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Doing Business 2018

- Since 2013/14, 19 economies have introduced reorganization procedures and another nine economies have improved their existing procedures. However, making them workable in practice can be challenging.
- France introduced a restructuring procedure—the *procédure de sauvegarde* (safeguard procedure)—in 2005 to enable debtors to prevent economic and financial difficulties. Today, the procedure facilitates business survival in three out of four initiated cases.
- Slovenia brought its legal framework closer to international good practices in 2013. Greater access to the reorganization procedures for creditors has been accompanied by an impressive survival rate of viable companies.
- Although it took some time for stakeholders in Thailand to get accustomed to reorganization procedures, filings at the Central Bankruptcy Court increased steadily from 1% of total insolvency cases in 2011 to almost 9% in 2016.

Resolving Insolvency

The challenges of successfully implementing insolvency reforms

Access to finance is key to the development of the private sector. Lenders need tools to assess not only the risk of non-repayment but also what happens if a debtor cannot repay debts as they mature. A good insolvency framework—one with clear rules, that efficiently rehabilitates viable companies and liquidates non-viable ones—provides entrepreneurs and lenders with tools to evaluate the consequences of a worst-case scenario.

Existing literature shows that legal protection of creditors and efficient enforcement are conducive to larger and more developed capital markets and that there is a link between insolvency reforms and access to credit.[1] The specific features of an economy's insolvency regime and its enforcement are important aspects for the legal protection of creditors. Several studies show that reforms strengthening the insolvency framework may reduce the cost of credit, increase the level of credit and lower interest rates on large loans.[2] A study on the 2005 Brazilian bankruptcy reform found a reduction in the cost of debt together with a significant increase in the amount of total and long-term debt.[3] A more recent study found that the same reform led to an increase in secured loans, as well as an increase in investment and value of output in the years after the reform in Brazilian municipalities with less-congested courts.[4] Another study shows that, across a sample of Organisation for Economic Co-operation and Development (OECD) countries, efficient bankruptcy procedures are associated with a higher proportion of new bank loans to large firms.[5]

Other studies show that insolvency reforms that introduce or promote reorganization procedures through the adoption of several international good practices may decrease the failure rate of insolvent firms. Research on the 1999 Colombian bankruptcy reform shows that by reducing reorganization costs through, for example, streamlining the reorganization process and establishing mandatory deadlines on the length of proceedings, the new law enabled viable companies to reorganize and inefficient ones to liquidate (this was not possible before the reform).[6]

Doing Business tracks insolvency reforms across 190 economies. Since *Doing Business 2005*, 110 economies have introduced 205 changes aimed at facilitating the efficient resolution of corporate insolvency. This case study uses the specific examples of France, Slovenia and Thailand to illustrate successful insolvency reforms that can inspire similar efforts elsewhere.

HOW HAVE ECONOMIES REFORMED THEIR INSOLVENCY SYSTEMS?

Insolvency laws have traditionally focused on enabling the swift liquidation of insolvent companies while organizing the repayment of creditors. The focus of modern insolvency regimes has been to offer restructuring tools to companies that are economically viable but face temporary

financial distress in order to maintain the business activity. Recent reform efforts around the world have introduced this modern feature to insolvency frameworks while also allowing the speedy liquidation of nonviable businesses.

In 2013/14, the resolving insolvency indicators started measuring whether insolvency laws complied with certain international standards, including access to reorganization proceedings for debtors and creditors. Since then, the most common type of reform recorded by the indicators has been the introduction of or improvements to reorganization procedures. During this period, 19 economies introduced reorganization procedures and another nine economies improved their existing procedures.[7]

Providing creditors with greater access to and participation in insolvency proceedings has been another common area of reform. Economies including Cyprus, Jamaica, Kazakhstan, Mexico, Mozambique, St. Vincent and the Grenadines, Switzerland and Uganda have implemented reforms in this direction. Enabling creditors' meaningful participation in the process can make them more cooperative and less litigious, and it can result in shorter proceedings.

Many factors, however, can make it challenging to implement insolvency reforms. Doing so requires not only the adoption of an insolvency law or amendments to existing legislation but also changes to regulation to make the law workable in practice. An insolvency law often requires setting up new structures under the regulatory framework such as, for example, a professional body of insolvency administrators. Successful implementation also requires the buy-in and active participation of the judiciary.

WHAT DID SUCCESSFUL REFORMERS DO DIFFERENTLY?

Doing Business has recorded several notable insolvency reforms. However, France, Slovenia and Thailand were selected for this case study because they implemented insolvency reforms that brought them closer to internationally -recognized good practices—particularly through the introduction and improvement of restructuring procedures (table 7.1). There is also a significant amount of information available on the evolution of court procedures following these reforms. Business reorganization has become an increasingly utilized option for viable firms in financial distress in all three countries.

