firms: A Theoretical Model of Contrarian Voting"

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## Summary

We analyze the implications of investment funds' ability to trade in multiple securities issued by distressed companies. We do so by creating a novel framework of corporate financing and governance: If a company defaults on its debt obligations the manager, who wants to maximize the payoff to shareholders, and has no agency problems, proposes a new debt contract to creditors, based on her knowledge of the creditors' positions in the company's securities. Voting occurs by the creditors who choose either to accept the restructuring plan and allow the firm to continue with its operations or to reject it, and file for bankruptcy. From a social surplus perspective, we assume that it is beneficial for the firm to continue its operations. The presence of unregulated creditors (such as investment funds) on the creditors' board implies the possibility that the equity of the company can be shortened by creditor board members and, moreover, that exposure in the distressed company's equity is unknown to the manager. We show that even if the manager is fully informed, though continuation in this case is guaranteed, the presence of creditors with short equity positions lowers the continuation payoff to shareholders. Furthermore, we explore the equilibrium optimal behavior of an investment fund in the case where trading is allowed on the firm's securities (debt & equity) after default and before voting. Preliminary results suggest that the investment fund will short the equity of the firm even if it is not pivotal in the voting game. This offers support to some of the anecdotal evidence in the popular press. Hence there is a lack of regulation in two dimensions: one by permitting funds to hold short equity positions, and the second by allowing them not to disclose their positions to the firm's management.

**Konstantinos E. Zachariadis** is a Lecturer in the Department of Finance of the London School of Economics. He received his PhD in Managerial Economics and Strategy from the Kellogg School Management of Northwestern University (USA). Prior to that he received an MSc from Northwestern University, and a BSc from the Aristotle University of Thessalonik (Greece) both in Electrical and Computer Engineering. His research areas are Market Microstructure and Design, Information Economics and Game Theory with Applications to Finance, and Corporate Governance as related to Economic Efficiency. He is also a Fulbright Fellow.