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Implementing an insolvency framework for micro and small firms

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Abstract

Micro-, small-, and medium-sized enterprises (MSMEs) represent the vast majority of businesses in most countries around the world. Despite the economic relevance of these firms, most insolvency jurisdictions do not provide adequate responses to MSMEs. Moreover, with a few exceptions, the academic literature on insolvency law has not traditionally focused on the treatment of MSMEs in insolvency. This article seeks to contribute to the debate by exploring the primary features and problems of MSMEs in insolvency as well as the weaknesses of the ordinary insolvency framework to deal with MSMEs. It also provides a general overview of the primary reforms and policy recommendations taking place around the world to deal with MSMEs in insolvency. The article concludes by suggesting several strategies to design an efficient insolvency framework for MSMEs.

1 | INTRODUCTION

Micro-, small-, and medium-sized enterprises (MSMEs) represent about 90% of businesses and more than 50% of employment worldwide.[1] Therefore, they play an essential role in most

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countries around the world and even more in emerging markets.[2] Despite the economic importance of small firms, most insolvency jurisdictions do not provide adequate responses to MSMEs. Moreover, with a few exceptions, the academic literature on insolvency law has not traditionally focused on the treatment of MSMEs in insolvency.

The lack of an adequate insolvency framework for MSMEs can generate various costs for society. *Ex post*, value can be destroyed if viable firms end up in a piecemeal liquidation or the assets of non-viable firms are not quickly reallocated toward more productive activities.[3] From an *ex ante* perspective, an inefficient allocation of assets in insolvency can lead to an increase in the cost of debt, harming firms' access to finance.[4] Moreover, the lack of an attractive exit for MSMEs may prevent many entrepreneurs from even starting a business. Therefore, an inefficient insolvency framework can also be harmful for entrepreneurship.

This article seeks to explore the features and problems of MSMEs and insolvency. It also suggests various policy recommendations to design an efficient insolvency framework for MSMEs. For that purpose, Section 2 starts by analyzing the concept and features of MSMEs, as well as the problems these firms generally face in a situation of financial distress. Section 3 analyzes the weaknesses of the ordinary insolvency system to deal with small firms. Section 4 explains the harmful economic effects generated by the lack of an adequate insolvency framework for MSMEs. Section 5 provides an overview of the primary reforms and policy recommendations suggested or adopted to enhance the insolvency framework for MSMEs. Section 6 suggests a new insolvency framework based on various pillars, including the promotion of workouts, the adoption of a simplified insolvency process using a system of auctions, a coordinated treatment of personal and corporate insolvency, and various strategies to reduce the stigma traditionally associated with insolvency proceedings. Section 7 concludes.

2 | UNDERSTANDING THE PROBLEMS AND FEATURES OF MSMEs

2.1 | Concept and features of MSMEs

The definition of MSME differs across jurisdictions.[5] In fact, countries may even adopt different definitions of small firms depending on the purpose.[6] Despite these divergences, however, most MSMEs around the world share some common features. First, they have very simple organizational structures. In many cases, MSMEs consist of just a single entrepreneur without any employees.[7] Second, most MSMEs have simple financial structures.[8] Indeed, small businesses often have just a few creditors, and they mainly rely on bank finance as their primary source of external finance.[9] Third, many small businesses are not incorporated. Hence, entrepreneurs do not enjoy the benefits associated with the corporate form, including the existence of limited liability.[10] Even if incorporated, the MSME's shareholder/manager often acts as a guarantor for the company's debts.[11] As a result, the life and welfare of the individuals behind MSMEs are inevitably tied to the business' fate.[12]

2.2 | Problems arising in financially distressed MSMEs

A situation of insolvency leads to various economic problems that are relatively similar across companies and industries.[13] For example, when debtors are unable to pay their debts, creditors become entitled to enforce their claims and ultimately seize the debtor's assets. Therefore, their

individual enforcement actions may end up destroying the going concern value of economically viable companies.[14] Second, the existence of a situation of insolvency may incentivize lenders, suppliers, and employees to terminate their contractual and business relationships with the firm, preventing the company from continuing its operations and having access to new finance.[15] Third, when a debtor faces financial trouble, the shareholders—or the directors acting on behalf of the shareholders—may have incentives to engage in a series of opportunistic behavior that can destroy or divert value at the expense of the creditors. This opportunistic behavior may include the transfer of assets to related parties, borrowing money in an irresponsible manner, investing in risky projects in a last attempt to rescue the firm, or just deciding to keep non-viable firms alive.[16] Fourth, negotiating with creditors can be costly. Collective action problems, asymmetries of information, transaction costs and holdout problems can prevent debtors from achieving an agreement that can also be beneficial for the creditors.[17] In order to solve these problems, most countries around the world have responded by providing a variety of regulatory strategies generally included in the insolvency legislation.[18]

While many of these problems can be found in any financially distressed firm, some of them are exacerbated in the context of MSMEs, and new problems may emerge. First, unlike many large companies, especially in the United Kingdom and the United States,[19] most MSMEs are managed by the shareholders/owners. Therefore, since the interest of managers and shareholders/owners are aligned, this situation may exacerbate the risk of opportunistic behavior of shareholders vis-à-vis creditors potentially existing in a situation of insolvency. Sometimes, this opportunistic behavior by debtors is generated by a moral hazard problem existing in insolvent firms: if the shareholders have already lost everything, and the existence of limited liability prevents them from incurring further losses, they will have incentives to "gamble for resurrection" or keep the company alive—even if it is not viable—to see if the company's situation improves at some point in the future.[20] After all, they do not face the costs potentially associated with these decisions, but they can recover their investments in the unlikely event that the company becomes solvent again.

In other cases, however, the decision to keep a firm alive can also be led by emotional and behavioral factors. These factors can include attachment to the business or cognitive biases such as over-optimism or those leading to remain married to their original choices even when it is no longer rational to do so.[21] Regardless of the reason, and the good or bad faith of the debtor, the interest of the creditors will be harmed by keeping non-viable firms alive.

Second, due to a variety of factors, including lack of advice, low bargaining power, reduced size, and (very often) lack of viability, financially distressed MSMEs usually face more problems having access to new financing. Therefore, the underinvestment problems potentially generated in a situation of insolvency can be exacerbated in the context of MSMEs.[22]

Third, many insolvent MSMEs do not even have assets.[23] This lack of assets may make it harder for MSMEs to obtain the legal and financial advice needed to implement a quick strategy in a situation of financial distress. This factor, among others (including lack of viability, poor organizational structures, and low diversification), may help explain why the rate of successful reorganizations in the context of MSMEs is lower than in large corporations.[24]

3 | THE WEAKNESSES OF THE TRADITIONAL INSOLVENCY SYSTEM FOR MSMEs

With a few exceptions, most insolvency jurisdictions around the world subject MSMEs to the same insolvency framework existing for large companies.[25] Traditional insolvency proceedings

can be particularly costly for MSMEs, especially taking into account the fact that many of these firms might not even have assets to fund the costs of the procedure.[26] Therefore, initiating an insolvency proceeding is a luxury that many MSMEs cannot afford.[27] Even if they can, they face a second problem: the insolvency procedure may not be suitable for them. The traditional insolvency proceedings existing in most countries around the world can be very burdensome, rigid, and complex for MSMEs.

Furthermore, even if the insolvency framework is suitable for small businesses, there is an additional problem: many jurisdictions do not provide an effective discharge of debts for individuals. Therefore, since sole traders and shareholders/managers often act as guarantors for the company's debts, there should be more coordination between the systems of corporate and personal insolvency.[28] Otherwise, honest but unfortunate sole traders and shareholders/managers of small companies will not find the insolvency system appealing despite the potential attractiveness of the corporate insolvency framework, as they do not enjoy an effective discharge of debts under the personal insolvency regime.

