

Closing a business

Carlos, the owner of a large Colombian manufacturing firm, got bad news: his main customer had just entered bankruptcy. Carlos feared that it might take years to recover the company's loan—and that his business could suffer harm.

But there is good news too. Colombia's new insolvency law came into effect at the end of 2007, streamlining bankruptcy procedures. Before, a debtor could object to every claim from any creditor, greatly delaying the court process. Now all objections must be resolved in one court hearing. The new law also tightens procedural time limits. And it gives creditors more power to influence the proceedings, such as allowing them to remove and replace the liquidator.

Efficient bankruptcy regulations improve access to credit. Where insol-

TABLE 11.1

Where is it easy to close a business—and where not?

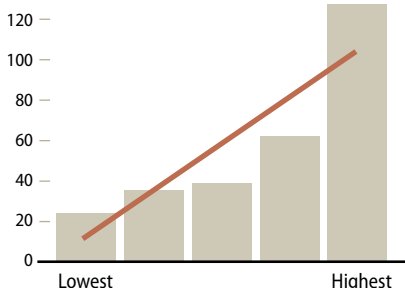
Easiest	Recovery rate	Most difficult	Recovery rate
Japan	92.5	Liberia	8.3
Singapore	91.3	Suriname	8.1
Norway	89.0	Mauritania	6.7
Canada	88.7	Venezuela	6.0
Finland	87.3	Congo, Dem. Rep.	5.4
Ireland	86.6	Philippines	4.4
Denmark	86.5	Micronesia	3.5
Belgium	86.3	Haiti	2.7
United Kingdom	84.2	Zimbabwe	0.0
Netherlands	82.7	Central African Republic	0.0

Note: Rankings are based on the recovery rate: how many cents on the dollar claimants (creditors, tax authorities and employees) recover from the insolvent firm. See Data notes for details. Source: *Doing Business* database.

FIGURE 11.1

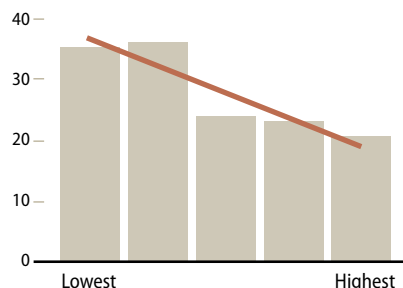
Higher recovery rates associated with more access to credit

Private credit as % of GDP



Economies ranked by recovery rate, quintiles

Percentage of firms perceiving access to credit as an obstacle



Economies ranked by recovery rate, quintiles

Note: Relationships are significant at the 1% level and remain significant when controlling for income per capita. Source: *Doing Business* database; World Bank, World Development Indicators database; World Bank Enterprise Surveys.

veny laws are most effective, creditors—confident that they will be able to collect on loans—are more likely to lend.¹

The benefits of efficient bankruptcy regulations are particularly evident when comparing rich economies. Recent studies in Europe find that actual returns to creditors are 92% of the value of the loan in the United Kingdom, 80% in the Netherlands, 67% in Germany and 56% in France.² Why the big spread? In part because it takes only a year to finish the insolvency process in London, 13 months in Amsterdam and 15 months in Berlin, but almost 2 years in Paris, according to *Doing Business* data.

Good bankruptcy laws do 3 main things. They seek to rehabilitate viable businesses and liquidate unviable ones. They aim to maximize the value received by creditors, shareholders, employees and other stakeholders by requiring that businesses be turned around, sold as going concerns or liquidated—which ever generates the greatest total value. And they establish a system for clearly ranking creditors. Countries with laws meeting these 3 objectives achieve a higher recovery rate than countries without such laws.

Doing Business studies the time, cost and outcomes of bankruptcy proceedings involving domestic entities. Speed, low cost and continuation of viable business operations characterize the top-performing economies. In these economies businesses are more likely to be sold or reor-

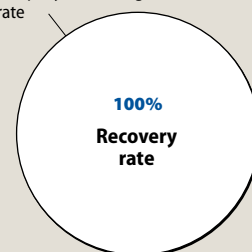
ganized as a going concern rather than liquidated through piecemeal sales. And most allow creditors significant input into the appointment of administrators and require special qualifications for trustees (figure 11.3).