The case of France

Since the 1980s France has regularly assessed and updated its insolvency legal framework to encourage business rescue. In the mid-1980s—when the number of firms declaring bankruptcy doubled compared to the previous decade—liquidation was the only option available to companies in financial distress. The number of business liquidations rose from 11,000 in 1970 to 25,000 in 1984. Members of the legislature realized that some of these companies could have been saved had they been given the tools to restructure. The legislature subsequently adopted three laws in 1985 with the objective of saving viable businesses. A reorganization procedure, open to debtors in cessation of payments that had a prospect of survival, was introduced.

Many companies, however, still ended up stopping operations and being liquidated, mainly because they began the reorganization process when their financial situation was already severely compromised. In response, the government amended the insolvency law in 2005 to focus on preventing firms' economic and financial difficulties. A new restructuring tool—the *procédure de sauvegarde* (safeguard procedure)—was introduced. It allowed debtors that are facing difficulties (but which have not yet ceased payments) to apply for court protection while they negotiate a restructuring plan with creditors.

Contrary to initial expectations, the safeguard procedure was not widely used. When the procedure became available for the first time in 2006, only 509 safeguard applications were filed (compared to 16,046 judicial reorganizations and 31,045 judicial liquidations).[8] One reason was that the criteria required to initiate the safeguard procedure were too strict. Debtors had to demonstrate that they were facing difficulties that would result in insolvency, which was challenging. Another reason was that the law did not clearly stipulate which party—the company managers or the court-appointed administrator—was responsible for the preparation of the safeguard plan, an issue which could deter managers from starting the proceedings.

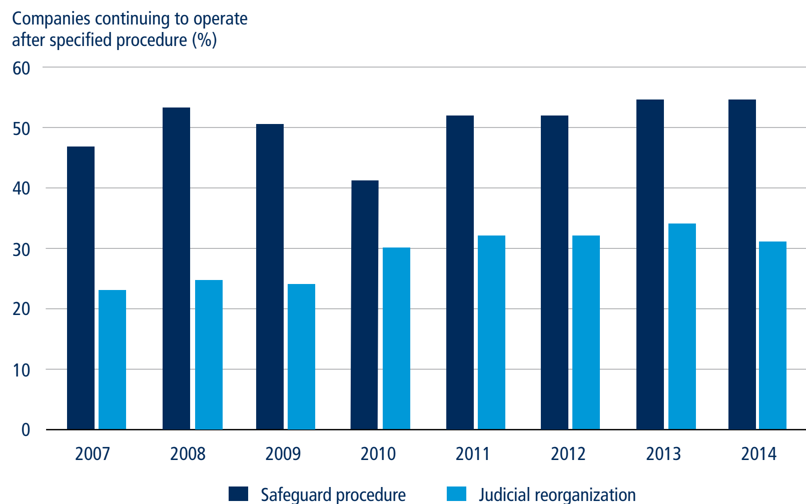
TABLE 7.1 France, Slovenia and Thailand successfully implemented insolvency reforms

Country	Motivation	Reform content	Outcome
France	High number of bankruptcy cases; no possibility for companies to reorganize prior to the reform	Starting in 1985, introduced restructuring procedures with focus on preventing firms economic and financial difficulties	Increased number of initiated and successful reorganization cases
Slovenia	High number of insolvent companies as a result of the 2008 global financial crisis; features of restructuring procedures not suited; no preventive procedures available	Starting in 2008, introduced preventive restructuring procedure for medium and large-size companies and simplified reorganization procedure for micro and small-size companies; improved access to reorganization proceedings for creditors	Increased number of initiated and successful reorganization cases
Thailand	High number of non-performing loans in the context of the 1997 Asian financial crisis; no possibility for companies to reorganize prior to the reform	Starting in 1998, introduced reorganization procedure for corporate debtors; created specialized bankruptcy court	Increased number of initiated and successful reorganization cases

Source: Doing Business database.

The insolvency law was amended again in 2008 to make the safeguard procedure more accessible and attractive to debtors by simplifying the eligibility criteria. Debtors had only to demonstrate difficulties—economic, financial, or legal—that they could not overcome, without having to define or qualify the gravity or extent of those difficulties. The 2008 amendment also made the procedure more attractive by clarifying that the managers of the company were responsible for preparing the safeguard plan with the assistance of the court-appointed administrator. Furthermore, in 2011 France introduced a procedure—the *sauvegarde financière accélérée* (accelerated financial safeguard)—under which a debtor can reach an out-of-court arrangement with a majority of its financial creditors and then initiate summary court proceedings to validate the agreement without negatively impacting non-financial creditors.