4 | THE HARMFUL ECONOMIC EFFECTS GENERATED BY NOT HAVING AN EFFICIENT INSOLVENCY FRAMEWORK FOR MSMEs

The unattractiveness of the insolvency framework for MSMEs can generate various costs for society. *Ex post*, it can hamper the reorganization of many *viable* MSMEs and the rehabilitation of honest but unfortunate entrepreneurs. Likewise, the assets of non-competitive MSMEs cannot be used for more productive activities. Therefore, an unattractive insolvency framework for MSMEs can end up destroying wealth, jobs, and growth. *Ex ante*, the lack of an attractive exit for both companies and honest but unfortunate entrepreneurs may discourage entrepreneurship, responsible risk taking, and the use of debt. As a result, an unattractive insolvency framework for MSMEs can ultimately harm entrepreneurship, innovation, and access to finance. Additionally, as the debtor's assets are not going to be efficiently allocated *ex post*, an unattractive insolvency framework for MSMEs may make lenders become more reluctant to extend credit from an *ex ante* perspective. Hence, this situation will exacerbate the problems already faced by many MSMEs to obtain external finance.

5 | LEGISLATIVE AND ACADEMIC PROPOSALS TO ENHANCE THE INSOLVENCY FRAMEWORK FOR MSMEs

5.1 | International organizations

In 2017, the World Bank published a comprehensive study on MSMEs in insolvency.[29] This study highlighted the primary problems and features of small firms facing financial trouble, as well as the weaknesses of the ordinary insolvency system in providing an efficient response to MSMEs. These problems and weaknesses include:

1. the complexity of many insolvency systems for MSMEs;
2. the lack of participation of creditors in insolvency proceedings of MSMEs, either because they are non-sophisticated creditors (generally unsecured creditors) without the knowledge

and resources to be part of the process or because they are lenders with security interests and they prefer to enforce their claims outside of the insolvency system;
3. lack of information about the viability and financial situation of the debtor, which is something potentially undermining creditors' trust;
4. difficulties having access to external finance;
5. lack of assets to even fund the costs of an insolvency proceeding; and
6. blurred distinctions between the business and the shareholders/managers/sole entrepreneur behind the firm.

As a result of these problems, the report suggests various recommendations to deal with MSMEs in insolvency, including:

1. the existence of expeditious liquidation procedures due to the fact that a majority of insolvent MSMEs will probably end up in liquidation;
2. promotion of out-of-court assistance to MSMEs such as mediation, debt counselling, and financial education; and
3. the need to keep exploring various aspects potentially relevant for the design of an appropriate insolvency framework for MSMEs, including the way to fund the procedure, the intersection between corporate and personal insolvency in the context of MSMEs, and the need to implement (or not) specific insolvency frameworks for MSMEs.

One year later, the World Bank published another interesting report providing further guidance on the design of an efficient insolvency framework for MSMEs, and the positive effects generally associated with the adoption of an efficient system of *personal* insolvency. One of the primary conclusions of this report is that an efficient insolvency system for MSMEs should facilitate the discharge of debts of the *individuals* running the MSME. Other proposals mentioned in this report included:

1. the adoption of simplified restructuring procedures;
2. the adoption of simplified liquidation procedures; and
3. the existence of institutions specifically skilled in and dedicated to MSMEs being used to administer the MSME-specific process.[30]

More recently, the United Nations Commission for International Trade Law (UNCITRAL) also started to work on the treatment of MSMEs in insolvency. In 2019, UNCITRAL published a draft text, suggesting a simplified insolvency regime for MSMEs. The main ideas suggested in this text are aligned with those suggested by the World Bank. Namely, this text suggests that an insolvency regime for MSMEs should ideally meet the following features:

1. putting in place expeditious, simple, flexible, and low-cost insolvency proceedings;
2. making simplified insolvency proceedings easily available and accessible to MSMEs;
3. facilitating a fresh start of the debtor behind the MSME;
4. ensuring protection of persons affected by simplified insolvency proceedings;
5. providing for effective measures to facilitate creditor participation and addressing creditor disengagement in simplified insolvency proceedings;

6. implementing an effective sanctions regime to prevent abuse or improper use of the simplified insolvency regime and to impose appropriate penalties for misconduct; and
7. addressing concerns over the stigmatization of insolvency.[31]

This text published by UNCITRAL also provides some specific examples and solutions to implement a simplified insolvency framework. For instance, to reduce the costs and length of simplified insolvency proceedings for MSMEs, the text suggests various policy recommendations including:

1. the commencement of insolvency proceedings without the need to prove that the debtor is unable to pay debts or imposing significant disclosure obligations for debtors;
2. the reduction of formalities of the procedure and the promotion of electronic devices for the allowance of claims and the sale of assets; and
3. the empowerment of the debtor during the procedure, advocating for a more debtor-in-possession governance of insolvency proceeding while providing various safeguards to protect the interest of the creditors.

Other policy recommendations mentioned in the UNCITRAL text include:

1. the enactment of two types of simplified procedures depending on their goal (reorganization or liquidation);
2. the desirability of designing a "default procedure" and the easy conversion from reorganization to liquidation procedures;
3. the need to promote the quick closure of the procedure, even if the insolvency proceeding (or part of it) can be reopened in cases of bad faith or any other unexpected circumstances; and
4. the ability of individual entrepreneurs to enjoy an effective discharge of debts.[32]

Finally, it is worth mentioning that while UNCITRAL supports the adoption of simplified insolvency rules for MSMEs, it does not have a strong view on whether this simplified insolvency framework should be implemented by adjusting some features of the standard insolvency framework or by establishing a separate simplified insolvency procedure for MSMEs.[33]

5.2 | Countries with simplified insolvency frameworks for MSMEs

Many countries around the world have implemented, or are planning to implement, insolvency frameworks for MSMEs. Jurisdictions with specific insolvency rules for MSMEs include the United States and Myanmar.[34] Other countries, including Australia, Chile, Colombia, and Singapore, have adopted or are planning to adopt simplified insolvency frameworks as a response to the coronavirus (COVID-19) pandemic. In some jurisdictions, such as Singapore and Colombia, these reforms are expected to be implemented temporarily, while other countries like Myanmar and Australia have adopted a simplified insolvency framework for MSMEs permanently. Finally, whereas various jurisdictions, including Australia and Singapore, have opted for simplified insolvency proceedings for MSMEs, other countries only have special rules for MSMEs.[35]

Despite these international divergences, most insolvency responses to MSMEs focus on the same aspects: reducing the costs and length of the procedure. This is carried out through a variety of mechanisms, including:

1. the implementation of a simplified restructuring procedure with stringent timelines and lower formalities for the commencement of the procedure and the approval of a reorganization plan[36];
2. the implementation of a simplified liquidation process seeking to promote an expeditious exit for non-viable firms[37];
3. the adoption of a debtor-in-possession model for the governance of simplified restructuring procedures, subjecting the debtor however to the supervision of a monitor or restructuring expert[38]; and
4. a more unified treatment of personal and corporate debt.[39]

5.3 | Views in the academic literature

Designing an efficient insolvency system has traditionally been the cornerstone of the economic literature on insolvency law.[40] However, economists and law and economics scholars have traditionally paid more attention to the optimal design of a corporate insolvency regime.[41] In the legal literature, corporate insolvency has also been the primary focus of most insolvency scholars.[42] In the past years, however, the treatment of MSMEs in insolvency has increasingly captured the attention of many legal scholars, leading to various books and several academic articles exploring whether and, if so, how countries can implement more efficient insolvency frameworks for MSMEs.[43]

Despite the different views expressed on the optimal design of an insolvency framework for MSMEs, most scholars seem to agree on various aspects. First, the ordinary insolvency system is very costly for MSMEs.[44] Second, since many businesses are not incorporated, and, even if they are, the shareholder/manager of the MSME often acts as a guarantor for the company's debts, any attempt to design an insolvency framework for MSMEs should provide a discharge of debts for the individuals behind an MSME.[45] Finally, providing an effective discharge of debts for individual entrepreneurs can be a useful tool to promote entrepreneurship.[46]

6 | BUILDING AN EFFICIENT INSOLVENCY FRAMEWORK FOR MSMEs

This article argues that an efficient insolvency regime for MSMEs should be based on four pillars. First, countries should adopt active policies to promote out-of-court restructuring for viable MSMEs facing financial trouble. Second, if the workout fails, MSMEs should have access to a simplified insolvency process based on a system of auctions. Third, an effective discharge of debts should be implemented for honest but unfortunate sole traders or shareholder/manager behind MSMEs. Finally, countries should adopt various policies to reduce the stigma associated with insolvency proceedings.

