Partnerships with bankrupt companies could be double-edged sword for investors

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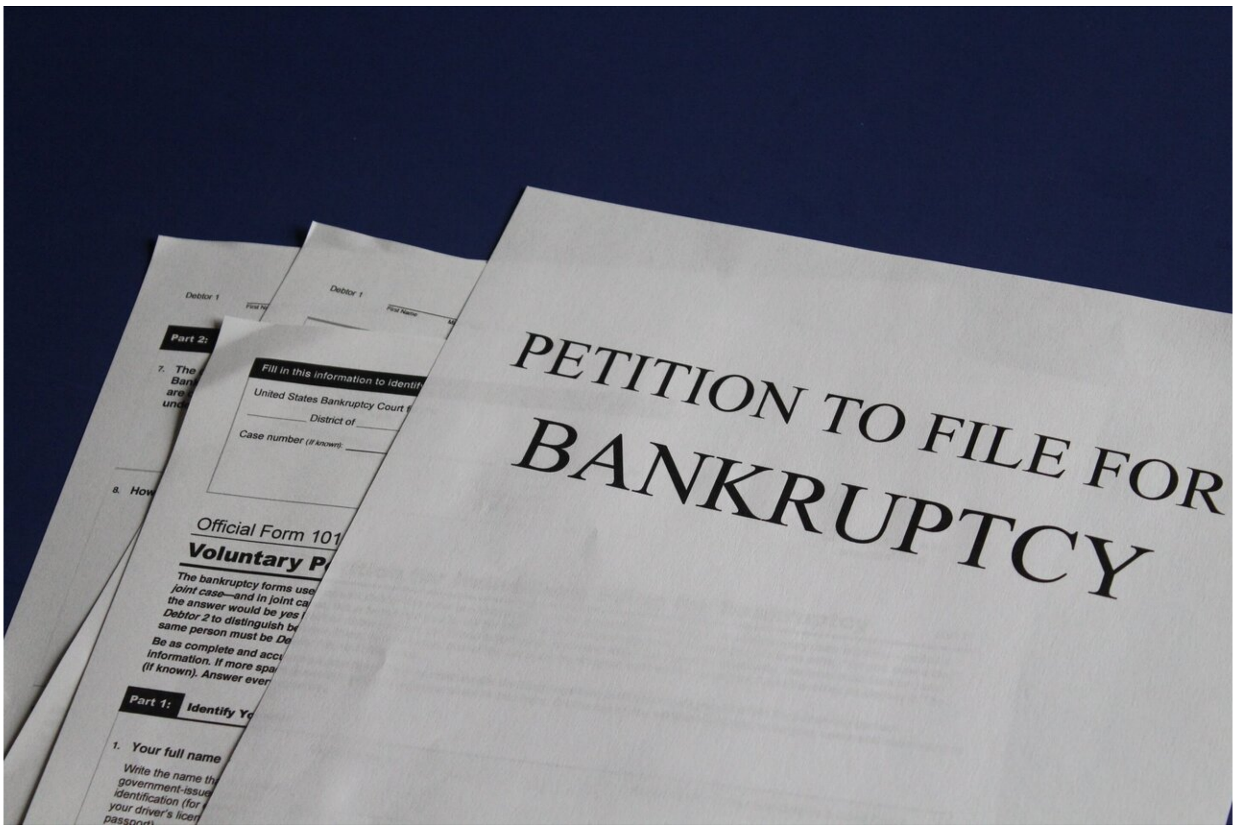

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The list of companies that have filed for bankruptcy during the first half of 2020 reads like a "who's who" of major retailers and recognized brands. Consumers may know J.C. Penney, Hertz, Neiman Marcus, J.

Crew and Pier 1, but the carnage also includes tech firms previously seen to have much potential.

With the recent rise in bankruptcies, suppliers and partners of these companies are being forced to make a difficult decision: Should they bet on the bankrupt customer or partner to survive by continuing to invest in the relationship? Or should they bet that the bankrupt customer or partner will not survive by cutting off their investments so they can minimize losses and redeploy resources?

New research from the Indiana University Kelley School of Business found that when a company is in bankruptcy, its advertising and research and development investments can cut both ways. They increase the odds of surviving for some bankrupt companies and decrease the odds for others.

"This difference hinges on the influence that the bankrupt company's suppliers have in the bankruptcy process," said Niket Jindal, assistant professor of marketing and the study's author. "Advertising and R&D increase bankruptcy survival when suppliers have high influence, whereas they decrease bankruptcy survival when suppliers have low influence."

His article, "The Impact of Advertising and R&D on Bankruptcy Survival: A Double-Edged Sword," appears in the current issue of the *Journal of Marketing*.

Jindal studied whether a company's past investments in intangible assets—specifically investments in advertising and R&D—can help suppliers and partners make a decision on whether to bet on the bankrupt company. He analyzed 1,672 bankruptcy cases filed in U.S. bankruptcy courts from 1996 to 2019 and found that managers could substantially improve their odds of correctly predicting whether a bankrupt customer or partner will survive by considering the company's past advertising and R&D investments, in addition to the usual financial predictors.

He found that by considering a bankrupt company's advertising and R&D, managers can increase the accuracy of predicting whether that company will survive by 11 percent.

Specifically, the results show that a bankrupt company's advertising increases the odds of its survival when at least 38 percent of the company's debt has been borrowed from suppliers. For R&D, the cutoff point is when at least 21 percent of the company's debt has been borrowed from suppliers.

"A losing bet can be catastrophic for a supplier or partner," Jindal said. "If the company bets on a bankrupt customer or partner to survive and they do not survive, investments in the relationship will be lost, and the company will have fewer resources and time to try to attract other customers and partners to make up for the lost sales. On the other hand, if the company bets against the bankrupt customer or partner and they do survive, the relationship will be soured and will put future sales from them at risk."

Jindal said that suppliers and partners should be careful when including a bankrupt firm's advertising and R&D investments in their decision-making process.

"The key is to look at the portion of the bankrupt company's debt that is due to suppliers versus banks, because this shows the influence that the bankrupt company's suppliers will have, relative to other creditors, in the bankruptcy process," he said.

Suppliers have greater noncontractual revenue and generally do not require collateral, while banks have less noncontractual revenue and generally do require collateral. The impact of advertising and R&D on the value that is received if the bankrupt firm survives versus gets liquidated differs for suppliers versus banks.

More information: Niket Jindal, The Impact of Advertising and R&D on Bankruptcy Survival: A Double-Edged Sword, *Journal of Marketing* (2020). DOI: 10.1177/0022242920936205

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