In Canada, Ireland, Japan, Norway and Singapore foreclosure, reorganization or liquidation is completed within a year (table 11.1). Canada and Ireland have specialized bankruptcy courts and statutory time limits. They also limit procedural appeals. Denmark introduced a “floating charge” in 2006 to allow secured creditors to take security over an entire business. This increases the likelihood that a viable business will be sold as a going concern. In Colombia, Kuwait, Norway and Singapore it costs only about 1% of the bankrupt estate's value to resolve insolvency (table 11.2).

FIGURE 11.2

Rankings on closing a business are based on 1 subindicator

Function of time, cost and other factors such as lending rate and the likelihood of the company continuing to operate

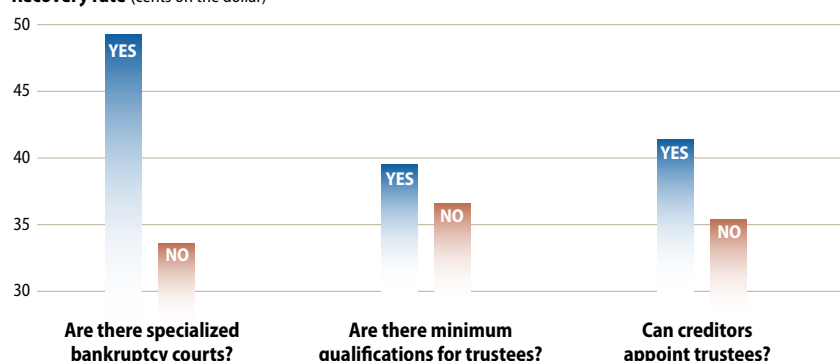


Note: Time and cost do not count separately for the ranking. See Data notes for details.

FIGURE 11.3

Higher recovery rates in economies with specialized courts and trustees

Recovery rate (cents on the dollar)



Source: Doing Business database.

WHO REFORMED IN 2007/08?

Poland was the top reformer in closing a business in 2007/08 (table 11.3). Its Law on Trustee Licensing took effect on October 10, 2007. The new law tightened professional requirements for administrators to ensure they have the skills and education needed to oversee bankruptcy proceedings. Obtaining a trustee's license now requires passing an exam in economics, law, finance and management. The reform also limits trustees' pay to 3% of the bankrupt estate's value, down from 5%.

Three economies in Latin America and the Caribbean rank close behind Poland as top reformers. Colombia, the runner-up reformer, introduced 2 new insolvency proceedings: a reorganization procedure to restructure insolvent companies and a mandatory liquidation procedure. Its new insolvency law tightens time limits for negotiating reorganization agreements. Before, the term allowed was 6 months, with a possible extension of 8 months. The new law limits the term to 4 months, and the extension to 2.

Mexico amended its bankruptcy law. Now debtors and creditors may enter into a reorganization agreement at any stage of the insolvency procedure. St. Vincent and the Grenadines enacted a bankruptcy law in 2007. The law is the country's first set of rules regulating the bankruptcy of private enterprises since its independence.

Four Eastern European economies joined Poland in streamlining bankruptcy procedures. Latvia passed a new insolvency law in November 2007. Now financially distressed companies can choose to continue operating by pursuing reorganization. Like Poland, Latvia also tightened the qualification standards for bankruptcy administrators. So did Bosnia and Herzegovina. The Czech Republic's Insolvency Act took effect on January 1, 2008. The law introduces reorganization as the preferred method for resolving insolvency, mandates stricter deadlines, establishes an electronic insolvency register and sets new qualification standards for trustees.

Bulgaria passed 2 laws: the Civil Procedure Code and the Law for the Commercial Registry. The first specifies that appeals will now take place at 2 levels: first before the court of appeals and then before the supreme court. Bulgaria's supreme court will be the final arbiter, with the discretion to decide whether or not to hear a case. Before, court decisions could be appealed only before the supreme court—which usually sent cases back to the district court—resulting in long delays. Another first for Bulgaria: major decisions and rulings of the bankruptcy court are posted on the commercial registry's website.