6.1 | Out-of-court restructuring

As a first pillar in the design of an efficient insolvency framework for MSMEs, regulators, practitioners, and policymakers should promote the use of out-of-court restructuring for

viable MSMEs facing financial trouble. In fact, the attempt to reach a workout can even be *required* as a condition for the initiation of a simplified insolvency procedure.[47] The adoption of this requirement may create several benefits. First, achieving a workout can save the significant costs associated with the commencement of an insolvency proceeding.[48] Therefore, requiring debtors to try a workout first can serve as a paternalistic approach to achieve a solution that is expected to be beneficial for both debtors and creditors.[49] Second, reaching an out-of-court agreement will also reduce the number of insolvency proceedings managed by the judiciary. Thus, reducing the number of insolvency cases can also be useful to enhance the efficiency of the judicial system, especially in countries with inefficient courts.[50] Third, MSMEs often have very simple financial structures with a few creditors. Therefore, reaching an out-of-court agreement is more feasible for these firms.[51] Fourth, formal reorganization procedures are generally provided to help *viable* firms facing financial trouble. Unfortunately, many MSMEs do not have the resources needed to hire professional experts that can help them determine whether their business is economically viable. Therefore, forcing them to try a workout before initiating a formal insolvency process can serve as a market mechanism to conduct a preliminary assessment of the viability of the business.

In order to promote workouts, regulators and private actors (including associations of lawyers, banks, and insolvency practitioners) can take several steps. First of all, they should enact good practices for out-of-court restructuring.[52] For that purpose, it would be useful to observe the practices enacted by some regulators, association of banks, and international organizations.[53] These practices usually require, among other aspects:

1. the existence of good faith negotiations between debtors and creditors, generally accompanied by stand-still agreements to prevent opportunistic behavior by any of the relevant actors involved in the negotiation;
2. disclosure obligations for the debtor; and
3. if possible, involvement of reliable third parties (e.g., restructuring advisors).

As it has been mentioned, however, many MSMEs cannot afford a restructuring advisor. If so, the probability of achieving a successful workout will be notably reduced, even if the business is economically viable.[54] For this reason, regulators should provide an alternative solution to these businesses.[55] Additionally, if an MSME has the financial resources needed to hire a restructuring advisor, it is important to hire someone with expertise not only in negotiation, mediation, and corporate restructuring but also in insolvency and finance. Indeed, expertise in *insolvency law* will be essential to facilitate negotiations taking into account the outcomes potentially achieved by all the relevant stakeholders in a hypothetical scenario of insolvency. Likewise, a background in *finance* is also important to verify that the business is economically viable. In the absence of this expertise in finance, the advisor leading the restructuring process may not be able to *credibly* convince the creditors about the viability of the business and therefore the desirability of reaching a workout. Consequently, the MSME would end up in an insolvency procedure even if, in the absence of asymmetries of information and lack of confidence about the viability of the business, all the relevant parties would have been better off.

Finally, in addition to enacting good practices for workouts, regulators as well as associations of lawyers, banks and insolvency practitioners should make sure that companies are aware of these good practices. Therefore, promoting education and awareness should also be

part of the overall strategy to facilitate the efficient resolution of financial distress in the context of MSMEs.[56]

6.2 | Simplified insolvency process based on a system of auctions

6.2.1 | Introduction

If the out-of-court restructuring fails, there will be reasons to believe that the company is not economically viable or the creditors do not trust the shareholders/managers. In those cases, the company should *not* be reorganized. Therefore, even though it is possible that the workout failed due to various factors other than the viability of the business (e.g., holdout problems, bad negotiations/advisors, etc), the insolvency system should prevent the use of reorganization procedures by non-viable businesses.[57] A desirable way to deal with this problem while still helping viable businesses unable to reach a workout may consist of implementing a simplified insolvency procedure for MSMEs based on a system of auctions. The following sections discuss how this system can be designed, and why it would be more efficient than adopting simplified reorganization and liquidation procedures.

6.2.2 | Features of the simplified insolvency process based on auctions

The design of the system of auctions

Under the proposed simplified insolvency process based on a system of auctions, any interested party (including the existing shareholders/managers) would be allowed to bid for the company's assets.[58] These bids can include cash and non-cash offers.[59] Therefore, a bid could even include the submission of a reorganization plan suggesting haircuts, deferrals on payments, debt for equity swaps, or any other mechanism facilitating the financial reorganization of the company. In some cases, bids will just consist of cash offers to acquire individual assets. In other situations, bidders may want to acquire the entire business as a going concern. Finally, as non-cash offers would also be allowed, it is expected that, at least in the case of *viable* businesses, some bidders (particularly insiders, since they enjoy lower asymmetries of information and therefore will be in a better position to know that the company is economically viable) may propose a reorganization plan.

All the offers will then be subject to creditor vote. If a reorganization plan potentially submitted by a bidder is preferred by the creditors, the company will exit the procedure with an agreement that allows the company to stay alive with a new capital structure. Therefore, the auction process would have ended with a "hypothetical sale" of the company's assets.[60] The only difference with a traditional reorganization procedure is that the identity of the debtor, or the shareholders/managers in the context of corporations, may change during the procedure if, for example, a reorganization plan is proposed by an outsider and approved by the creditors. However, if the creditors opt for selling the assets individually or as a going concern, the insolvency process would end with an *actual* sale. Still, even in these circumstances, the procedure can lead to a *business* rescue if, for example, the bidder acquires the assets as a going concern.

If the auction concludes with a hypothetical sale (that is, a reorganization plan) approved by the creditors, the business will survive along with the legal entity (if any) used to conduct the business. In an actual sale of the company's assets either as a going concern or piecemeal,

the legal entity should be immediately dissolved. In both cases, that is, the hypothetical sale or the actual sale, the insolvency process should conclude. Any investigation of the debtor's behavior or the initiation of avoidance actions should be conducted separately. Moreover, they should be funded by the creditors or any other parties.[61]

In cases potentially involving fraud, the state should also be allowed to initiate these investigations. In fact, due to the public policy concerns associated with the existence of fraud, public agencies should ideally play an active role in these investigations. If it is shown that the debtor committed fraud, the debtor or, in corporate entities, the directors/managers committing any fraudulent behavior should be subject to various sanctions, including imprisonment. Thus, even though this proposed simplified regime for MSMEs will be more indulgent with negligent but bona fide owners/directors, it will preserve, or even increase, the severity of the punishment for fraudulent debtors.

The governance of the insolvency process

Throughout the auction process, someone has to manage both the procedure and, if applicable, the business. To thad end, several factors suggest the adoption of a debtor-in-possession model subject to the supervision of an insolvency practitioner. First, if debtors know that they can keep running the firm during the process, they may have incentives to initiate the insolvency petition earlier. Second, while the auction process is being conducted, some business decisions might need to be made. Therefore, owners/managers may be in a better position to make these business decisions, even if some of them—particularly those outside the ordinary course of business—may be subject to the approval of the insolvency practitioner. Third, since the insolvency practitioners would only focus on supervising the debtor and the auction process instead of running the business, the fees charged by insolvency practitioners involved in these procedures will be reduced.

