

Accepted Manuscript

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PII: S0304-405X(18)30072-2
DOI: [10.1016/j.jfineco.2018.03.004](https://doi.org/10.1016/j.jfineco.2018.03.004)
Reference: FINEC 2874

To appear in: *Journal of Financial Economics*

Received date: 7 July 2016
Revised date: 27 April 2017
Accepted date: 29 April 2017

Please cite this article as: Nina Baranchuk, Michael J. Rebello, Spillovers from good-news and other bankruptcies: real effects and price responses, *Journal of Financial Economics* (2018), doi: [10.1016/j.jfineco.2018.03.004](https://doi.org/10.1016/j.jfineco.2018.03.004)

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Spillovers from good-news and other bankruptcies: real effects and price responses[☆]

Nina Baranchuk,^{1,2} Michael J. Rebello¹

Abstract

We model debt restructurings that could endogenously end in bankruptcy, and study spillovers to competitors' operating decisions, profits, restructuring outcomes and security prices. We show that while bankruptcy could cause the firm's share price to drop, bankruptcy always signals good news about the firm. We identify the conditions under which a bankruptcy also signals good news about competitors. We demonstrate that when a firm's bankruptcy costs are relatively small, bankruptcy raises its share price while lowering the prices of competitors' shares and debt as well as boosting the probability that they will enter bankruptcy. When there is little information asymmetry about the firm's prospects, or the information asymmetry is about industry prospects, bankruptcy raises competitors' share and debt prices and lowers their probability of bankruptcy.

JEL Classification Code: G33

Keywords: restructuring, distress, spillover, feedback

[☆]We thank Toni Whited (the editor), an anonymous referee, David Smith, seminar participants at Baruch College, University of Texas at Dallas, Singapore Management University, University of Oklahoma, the 2012 China International Finance Conference, and the 2016 Midwest Finance Association meeting for comments. An earlier version of the paper was titled "Product Market Linkages and the Spillovers from Corporate Debt Restructurings." We alone are responsible for all errors.

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