FIGURE 7.1 A significant number of companies undergoing restructuring proceedings in France continue operating at the end of proceedings



Source: Deloitte and Altares 2016.
Note: Companies that continue operating include companies that adopted a reorganization or safeguard plan, or that were sold as a whole.

These changes led to a significant increase in the number of new safeguard procedures filed, to 1,386 cases in 2009. Since then the number of filings has risen steadily, to 1,620 new cases in 2014. Not only did the use of safeguard procedures increase, but three out of four cases terminated with an agreement with creditors to enable the company to continue operating (figure 7.1). However, the increased use of the safeguard procedure was accompanied by a significant number of filings for liquidation, which in 2014 amounted to 69% of all insolvency cases filed.

By allowing viable companies to restructure and continue operating as going concerns, the amendments to the insolvency law aimed to support entrepreneurial risk-taking and encourage enterprise creation. Insolvency reforms may have contributed in part to the surge in new businesses in France—525,000 companies were created in 2015, twice as many as in 2000. This growth underscores the connection made in the literature between sound insolvency systems and the level of entrepreneurship development as measured by the rate of new firm entry and entrepreneurship support.[9]

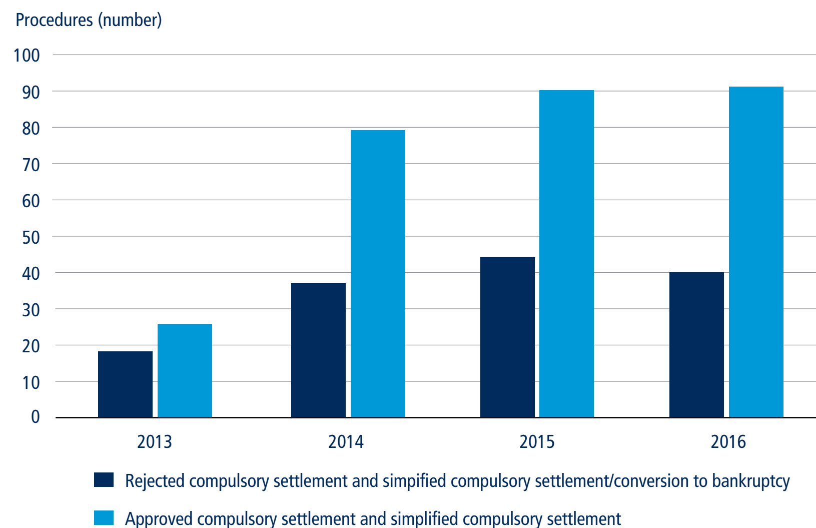
The case of Slovenia

The early 2000s were a period of significant reform in Slovenia as the country prepared to join the European Union in 2004. A new insolvency law was adopted in 2007, but it was insufficient to cope with the challenging economic and financial conditions brought on by the global financial crisis of 2008; many companies became insolvent. Firms suffered from over-indebtedness and had difficulties repaying their loans, leading to an increase in corporate non-performing loans to around 20% of total loans.[10] Firms in Slovenia needed effective corporate restructuring procedures to guide the restructuring of their debt.

To address these needs and to bring the legal framework closer to international good practices, the government modified the corporate restructuring framework in 2013. The changes included the creation of a new pre-insolvency restructuring procedure for distressed medium and large-size companies to restructure their financial claims, as well as a new simplified compulsory settlement procedure to offer a reorganization option for micro and small companies. A change was also made to the existing compulsory settlement procedure to enable creditors to initiate the reorganization of companies for the first time.

The procedures quickly became a popular option for debtors and creditors. In the first two years following the reform, the proportion of companies using one of the three procedures more than doubled, rising from 6% of total insolvency proceedings in 2013 to 14% in 2015.[11] Microenterprises, however, underwent corporate liquidation proceedings in the vast majority of cases (96%) in 2016. Microenterprises have less capacity to face a reorganization and to secure resources to enable them to operate in a situation of financial distress. Despite these challenges, microenterprises have also benefited from the restructuring options. Indeed, the number of simplified compulsory settlement proceedings for the benefit of microenterprises increased from 59 cases in 2014 to 85 in 2016.

FIGURE 7.2 Corporate reorganizations in Slovenia have become more successful over time



Source: Slovenia Ministry of Justice 2017.

Creditors have progressively taken advantage of the enabled access to compulsory settlement proceedings granted to them in 2013; by 2016 they initiated almost one-third of all cases. During the same period, the number of successfully terminated reorganization proceedings increased significantly. In 2016, most ended with an approved settlement (figure 7.2).