Unfortunately, even if this system reduces the direct costs of the procedure for debtors, many insolvent MSMEs might not even have the resources to afford the appointment of an insolvency practitioner. In these situations, countries may adopt two possible strategies. On the one hand, they can recognize this situation as a "market failure" and respond with a governmental intervention consisting of the appointment of a public trustee.[62] Alternatively, a country can adopt a "private solution" based on a (purely) debtor-in-possession model. Therefore, the procedure would be exclusively managed by the company's directors, as happens in the US Chapter 11 reorganization procedure.[63]

In the case of adopting this "private solution," however, various safeguards should be implemented to protect the interest of the creditors. Among others, the directors should be liable for damages, and the creditors should retain the power to appoint an insolvency practitioner even if, due to the lack of assets, many insolvency practitioners might not be interested in managing the case unless they foresee that some assets can be brought back to the estate as a result of avoidance actions or liability of directors. In my view, the desirability of each solution—private or public—will depend, among other factors, on the institutional framework existing in a country. In countries with reliable institutions and efficient public agencies, as happens in many advanced economies, the appointment of a public trustee may work. However, in countries with more problems of corruption and inefficiencies in the public sector, as it generally occurs in emerging economies, the private solution will probably be more desirable.[64]

Reduction of formalities and use of technology

To reduce the costs of the procedure, various measures should be adopted. First, the procedure should be automatically opened upon the petition of the debtor. This petition should be

submitted electronically, and the debtor should be required to provide some information about various details of the MSME potentially relevant for the success of the auction process, including:

1. information about the company (if applicable), such as the history, place of incorporation, activity, directors, shareholders, and financial statements;
2. information about the assets (e.g., value of the assets in a piecemeal liquidation, value of the assets as a going concern, existence of security interests over certain assets, and ownership of the assets);
3. information about the creditors (e.g., name and contact details, tentative classification of creditors in the ranking of claims);
4. information about existing contracts (e.g., executory contracts, essential contracts/suppliers):
5. information about the business (e.g., geographical location, prospects, and business model); and
6. the reasons leading to the insolvency petition.

Second, the allowance and verification of claims should be conducted electronically, and the timeline to submit claims should be reduced. Third, the creditors' meeting and any decision adopted by the creditors during the procedure should also take place electronically. Fourth, all the details of the debtor and the auction process should be properly disclosed through a transparent and public platform.

In fact, similar to other forms of international cooperation observed in the insolvency space, it would be desirable to facilitate cooperation among national platforms auctioning insolvent firms. By sharing the details of the auction process internationally, more bidders might be interested in acquiring a business or at least some of the assets. If so, the risk of fire sales will be reduced; more viable businesses can be saved; more liquidity will be provided to the insolvency process; the risks of collusion and other fraudulent practices potentially existing in auctions will be reduced; and the creditors will have the opportunity to choose from more bidders, potentially leading to the maximization of their returns. Therefore, an auction conducted in a public, competitive, and transparent manner, and reaching an international audience, can be beneficial for debtors, creditors, and society as a whole. To facilitate this goal, the use of technology and internet-enabled platforms will play an essential role in the success of the auction process.

Financing the procedure

If having access to finance is already difficult for many solvent MSMEs, this problem is exacerbated in a situation of insolvency. Additionally, even if the system of auctions reduces the costs of the procedure, debtors might still need to incur some debts and expenses while the auction takes place, and not many MSMEs can afford such costs.

To address these problems, two measures should be adopted in the proposed simplified insolvency process. First, debts and expenses needed to create or preserve value (e.g., new debts and expenses incurred with critical employees and suppliers) and those potentially required to manage the procedure (e.g., professional fees) should enjoy an administrative expense priority. However, in order to avoid any opportunistic or wasteful dilution of the pie available for the general body of unsecured creditors, this priority should be authorized by the insolvency practitioner. If, by any chance, the debtor is not subject to the supervision of any insolvency practitioner, as it has been suggested for assetless MSMEs in emerging economies,[65] corporate directors should be personally liable for any damages to the creditors as a result of any negligent or disloyal behavior.

Second, in order to facilitate the financing of many aspects of the procedure, including the initiation of avoidance actions, the investigation of the debtor's conduct, and the appointment of insolvency practitioners, the simplified insolvency process for MSMEs should favor a system of litigation funding. This would allow third parties to fund many aspects of the procedure not only for the benefit of creditors and society as a whole but, in many cases, also for the benefit of debtors if, for example, the system of litigation funding facilitates the recovery of certain assets (some of them sold at a discount as a result of the financial trouble potentially experienced prior to the commencement of the insolvency process) or the appointment of an insolvency practitioner that can add value to the process.

6.2.3 | Superiority of auctions over simplified reorganization and liquidation procedures

As has been mentioned, many MSMEs seeking to initiate the simplified insolvency process will not deserve to be reorganized. If the workout fails, it is probably because the business is not viable or the creditors do not trust the shareholder/managers.[66] Despite this lack of viability, many MSMEs may still wish to attempt a reorganization procedure as a result of several factors, including behavioral biases, lack of knowledge about the viability of the company, and the moral hazard problem associated with not bearing further losses if the MSME is a company and the shareholders have already lost everything.[67] Therefore, the existence of these factors can make non-viable firms stay alive at the expense of creditors. As a result, the recoveries of the creditors will be reduced in insolvency, encouraging lenders to be more reluctant to extend credit to MSMEs.

Second, even if countries implementing simplified reorganization and liquidation procedures adopt efficient rules for the conversion of the procedure,[68] this process may involve time, resources, and disputes between debtors and creditors. Also, determining whether a business is viable or not is not always an easy task. In many countries (especially emerging economies), judges and insolvency practitioners might not have the expertise to conduct this viability assessment. Even if they are experienced, the concept of a "viable firm" is not always clear. For some authors, a firm is economically viable if the business has a going concern value which is greater than the value of the assets on a break-up basis and also greater than zero.[69] For others, a firm is economically viable if the firm's revenues can cover its costs, exclusive of financing costs.[70] Regardless of the definition adopted, conducting this assessment will be costly, and it will be subject to subjective valuations.

The adoption of a system of auctions will avoid some of the costs and problems associated with defining and distinguishing between viable and non-viable firms. Namely, instead of leaving this decision to judges and insolvency practitioners, a system of auctions will indirectly leave this decision to the market. After all, whether a company is viable or not often depends on subjective perceptions as well as the vision and ability of the individuals behind a business. Therefore, the market will be in a better position to conduct this viability test.

Potential detractors of a simplified insolvency process based on a system of auctions may argue that this system can create several problems, including fire sales, collusion, excessive liquidation of viable businesses, and the delay in the commencement of the insolvency process. However, as the (certainly limited) empirical evidence analyzing auctions in bankruptcy has shown, none of these problems seems to exist.[71]

First, the delay in the initiation of the procedure may not necessarily occur. On the one hand, the owners (or, in companies, shareholders/managers) of the business will not always lose the firm during the auction process. Since they face lower asymmetries of information, they will probably have incentives to submit the highest bids for the business, assuming that it is economically viable. Besides, as the proposed system of auctions would allow non-cash offers, the shareholders/managers could offer a reorganization plan. Therefore, many cases will end up with an actual agreement between the existing debtors and the creditors, allowing the owners/shareholders/managers to retain the business as in a regular reorganization procedure. On the other hand, external bidders do not often have the expertise to run the business. Therefore, even if they end up owning the business, they may be interested in keeping the previous shareholders/managers.[72] In both cases, the shareholders/managers will keep running the business while preserving their jobs.

Second, this simplified insolvency process should not lead to excessive liquidations of *viable* businesses. As it has been mentioned, companies should be required to try a workout before initiating this simplified insolvency process. If the workout fails, there are reasons to believe that the business might not be viable. Besides, even if it is viable, the auction process may still end with a reorganization agreement or with a going concern sale. In both cases, the process will conclude with the survival of the business.

Third, the risk of collusion and similar fraudulent practices in auctions can be minimized by promoting a system of public, transparent, and internationally available auctions. Therefore, this argument does not seem very convincing either. In fact, since this system can create an international market for distressed assets, the existence of more actors, analysts, and information can actually reduce, rather than increase, the problem of collusion in the acquisition of assets of distressed firms.