In East Asia and Pacific, Hong Kong (China) and Cambodia were the only reformers. Hong Kong (China) issued the Bankruptcy Amendment Rules for 2007,

strengthening trustees' role and powers. Cambodia adopted the 2007 Bankruptcy Law, its first regulating the bankruptcy of private enterprises. The law introduces a reorganization procedure to restructure insolvent companies.

Five OECD high-income economies joined the list of reformers in 2007/08. Finland streamlined court-supervised reorganization. Now a simple majority of creditors can approve simplified reorganization plans; before, unanimous consent was required. Finland revised its Restructuring of Enterprises Act, accelerating hearings and making the entire process more flexible. Germany amended its insolvency code to make it easier to maintain a debtor's business as a going concern. The new law allows the insolvency court to suspend enforcement actions against assets essential to continuing the business.

Portugal cut the formality of publishing insolvency notices in newspapers. It also introduced a fast-track procedure

TABLE 11.2

Where is bankruptcy the most efficient—and where the least?

Time (years)			
Fastest		Slowest	
Ireland	0.4	Ecuador	5.3
Japan	0.6	Indonesia	5.5
Canada	0.8	Haiti	5.7
Singapore	0.8	Philippines	5.7
Belgium	0.9	Belarus	5.8
Finland	0.9	Angola	6.2
Norway	0.9	Czech Republic	6.5
Australia	1.0	Maldives	6.7
Belize	1.0	Mauritania	8.0
Iceland	1.0	India	10.0
Cost (% of estate)			
Least		Most	
Colombia	1.0	Micronesia	38.0
Kuwait	1.0	Philippines	38.0
Norway	1.0	Samoa	38.0
Singapore	1.0	Solomon Islands	38.0
Bahamas, The	3.5	Vanuatu	38.0
Belgium	3.5	Venezuela	38.0
Brunei	3.5	Sierra Leone	42.0
Canada	3.5	Ukraine	42.0
Finland	3.5	Liberia	42.5
Georgia	3.5	Central African Republic	76.0

Source: Doing Business database.

TABLE 11.3

Establishing or promoting reorganization procedures—a popular reform feature in 2007/08

Established or promoted reorganization procedure	Colombia, Czech Republic, Finland, Germany, Greece, Latvia, Mexico, New Zealand
Developed the trustee profession	Bosnia and Herzegovina, Czech Republic, Hong Kong (China), Latvia, Poland
Introduced or tightened time limits and streamlined procedural appeals	Bulgaria, Colombia, Portugal, Saudi Arabia
Established a first bankruptcy law	Cambodia, St. Vincent and the Grenadines
Granted priority to secured creditors	Czech Republic

Source: Doing Business database.

for debtors with less than €5,000 in assets and new procedures to accelerate payments to insolvency administrators. In addition, Portugal limited procedural appeals by unifying its appeals process and raising the value threshold for claims heard in the courts of first and second instance. In the future, appeals of appeals court decisions that confirm first-instance decisions will be possible only in limited circumstances. This is expected to cut the number of appeals before the supreme court.

New Zealand introduced a reorganization procedure similar to the one in Australia. The aim is to provide an alternative to liquidation and receivership and maximize a company's chances of continuing as a going concern. Greece thoroughly revised its bankruptcy system to maximize creditors' recovery of debt. A new law aims to reorganize financially distressed companies, preserve the business assets, treat creditors equally and prevent piecemeal sale. This law is expected to lead to a boom in restructurings and, together with a better early detection system, allow more companies to continue as going concerns.

Saudi Arabia was the only reformer in the Middle East and North Africa. Its Ministry of Commerce introduced strict deadlines for bankruptcy procedures. Auctions of debtors' assets are expected to take place quicker than before.

Bolivia made going through bankruptcy more complex, by suspending applications for voluntary restructuring. The only option now is a bankruptcy procedure that typically takes years.

WHAT ARE THE REFORM TRENDS?

