

The role of absolute priority rule violations under coordination failure among creditors

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Abstract

In determining the efficiency of absolute priority rule (APR) violations, the interaction between two types of problem should be considered: one is the agency problem between a debtor and creditors, and the other is a coordination problem among creditors. In this paper, by using the concept of the global game, we analyze how the two types of problem affect each other and then determine analytically when APR violations should be adopted. We show that when creditors receive clear signals about firms, the amount of repayment creditors demand from a firm decreases as the liquidation value of the firm increases. In this case, if APR violations are adopted, creditors require a greater amount of repayment *ex ante*, in which case, the debtor is more likely to choose an inefficient and risky action. On the other hand, when a noisy signal is transmitted to creditors, repayment increases when the liquidation value becomes sufficiently high. In this case, a high liquidation value may induce coordination failure among creditors. Because this also induces moral hazard on the part of the debtor, under these circumstances, adopting APR violations may be a useful way of improving *ex ante* efficiency.

Key words: coordination failure, absolute priority rule, global game