Finally, it could be argued that a system of auctions can lead to fire sales.[73] This problem generally exists due to the lack of liquidity and potential acquirers in the market.[74] However, if the auctions take place publicly through an electronic system facilitating the internationalization of these auctions, this mechanism can actually increase the number of bidders interested in the distressed firm or at least in some of its assets. Therefore, the proposed insolvency process based on a system of auctions may actually reduce the risk of experiencing a problem of fire sales in insolvency.[75]

6.3 | Discharge of debts for individual entrepreneurs

As mentioned in Section 2, many MSMEs are not incorporated. Even if they are, the shareholders/managers usually guarantee the company's debts.[76] Therefore, any effort to enhance the attractiveness of the *corporate* insolvency regime should be accompanied by a simultaneous reform of the *personal* insolvency regime in order to allow an effective discharge of debts for honest but unfortunate individual debtors.[77] This discharge can even take place during the same auction procedure, saving the costs associated with opening a separate insolvency proceeding just for discharge of debts of the shareholders/managers running the insolvent MSMEs.[78] In the absence of an effective discharge of debts for honest but unfortunate sole traders and shareholders/managers, the insolvency regime will still be unattractive for MSMEs.

6.4 | Reducing the stigma of insolvency

Finally, while the stigma associated with insolvency proceedings is a problem for all types of firms, it becomes even more pronounced in the context of MSMEs due to the close association

of the shareholders/managers with the business. Therefore, if the business fails, it may end up harming the reputation of the owners/shareholders/managers.

Regulators and lawmakers can implement different policies to reduce the stigma associated with insolvency proceedings.[79] For instance, they could start by separating insolvency law from criminal law.[80] Business failure should not be punished. Only fraudulent behavior should be punished through criminal sanctions, and these sanctions can be imposed outside of the insolvency framework. Additionally, regulators can reduce the stigma of insolvency proceedings by implementing several "nudges".[81] For example, in the United States, the legislator decided to use the word "debtor" rather than "bankrupt" to refer to insolvent companies. In the United Kingdom, Singapore and other countries around the world, the term "restructuring law" is starting to be used for reorganization and pre-insolvency procedures.[82] More interestingly, in Chile, the institution in charge of overseeing insolvency proceedings is called "Superintendence of Insolvency and *Re-entrepreneurship*" in an attempt to reduce the stigma traditionally associated with insolvency proceedings.[83]

Finally, another solution potentially adopted to reduce the stigma associated with insolvency proceedings may consist of promoting education and awareness in the insolvency space. Moreover, it is also important to change the way insolvency law has been traditionally taught and understood. Instead of seeing insolvency law as an area exclusively dealing with financially distressed companies, it should be analysed as an essential part of the entrepreneurial system.[84] In fact, since the way insolvency law is designed may affect how debtors and creditors make business decisions from an *ex ante* perspective, an insolvency legislation can actually be more relevant for solvent than for insolvent firms.[85] Therefore, even in the absence of a situation of financial distress, insolvency law has the ability to affect the levels of entrepreneurship, innovation, access to finance, and economic growth in a country.[86] As a result, changing the way insolvency law has been traditionally taught and understood in many countries can also reduce the stigma traditionally associated with this area of law.[87]

7 | CONCLUSION

Many countries around the world are currently adopting, or planning to adopt, special insolvency frameworks for MSMEs. While the adoption of simplified insolvency rules for MSMEs has been studied in the past decades, and even more in recent years, it has become more relevant in times of COVID-19. This article has analyzed the primary features and problems of MSMEs in a situation of financial distress, and why the traditional insolvency framework fails to provide an effective response to MSMEs. After providing a general overview of various proposals and insolvency reforms for MSMEs taking place around the world, this article has suggested several recommendations to design an efficient insolvency framework for micro and small firms.

ENDNOTES

[1] World Bank, "Report on the Treatment of MSME Insolvency" (2017), available at: <http://documents.worldbank.org/curated/en/973331494264489956/Report-on-the-treatment-of-MSME-insolvency>; UNCITRAL Working Group V (Insolvency Law), "Draft Text on a Simplified Insolvency Regime" (16 February 2021), available at: <https://undocs.org/en/A/CN.9>/WG.V/WP.172; World Trade Organization, "Helping MSMEs Navigate the Covid-19 Crisis" (World Trade Organization 2020), available at: <https://www.wto.org/english/tratop_e/covid19_e/msmes_report_e.pdf>; OECD, "Statistical Insights: Small,

Medium and Vulnerable" (2020), available at: <https://www.oecd.org/sdd/business-stats/statistical-insights-small-medium-and-vulnerable.htm>.

[2] Aurelio Gurrea-Martínez, "Insolvency Law in Emerging Markets" (2020) Ibero-American Institute for Law and Finance Working Paper No. 3, available at: <https://ssrn.com/abstract=3606395>.

[3] For an analysis of these costs, see Michelle White, "The Costs of Corporate Bankruptcy: A US-European Comparison," in Jagdeep Bhandari and Lawrence Weiss (eds), *Corporate Bankruptcy: Economic and Legal Perspectives* (Cambridge University Press 1996), 489.

[4] For a review of the literature on the impact of creditor protection on firms' access to finance, see John Armour, Antonia Menezes, Mahesh Uttamchandani, and Kristin van Zwieten, "How do creditor rights matter for debt finance? A review of empirical evidence," in Frederique Dahan (ed), *Research Handbook on Secured Financing of Commercial transactions* (Edward Elgar 2015), 3-25.

[5] These international divergences are justified, among other aspects, on the different sizes and structures of many economies. For example, while a company in a large economy may be classified as "small" or "medium," the same entity can be classified as a "large company" in many other countries. For this reason, the lack of a universal definition of MSME actually makes sense.

[6] For example, under Australian corporate law, a firm is defined as a "small company" if it satisfies at least two of the following criteria: (a) an annual revenue of less than AUD 50 million; (b) less than 100 employees; and (c) assets of less than AUD 25 million. For taxation purposes, the Australian Taxation Office defines a small business entity as having less than AUD 10 million aggregated turnover. For employment purposes, Fair Work Australia defines a small business as one that has less than 15 employees. See: <https://asic.gov.au/for-business/small-business/>. Under the new insolvency framework for MSMEs implemented in Australia, an MSME will be mainly defined depending on their liabilities. Namely, a company will have access to the simplified insolvency process if its liabilities do not exceed AUD 1 million. See regulations 5.3B.03 and 5.5.03, Corporations Amendment (Corporate Insolvency Reforms) Act 2020 (Cth). In Singapore, something similar occurs. For example, under Singapore company law, small firms are generally defined as companies that fulfil at least two out of the following three conditions: (a) total annual revenue of the company not exceeding SGD 10 million; (b) total assets not exceeding SGD 10 million; and (c) number of full-time employees at the end of the financial year not exceeding 50. See paragraph 2, Thirteenth Schedule, Companies Act (Cap. 50). However, for the purpose of the simplified restructuring process suggested as a response to the COVID-19 crisis, the concept of MSME refers to companies meeting the following requirements: (a) annual sales turnover not exceeding SGD 10 million; (b) no more than 30 employees; (c) no more than 50 creditors; and (d) liabilities (including contingent and prospective liabilities) not exceeding SGD 2 million. An additional requirement of no more than SGD $50,000 in unencumbered assets is imposed for the initiation of the simplified *liquidation* process. See sections 72F(2) and 250F(1), Insolvency, Restructuring and Dissolution (Amendment) Act (No. 39 of 2020).

[7] World Bank (above footnote 1).

[8] World Bank, "Small and Medium Enterprises (SMEs) Finance," available at: <https://www.worldbank.org/en/topic/smefinance>.