Reform continues even in the jurisdictions with the best performance. *Doing Business* has recorded 58 reforms making it easier to close a business in the past 5 years. Most focused on expanding creditors' rights and speeding bankruptcy proceedings in the court.

Economies in Eastern Europe and Central Asia have had the most reforms making it easier to close a business in the past 5 years, especially in speeding bankruptcy proceedings (figure 11.4). High-income OECD economies follow close behind, focusing more on empow-

ering creditors.

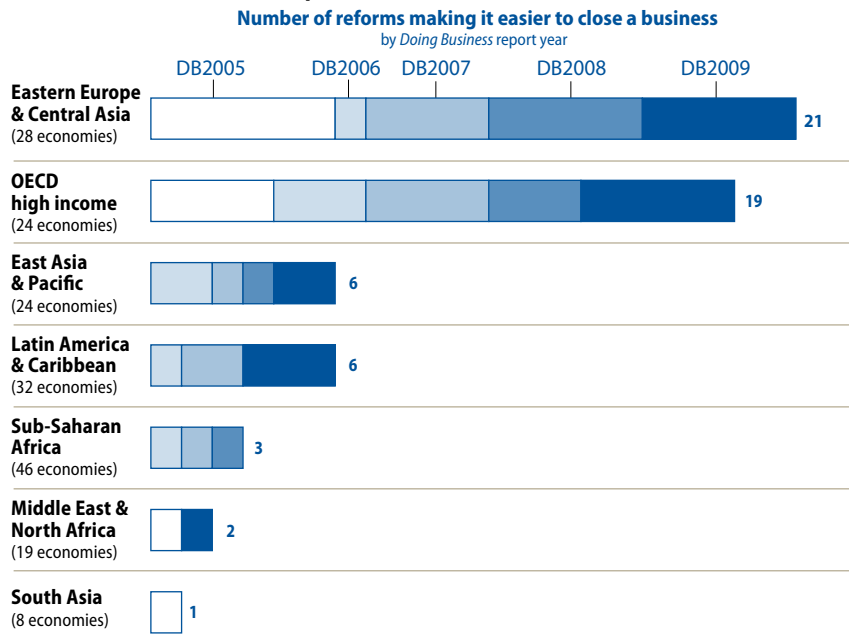
Elsewhere in the world reform has been moving more slowly. The 10 reforms in Latin America and the Caribbean, Sub-Saharan Africa and South Asia have ranged from introducing stricter deadlines to establishing specialized bankruptcy courts. In 2006 Burundi enacted its first bankruptcy law, setting clear time limits for procedures. In the Middle East and North Africa only Tunisia and Saudi Arabia have reformed.

EXPANDING CREDITORS' RIGHTS

Expanding creditors' rights has been the most popular reform feature over the past 5 years (figure 11.5). Seventeen economies have empowered creditors: China, the Czech Republic, Denmark, Finland, France, Hungary, Indonesia, Italy, Korea, Poland, Portugal, Puerto Rico, Romania, Serbia, Slovakia, the United States and Vietnam. Giving creditors more say in the process speeds the resolution of bankruptcy and is likely to result in the continuation of the business. Allowing creditors a greater role in decision making increases the recovery rate.

Reforms expanding the powers of

FIGURE 11.4

Most reforms in Eastern Europe & Central Asia and rich economies

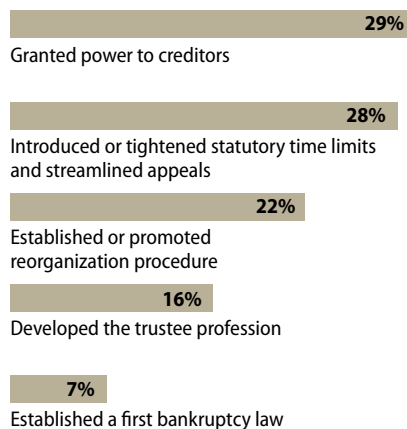
Note: A reform is counted as 1 reform per reforming economy per year.

Source: Doing Business database.