One of the companies that benefited from the restructuring procedures was Pivovarna Laško, Slovenia's largest brewer. By the end of 2014, the company's total financial liabilities stood at 226.8 million euros (about $268 million). It negotiated a restructuring plan with its creditors, which included a two-year debt rescheduling, the sale of shares in other companies and an intensive search for additional capital. Following the agreement, the company was bought by Heineken International BV, which committed to provide financial stability to the company. Following the sale of its assets in various corporations and entering into long-term loan agreements with Heineken, the company was able to repay its creditors in full in October 2015. Its value increased, the brewery was able to continue operating, saving hundreds of jobs.

Apart from increasing the likelihood of business survival—as shown by the rising number of successfully-terminated compulsory settlement and simplified settlement procedures—the insolvency reform may have contributed to broader positive economic effects. First, the level of entrepreneurship and company formation in Slovenia increased. One year after the reform was introduced, 6,243 new businesses were registered in Slovenia, the highest number in a decade (and similar to pre-crisis levels). Second, progress has been made in addressing Slovenia's high level of non-performing loans, which decreased from 15% of total loans in 2012 to 7.9% in 2016. While these results do not establish a causal relationship with the insolvency reform, they suggest that sound insolvency regimes may encourage entrepreneurship and accelerate the speed of adjustment of non-performing loans.[12]

The case of Thailand

The 1997 Asian financial crisis prompted a major insolvency reform in Thailand. Non-performing loans had been increasing before the crisis, reaching a peak of 42.9% of total loans in 1998. Thailand's antiquated insolvency law needed to be revised and given the features necessary to perform. The 1940 Thai Bankruptcy Act established the procedure of judicial liquidation for debtors unable to meet their financial commitments. It relied on an agency within the Ministry of Justice—the Legal Execution Department—to direct the proceedings. The only aim of the law was to organize the repayment of creditors through liquidation procedures; it did not offer a channel for viable companies to survive.

Amendments brought by the Bankruptcy Act of 1998 built on the existing legal and institutional framework. They introduced a reorganization procedure for corporate entities, giving insolvent debtors the chance to negotiate a reorganization plan with creditors. A specialized bankruptcy court was established in 1999 to adjudicate cases. Also, the Business Reorganization Office (within the Legal Execution Department) was set up to administer new reorganization cases.

Considerable time was needed in Thailand for stakeholders to become accustomed to reorganization procedures. Finding expertise within Thailand to prepare reorganization plans proved challenging; it required the capacity to negotiate a plan with multiple creditors in a short period of time to return the company to profitability. Managers of companies in financial difficulties found it challenging to formulate a reorganization plan effectively. Debtors turned to large companies with foreign human capital that had expertise in drafting such plans. However, this approach was expensive, making reorganization procedures accessible to only a small number of large debtors.

As a result, in the years following the reform, the number of annual applications for reorganization was modest, averaging 30 to 70 (compared to approximately 700 annual applications for

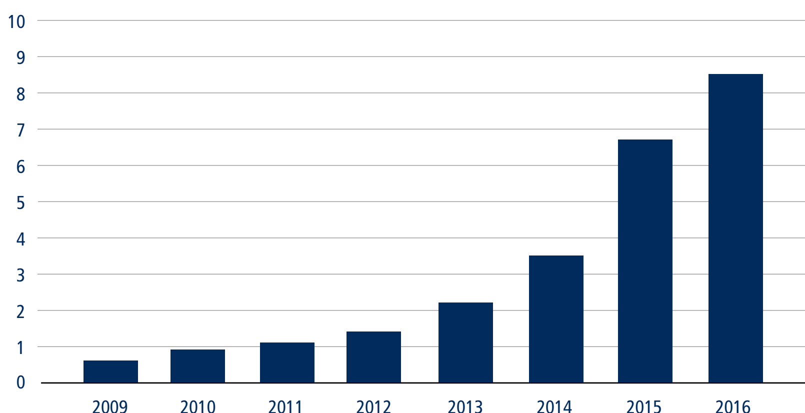
liquidation).[13] Realizing that the benefits of the procedure had to be explained to stakeholders, the government undertook outreach efforts. As local firms gained the necessary expertise to advise debtors during the reorganization process, reorganization practices progressively became more widespread in Bangkok. Consequently, all parties were able to experience the advantages of the new mechanism, enabling them to make use of it to save viable businesses. Together with a greater understanding of the law, reorganization filings rose to 3.5% of total insolvency cases in 2014 (from 1.1% in 2011).[14] The share almost doubled in 2015 and continued to rise in 2016, when 8.5% of insolvency petitions received by the judiciary were reorganization cases (figure 7.3).