[9] See Shigehiro Shinozaki, "Capital Market Financing for SMEs: A Growing Need in Emerging Asia" (2014) ADB Working Paper Series on Regional Economic Integration No. 121, available at: <https://www.adb.org/sites/default/files/publication/31179/reiwp-121.pdf>; Ana Carvajal, Richard Davis, Shanthi Divakaran and Tanya Konidaris, "Capital Markets and SMEs in Emerging Markets and Developing Economies: Can They Go the Distance?" (2020), available at: <http://documents.worldbank.org/curated/en/270221582271669731/Capital-Markets-and-SMEs-in-Emerging-Markets-and-Developing-Economies-Can-They-Go-the-Distance>.

[10] For a general overview of the primary features of a corporation, including the existence of limited liability, see John Armour, Henry Hansmann, Reinier Kraakman, and Mariana Pargendler, "What is Corporate Law?" in John Armour, Luca Enriques et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press 2017), 5–15. For an economic analysis of the limited liability, see Frank Easterbrook and Daniel Fischel, "Limited Liability and the Corporation" (1985) 52 *University of Chicago Law Review* 89;

Stephen Bainbridge and M Todd Henderson, *Limited Liability: A Legal and Economic Analysis* (Edward Elgar 2016).

[11] In fact, the number of shareholders/managers acting as guarantors for the company's debts is also very high in many advanced economies. For example, in a study conducted in the United States, it was found that 56% of shareholders of small companies actually have *unlimited* liability due to the existence of guarantees. See Douglas Baird and Edward Morrison, "Series Entrepreneurs and Small Business Bankruptcies" (2005) 105 *Columbia Law Review* 8.

[12] See Janis Sarra, "Micro, Small and Medium Enterprise (MSME) Insolvency in Canada" (2016), available at: <https://commons.allard.ubc.ca/cgi/viewcontent.cgi?article=1309&context=fac_pubs>. See also World Bank, "Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency" (2018), available at: <http://documents1.worldbank.org/curated/en/989581537265261393/pdf/Saving-Entrepreneurs-Saving-Enterprises-Proposals-on-the-Treatment-of-MSME-Insolvency.pdf>.

[13] For an analysis of these problems and the role of corporate insolvency law in the real economy, see Aurelio Gurrea-Martínez, "Role of Corporate Insolvency Law in the Promotion of Economic Growth" (*Singapore Global Restructuring Initiative* 2020), available at: <https://cebcla.smu.edu.sg/sgri/blog/2020/07/01/role-corporate-insolvency-law-promotion-economic-growth>. See also Gurrea-Martínez (above footnote 2).

[14] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986), 16–17.

[15] For this reason, some authors have argued that insolvency law can serve as a "liquidity provider" for viable but financially distressed firms, at least in countries with a system of rescue or debtor-in-possession (DIP) financing. See Kenneth Ayotte and David Skeel Jr, "Bankruptcy Law as a Liquidity Provider" (2013) 80 *University of Chicago Law Review* 1557.

[16] For an analysis of various forms of opportunism of debtors vis-à-vis, and how these problems are intensified when a company becomes insolvent, see John Armour, Gerard Hertig and Hideki Kanda, "Transactions with Creditors," in Armour et al. (above footnote 10), 111.

[17] See above footnote 14.

[18] For example, insolvency law often provides debtors with the possibility of obtaining a moratorium or automatic stay that stops creditors in their attempt to initiate individual enforcement actions. The existence of rescue or DIP financing existing in some insolvency legislations can minimize the costs associated with not being able to finance post-petition suppliers, employees, and investment projects that can create or preserve value. Disclosure obligations to debtors and the intervention of reliable third parties such as judges and insolvency practitioners can facilitate negotiations and mutually beneficial solutions. A system of avoidance actions and directors' duties and liability in the zone of insolvency can help reduce the risk of opportunistic behavior of shareholders vis-à-vis creditors. See above footnote 13.

[19] Except for the United States, the United Kingdom and, to a lesser extent, Japan and Australia, most countries around the world usually have companies with controlling shareholders. See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, "Law and Finance" (1998) 106 *Journal of Political Economy* 1113; Rafael La Porta, Florencio Lopez-de-Silanes and Robert Vishny, "Corporate Ownership Around the World" (1999) 54(2) *Journal of Finance* 471; Adriana de la Cruz, Alejandra Medina and Yun Tang, "Owners of the World's Listed Companies" (2019) OECD Capital Market Series, available at: <https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=3475351>; Gur Aminadav and Elias Papaioannou, "Corporate Control around the World" (2020) 75(3) *Journal of Finance* 1191.

[20] Michael Jensen and William Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3(4) *Journal of Financial Economics* 305, 333–343; Barry Adler, "A Re-Examination of Near-Bankruptcy Investment Incentives" (1995) 62 *University of Chicago Law Review* 575; Paul Davies, "Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency" (2006) 7 *European Business Organization Law Review* 301, 306–309.

[21] For an analysis of behavioural biases potentially affecting managerial decisions, see Dan Lovallo and Daniel Kahneman, "Delusions of Success: How Optimism Undermines Executives'Decisions" (2003) 81 *Harvard Business Revie*w 56. In the zone of insolvency, see Amir N Licht, "My Creditor's Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency" (2020) European Corporate Governance

Institute - Law Working Paper No. 551<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3680768> (emphasizing the behavioral problem associated with remaining married to original choices even when it is not rational to do so).

[22] An underinvestment problem occurs when a firm does not pursue investment projects with a positive net present value, sometimes because of the inability to obtain new financing. See See Steward Myers, "The Determinants of Corporate Borrowing" (1977) 5(2) *Journal of Financial Economics* 147.

[23] World Bank (above footnote 1). See also Jason Harris and Michael Murray, "Insolvency Law Failing Small Business" (University of Sydney Law School, 6 August 2020), available at: <https://www.sydney.edu.au/law/news-and-events/news/2020/08/06/insolvency-law-failing-small-business.html>.

[24] In a recent study conducted in Chile, it was shown that, from October 2014 (when the new insolvency legislation came into force) to August 2020, 54% of the reorganization procedures initiated in Chile ended up with a successful reorganization agreement. Among these companies, 79% of them successfully performed the obligations established in the reorganization plan. The study shows that the percentage of successful reorganization agreements is significantly lower for MSMEs (33.3%) compared to large companies (61.7%). See Hugo Sánchez, "¿Ha Sido la Reorganización Judicial una Alternativa Real de Solución Para las Empresas?" *Latercera* (28 September 2020), available at: <https://www.latercera.com/pulso/noticia/ha-sido-la-reorganizacion-judicial-una-alternativa-real-de-solucion-para-las-empresas/5QYZ4W45RVEUDCKLOFUDY3W5YU/>.

[25] There are some notable exceptions though. For example, Myanmar and, to a lesser extent, India, and Laos have implemented special insolvency rules for micro and small firms. See ABLI, *Corporate Restructuring and Insolvency Law in Asia* (Asian Business Law Institute 2020), 307–308, 427–429, 522–529. Likewise, as a response to the COVID-19 pandemic, Colombia has adopted new insolvency rules for small firms. See Aurelio Gurrea-Martínez, "Insolvency Law in Times of COVID-19" (2020) Ibero-American Institute for Law and Finance Working Paper No. 2, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3562685>. In 2019, the United States adopted an insolvency framework for small firms through the Small Business Reorganization Act. In Australia, a new insolvency regime for MSMEs came into force on January 1, 2021. Singapore has also adopted a simplified insolvency programme for MSMEs. This framework came into force on January 29, 2021, and even though it is initially available for 6 months, it may be extended. See Ministry of Law, "Financially Distressed Micro and Small Companies May Apply for Simplified Insolvency Programme From January 29, 2021" *Press Release* (28 January 2021), available at: <https://www.mlaw.gov.sg/news/press-releases/simplified-insolvency-programme-commences>.