FIGURE 11.5

Top 5 reform features in closing a business

Reforms including feature since DB2005 (%)



Note: A reform may include several reform features.
Source: *Doing Business* database.

creditors have been most concentrated among OECD high-income economies. Finland gave creditors the right to set up a creditors' committee to advise the administrator. France and Korea now allow the creditors' committee to vote on the reorganization plan. Denmark encouraged creditors to report to the court any trustee actions that appear to delay the process. The court can then replace the trustee if it decides—based on the creditors' reports—that the trustee is incompetent.

Several economies, including Finland and France, granted higher priority to creditors in bankruptcy claims. France gave a “supersecured” position to creditors that lend money to distressed companies, giving them priority over previous secured creditors. That makes it easier for such companies to obtain new loans and continue operating.

OECD high-income economies have also promoted reorganization. Finland, France, Italy and Korea made reorganization more accessible to troubled companies. Italy now allows distressed companies to seek an agreement with creditors before entering formal bankruptcy and with no prerequisites. That permits the companies to continue operating.³

Besides OECD high-income economies, several in East Asia and Pacific also empowered creditors. Indonesia

expanded the powers of creditors' committees so they can file and vote on reorganization plans. China adopted a new bankruptcy law in 2007, its first since 1949, significantly strengthening creditors' rights. Secured creditors now rank first in payment priority.⁴ Vietnam also gave higher priority to secured creditors, and removed priority for tax claims, when it changed its 1993 bankruptcy law in 2004.

SPEEDING BANKRUPTCY PROCEEDINGS

The second most popular reform feature in closing a business has been introducing or tightening deadlines in court procedures and streamlining appeals. Sixteen economies have undertaken such reforms: Armenia, Bulgaria, Colombia, Estonia, Georgia, Lithuania, Portugal, Puerto Rico, Romania, Saudi Arabia, Serbia, Slovakia, Spain, Tunisia, the United Kingdom and the United States. Imposing time limits facilitates fast resolution of bankruptcy, avoiding deterioration in a company's value over time.

This type of reform has been most popular in Eastern Europe and Central Asia, where no fewer than 8 economies have reformed in this direction in the past 5 years. Romania, Bulgaria and Estonia restricted procedural appeals. In 2004 Romania reduced the time allowed for each appeal from 30 days to 10, shortening the total duration of the bankruptcy procedure from 55 months to 40. Bulgaria restricted opportunities for procedural appeals. Before the reform, the initial decision could be appealed to 2 higher levels of courts. Now only 1 appeal is possible. Estonia allows debt recovery to continue even when there is an appeal, avoiding disruption of the process.

Armenia, Bulgaria, Estonia, Georgia, Lithuania, Serbia and Slovakia introduced or tightened procedural time limits. Armenia passed a new law incorporating time limits into the reorganization procedure. Serbia set strict time limits: claimants have 5 days to raise objections to the resolution, appeals must be made within 8 days after the rul-

ing, and the court has 30 days to issue a decision on an appeal. Slovakia tightened time limits, speeding bankruptcy by at least 9 months in 2006.

GETTING THE FOCUS RIGHT

When it comes to reforming bankruptcy regulations, it is often assumed that reorganization is always the best course of action. But in low-income economies reorganization does not always lead to the highest return for creditors.

Mandatory reorganization procedures in some African economies often make matters worse. Take for example Benin, the Republic of Congo and Côte d'Ivoire. All have mandatory reorganization provisions, but their judicial systems lack the capacity to handle these types of cases. Among the main problems: frequent adjournments and courts that fail to hand down timely decisions.

In such systems, reorganization usually ends in liquidation. The time spent in reorganization only delays the process and increases the cost. Reforms that focus on debt enforcement or foreclosure are more likely to show results in those countries. And reforms that ensure properly resourced and well-functioning courts can help a larger number of viable businesses to reorganize successfully.

Overall, economies around the world are reforming toward more efficient bankruptcy systems. In the years since *Doing Business* started collecting data on the topic, the average time to complete bankruptcy proceedings has declined by 4%.

NOTES

1. Djankov and others (2006).
2. Davydenko and Franks (2008) and de Jong and Couwenberg (2007).
3. Beye and Nasr (2008).
4. Only wage claims made before the new law came into effect have priority over secured creditors.