The rising use of reorganization proceedings in Thailand has driven an increase in the rate of successful reorganizations (that is, cases that end up with the approval of the reorganization plan, regardless of whether they continue operating in the longer term). The Central Bankruptcy Court's reorganization plan approval rate reached 25% in 2016, up from 20% in 2015.

The connection between the insolvency reform and the likelihood of business survival is reflected in *Doing Business* data. Resolving simple reorganization cases in Bangkok has become easier over time. Companies are now more likely to continue operating at the end of reorganization procedures. Also, today it takes 18 months on average, half the time it took in 2010, for a small company to go through reorganization, counted up to the moment the reorganization plan is approved by creditors.

Studies on the effect of insolvency reforms that accelerate the procedures find that they increase the aggregate level of credit. Other studies suggest that where insolvency regimes are most effective, creditors are more willing to lend because they are more likely to recoup a larger share of a troubled loan.[15] Following the reform in Thailand, domestic credit to the private sector rose from 93% of GDP in 2001 to 147% of GDP in 2016.[16] Banks are more willing to lend in Thailand than in other parts of East Asia and the Pacific. Data from the World Bank Enterprise Surveys show that only 2.4% of firms in Thailand identify access to finance as a major constraint to doing business, compared to 12.2% of firms in the region and 26.5% in all economies. While no causal relationship can be established between these results and the bankruptcy reform in Thailand, they do show that access to credit improved in the years following the reform.

FIGURE 7.3 Distressed businesses in Bangkok are more likely to pursue reorganization today than seven years ago



Source: Thailand Office of the Judiciary 2016.

CONCLUSION

The successful implementation of insolvency reforms is not easy. Many factors must come into play for an insolvency reform to yield positive effects in both insolvency practice and the economy. Even in economies with strong legal frameworks and institutions, insolvency reforms take time. It is a complex area of law, which is why different agencies—including the judiciary as well as insolvency administrators—need to be trained and given the means to carry out the tasks envisioned in the law.

Lessons can be drawn from reforms implemented worldwide. The French and Slovenian examples show the importance of constantly assessing the insolvency system. Insolvency law is not a static field. Rather, it serves the economic system and needs to adapt as the structure of the economy evolves. Implementing and refining insolvency reform takes time; a quick fix will not bring positive long-term results. The example of Thailand illustrates the importance of utilizing the existing infrastructure to drive change—the focus should be on building on existing laws and institutions and creating new ones only when the existing system cannot be adapted. A new framework requires training along with patience. Amending the law should not be seen as a goal in itself, but rather as a first step to be followed by the thorough implementation of the amended law.

All in all, the three examples suggest that sound insolvency reforms can have a positive impact on an economy. Providing corporate debtors with the option to

reorganize increases the chances of debt recovery by creditors, positively influencing their willingness to lend. The availability of reorganization procedures also increases the likelihood that viable firms will continue operating despite financial difficulties, thus decreasing the failure rate of firms, preserving jobs and encouraging entrepreneurship.

NOTES

This case study was written by Faiza El Fezzazi El Maziani, Raman Maroz and María A. Quesada.

1. La Porta and others 1997; La Porta and others 1998; Klapper 2011.
2. Visaria 2009; Funchal 2008; Rodano, Serrano-Velarde and Tarantino 2011.
3. Araujo, Ferreira and Funchal 2012.
4. Ponticelli and Alencar 2016.
5. Neira 2017.
6. Foley 1999; Dewaelheyns and Van Hulle 2006. For Colombia, Giné and Love 2008.
7. The 19 economies that have introduced reorganization procedures are Brunei Darussalam, Cabo Verde, Cyprus, the Dominican Republic, Grenada, India, Jamaica, Kenya, Kosovo, Liberia, Malawi, Mozambique, Panama, St. Kitts and Nevis, St. Vincent and the Grenadines, the Seychelles, Trinidad and Tobago, Uganda, and the United Arab Emirates. The nine economies that improved their existing reorganization procedures are Chile, Georgia, Kazakhstan, Kenya, Mexico, Romania, Slovenia, Thailand, and Switzerland.
8. Deloitte and Altares 2016.
9. Lee and others 2011; Peng, Yamakawa and Lee 2010.
10. IMF 2015.
11. Slovenia, Ministry of Justice 2017.
12. Carpus-Carcea and others 2015.
13. Wisitsora-at 2015.
14. Thailand, Office of the Judiciary 2016.
15. Visaria 2009; Funchal 2008.
16. These data are from the World Development Indicators database (http://data.worldbank.org/indicator), World Bank.