[26] Highlighting the significant costs of insolvency proceedings for MSMEs, see Merton Miller, "Leverage" (1990) 46(2) *Journal of Finance* 479, 484. From an empirical perspective, see Julian Franks and Oren Sussman, "Financial Distress and Bank Restructuring of Small to Medium Size UK Companies" (2005) 9(1) *Review of Finance* 65.

[27] See above footnote 23.

[28] See above footnote 12.

[29] See above footnote 7 .

[30] World Bank (above footnote 12).

[31] See UNCITRAL Working Group V (above footnote 1).

[32] Idem.

[33] Idem.

[34] For an overview of the simplified insolvency framework in the United States, see William Norton III and James Bailey, "The Pros and Cons of the Small Business Reorganization Act of 2019" (2020) 36 *Emory Bankruptcy Developments Journal* 384. For Myanmar, see Scott Atkins, "Jurisdictional Report: Myanmar," in ABLI (above footnote 25), 522–529.

[35] For these latter jurisdictions, see ABLI (above footnote 25), 307–308, 427–429. See also Paul Omar, "SMEs and Insolvency: Towards a New Approach in Asia" (Global Law and Business 2017), available at: <https://www.globelawandbusiness.com/index.php/blog/smes-and-insolvency-towards-a-new-approach-in-asia>.

[36] Provisions achieving these goals are found, for example, in the simplified insolvency framework implemented in Myanmar and Colombia and the simplified procedure adopted in Australia and Singapore. The way to achieve these goals differ across jurisdictions though. For example, in Australia, debtors subject to the simplified restructuring procedure are required to submit a reorganization plan within 20 business days. See Corporations Amendment (Corporate Insolvency Reforms) Act 2020 (Cth), reg 5.3B.17(1). The directors are allowed to remain in possession just subject to the supervision of a "small business restructuring practitioner". See regulations 5.3B.08 and 5.3B.37, Corporations Amendment (Corporate Insolvency Reforms) Act 2020 (Cth). In Singapore, the simplified debt restructuring procedure implemented for MSMEs is inspired by the pre-pack Scheme existing under the Insolvency, Restructuring and Dissolution Act of 2018. Therefore, since the pre-pack Scheme only requires one court application –just to sanction the Scheme–, and it dispenses the debtor from convening the meeting of creditors, the use of this mechanism provides MSMEs with a more affordable and expedite restructuring procedure. There are two primary differences between the pre-pack Scheme and the simplified debt restructuring procedure. First, under the new simplified debt restructuring procedure, a reorganization plan can be approved with a majority of two thirds in value of the creditors. A pre-pack Scheme, however, requires a majority in number and 75% in value. Second, unlike the typical scheme of arrangement (including a pre-pack Scheme), the simplified debt restructuring procedure requires the appointment of a restructuring advisor to monitor the procedure and formulate the reorganization plan. See sections 72F(3)(h)(ii), 72M(3)(d) and 72L, Insolvency, Restructuring and Dissolution (Amendment) Act (No. 39 of 2020).

[37] For example, the simplified liquidation process implemented in Singapore has been inspired by the creditors' voluntary winding up. See section 250L, Insolvency, Restructuring and Dissolution (Amendment) Act (No. 39 of 2020). Therefore, it reduces the intervention of courts and the length of the procedure. In Myanmar, a liquidator can only investigate the affairs of a company if the creditors of the debtor consent and provide funding for such investigation. As a result, these reduced functions of the liquidators are expected to reduce the length of liquidation procedures. For an analysis of the simplified insolvency framework in Myanmar, see Atkins (above footnote 34), 522–529.

[38] Countries adopting this model include Australia, Myanmar, the United States, and Singapore. In Colombia, as in many other countries in Latin America and Europe, however, the existence of a debtor-in-possession subject to the supervision of an insolvency practitioner is the general rule for ordinary reorganization procedures, and it also applies to MSMEs.

[39] In Myanmar, the simplified insolvency framework for MSMEs focuses on business debt instead of distinguishing between personal debt and corporate debt. See above footnote 34. In most jurisdictions implementing simplified insolvency frameworks, however, this coordination between corporate and personal insolvency is still missing.

[40] See Joseph Stiglitz, "Bankruptcy Laws: Basic Economic Principles," in Stijn Claesens, Simeon Djankov and Ashoka Mody (eds), *Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws* (World Bank Publications 2001); Philippe Aghion, Oliver Hart, and John Moore, "The Economics of Bankruptcy Reform," in Olivier Blanchard, Kenneth Froot, and Jeffrey Sachs (eds), *The Transition in Eastern Europe* (Vol 2) (Chicago University Press 2004), 215–244; John Armour, "The Law and Economics of Corporate Insolvency" (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No. 197, available at: <https://www.cbr.cam.ac.uk/wp-content/uploads/2020/08/wp197.pdf>.

[41] There are many notable exceptions though. Among others, see Jeremy Berkowitz and Michelle White, "Bankruptcy and Small Firms' Access to Credit" (2004) 35 *The Rand Journal of Economics* 69; Kenneth Ayotte, "Bankruptcy and Entrepreneurship: The Value of a Fresh Start" (2007) 23 *Journal of Law, Economics and Organization* 161; John Armour and Douglas Cumming, "Bankruptcy Law and Entrepreneurship" (2008) 10 *American Law and Economics Review* 303; Edward Morrison, "Bargaining Around Bankruptcy: Small Business Distress and State Law" (2009) 38 *Journal of Legal Studies* 255; Michelle White, "Small Business Bankruptcy" (2016) 8 *Annual Review of Financial Economics* 317.

[42] There are many notable exceptions too. Among many authors, see for example Jason Kilborn, *Comparative Consumer Bankruptcy* (North Carolina Press 2007); Iain Ramsay, *Personal Insolvency in the 21st Century: A Comparative Analysis of the US and Europe* (Hart Publishing 2017).

[43] Sarra (above footnote 12); World Bank (above footnote 12). For the most comprehensive study in the academic literature, see Riz Mokal et al., *Micro, Small, and Medium Enterprise Insolvency: A Modular Approach* (Oxford University Press 2018).

[44] Edward Morrison and Andrea Saavedra, "Bankruptcy's Role in the COVID-19 Crisis" (2020) Columbia Law and Economics Working Paper No. 624, 6–7, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3567127>. See also above footnote 26.

[45] See above footnotes 11 and 12 .

[46] Armour and Cumming (above footnote 41).

[47] For an analysis of the use of mediation in insolvency and restructuring, see Ashok Kumar and Koh Wei Lun, "Court-ordered Mediation in Restructuring Proceedings: The Next Reform?" (2020) *SAL Prac* 14. According to these authors, while mediation should not always be imposed, courts—at least in Singapore—should have the ability to compel parties to use mediation, provided that several safeguards are put in place. In my view, in the particular context of MSMEs, *trying* a workout—with or without mediation—can be required as a condition to initiate a formal insolvency proceeding.

[48] According to some studies, the costs of financial distress represent 10 to 20% of the market value of the firm. See Gregor Andrade and Steven Kaplan, "How Costly Is Financial (Not Economic) Distress? Evidence from Highly Leveraged Transactions That Became Distressed" (1998) 53 *Journal of Finance* 1443. In liquidations, however, these costs can be even higher. See also Franks and Sussman (above footnote 26) (reporting that, at least in the context of small and medium size companies in the United Kingdom, insolvency liquidations subtract 20 to 40% of the company's proceeds).

[49] This assumption will only be true in the context of viable businesses, that is, businesses that are worth more alive than dead. For this reason, workouts should only be promoted in the context of viable businesses. In these circumstances, achieving an out-of-court restructuring will be beneficial for debtors, creditors, and society as a whole.

[50] Analyzing the importance of positive impact of having an efficient judicial system, see Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, "Courts" (2003) 118(2) *The Quarterly Journal of Economics* 453; Dani Rodrik, Arvind Subramaniam and Francesco Trebbi, "Institutions Rule: The Primacy of Institutions Over Geography and Integration of Economic Development" (2004) 9 *Journal of Economic Growth* 131; Dimitri Lorenzani and Federico Lucidi, "The Economic Impact of Civil Justice Reforms" (2014) European Commission Economics Paper 530; Magda Bianco, Tullio Jappelli and Marco Pagano, "Courts and Banks: Effects of Judicial Enforcement on Credit Markets" (2005) 37(2) *Journal of Money, Credit and Banking* 223; Simeon Djankov, Oliver Hart, Caralee McLiesh, and Andrei Shleifer, "Debt Enforcement Around the World" (2008) 116(6) *Journal of Political Economy* 1105.

[51] Stuart Gilson, Kose John and Larry Lang, "Troubled Debt Restructurings: An Empirical Study of Reorganization of Firms in Default" (1990) 27(2) *Journal of Financial Economics* 315; Edward Morrison, "Bargaining Around Bankruptcy: Small Business Distress and State Law" (2009) 38 *Journal of Legal Studies* 255.

[52] For example, in the United Kingdom, the British Bankers' Association advocated for the use of the so-called "London Approach," which consists of a non-statutory and informal framework supported by the Bank of England for dealing with companies or groups in financial difficulties. See John Armour and Simon Deakin, "Norms in Private Insolvency: The 'London Approach' to the Resolution of Financial Distress" (2001) 1 *Journal of Corporate Law Studies* 21. In Singapore, the Association of Banks has promulgated a set of principles for facilitating out-of-court workouts through its Principles & Guidelines for Restructuring of Corporate Debt ("ABS Guidelines"), which are available at: <https://www.abs.org.sg/docs/library/spore_approach.pdf>. See also World Bank Group, "A Toolkit for Out-of-Court Workouts" (2016), available at: <http://documents1.worldbank.org/curated/en/851561511964075432/pdf/121753-WP-PUBLIC-OCWToolkitFINALENGLISHWEB.pdf>; INSOL International, "Statement of Principles for a Global Approach to Multi-Creditor Workouts II" (2017), available at: <https://original.insol.org/_files/Publications/StatementOfPrinciples/Statement%20of%20Principles%20II%2018%20April%202017%20BML.pdf>. These can all serve as a valuable guidance for countries interested in encouraging workouts.

[53] Idem.

[54] See above footnote 24.

[55] This mechanism will be discussed in Section 6.2.2.

[56] See World Bank (above footnote 1).

[57] Analyzing the costs associated with liquidating viable companies and keeping non-viable firms alive, see White (above footnote 3). Analyzing how many non-viable business may use reorganization procedures opportunistically, see Horst Eidenmüller, "Contracting for a European Insolvency Regime" (2017) 18 *European Business and Organization Law Review* 273; Aurelio Gurrea-Martínez, "The Future of Reorganization Procedures in the Era of Pre-Insolvency Law" (2020) 21(4) *European Business Organization Law Review* 829.

[58] The importance of auctions has been recognized by The Royal Swedish Academy of Sciences by awarding the Nobel Prize in Economics to Paul Milgrom and Robert Wilson for their contributions to the development of auction theory and the optimal design of auctions. In the context of bankruptcy law, the use of auctions has been explored by many authors. Among others, see Philippe Aghion, Oliver Hart, and John Moore, "The Economics of Bankruptcy Reform" (1993) 8(3) *Journal of Law, Economics and Organization* 523; Douglas Baird, "Revisiting Auctions in Chapter 11" (1992) 36 *The Journal of Law & Economics* 633; Oliver Hart, Rafael La Porta, Florencio Lopez-de-Silanes and John Moore, "Proposal for a New Bankruptcy Procedure in Emerging Markets," in Richard Levich (ed), *Emerging Capital Flows* (Kluwer 1988), 401–419; B Espen Eckbo and Karin Thorburn, "Bankruptcy as an Auction Process: Lessons from Sweden" (2009) 21(3) *Journal of Applied Corporate Finance* 38.

[59] Hart et al. (above footnote 58), 401–419.

[60] Some authors actually define a reorganization agreement as a "hypothetical sale" of the company's assets to the company's existing claimants. See Douglas Baird, "The Uneasy Case for Corporate Reorganizations" (1986) 15 *The Journal of Legal Studies* 127.

[61] This is the solution adopted in Myanmar. See above footnote 34.

[62] Harris and Murray (above footnote 23).

[63] Nonetheless, it should be noted that, in a US Chapter 11 reorganization procedure, the debtor-in-possession is subject to the supervision of the court, and a trustee or an examiner can be exceptionally appointed in cases of fraud and mismanagement. See Jonathan Lipson, "Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies" (2010) 84 *American Bankruptcy Law Journal*, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1605285>.

[64] See above footnote 2.

[65] See sub-section 6.2.2(b).

[66] The lack of viability of many financially distressed MSMEs has also been recognized by the World Bank and UNCITRAL. See above footnote 1.

[67] See Section 2.

[68] See UNCITRAL (above footnote 1).

[69] Armour (above footnote 40). This definition is more consistent with the concept of "economically efficient firms" used by the economic literature. See Michelle White, "The Corporate Bankruptcy Decision" (1989) 3 (2) *Journal of Economic Perspectives* 129; Michelle White, "Does Chapter 11 Save Economically Inefficient Firms?" (1994) 72 *Washington University Law Quarterly* 1319. In any case, it should be noted that, even if this concept is adopted, the going concern value depends on many subjective variables, including the company's future cash flows and the firm's weighted average cost of capital (WACC). Therefore, determining the going concern value will also generate other problems.

[70] Alan Schwartz, "A Normative Theory of Corporate Bankruptcy" (2005) 91 *Virginia Law Review* 1199, 1200–1201.

[71] Karin Thorburn, "Bankruptcy Auctions: Costs, Debt Recovery and Firm Survival" (2000) 58 *Journal of Financial Economics* 337; Eckbo and Thorburn (above footnote 58).

[72] Eckbo and Thorburn (above footnote 58).

[73] For an analysis of this problem of in distressed markets, see Andrei Shleifer and Robert Vishny, "Liquidation Values and Debt Capacity: A Market Equilibrium Approach" (1992) 47 *Journal of Finance* 1343. For an examination of whether bankruptcy auctions lead to fire sales, see above footnote 71.

[74] Idem.

[75] This intuition is also consistent with the empirical evidence suggesting that auctions do not lead to fire sales. See above footnote 71.

[76] See above footnotes 11 and 12.

[77] See above footnote 12.

[78] Idem.

[79] Reducing the stigma of insolvency proceeding is also a policy recommendation suggested by the World Bank and UNCITRAL. See above footnote 1.

[80] This close connection between insolvency law and criminal law can be found in many countries (including advanced economies), especially in Asia and the Middle East.

[81] For an analysis of this concept, see Richard Thaler and Cass Sunstein, *Nudge* (Yale University Press, 2008). For an analysis of a variety of "nudges" that can be implemented to reduce the stigma associated with insolvency proceedings, see Gurrea-Martínez (above footnote 57).

[82] Some authors distinguish between "insolvency law" and "restructuring law," arguing that both areas of law are part of the general concept of the "law of corporate distress." See Sarah Paterson, "Rethinking the Role of the Law of Corporate Distress in The Twenty-First Century" (2015) 35 *Oxford Journal of Legal Studies* 1. For a distinction between "insolvency law" and "restructuring law," see Stephan Madaus, "Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law" (2018) 19(3) *European Business Organization Law Review* 615.

[83] For an analysis of the role and functions of this institution, see <http://www.superir.gob.cl>.

[84] See above footnote 13.

[85] Aurelio Gurrea Martinez, "Hacia un nuevo paradigma en el estudio y el diseño del Derecho concursal en Iberoamérica" (2016) Ibero-American Institute for Law and Finance Working Paper No. 7, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2805303>; Horst Eidenmüller, "Comparative Corporate Insolvency Law" (2016) European Corporate Governance Institute Law Working Paper No. 319, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2799863>.

[86] Idem.

[87] Gurrea-Martínez (above footnote 85).

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