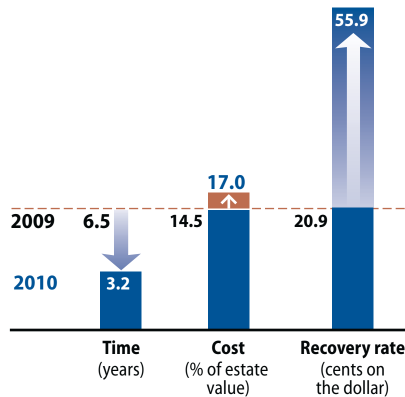
Starting a business
Dealing with construction permits
Registering property
Getting credit
Protecting investors
Paying taxes
Trading across borders
Enforcing contracts

Closing a business

FIGURE 11.1
Insolvency act starts to pay off in the Czech Republic



Who improved the most in closing a business?

1. *Czech Republic*
2. *Serbia*
3. *Latvia*
4. *United Kingdom*
5. *Belgium*
6. *Japan*
7. *Spain*
8. *Korea, Rep.*
9. *Lithuania*
10. *Hungary*

Source: Doing Business database.

When Jan checked into Starý zámek, a business hotel in downtown Prague, he found everything just as expected: a polite greeting from the reception staff, a comfortable room, neatly arranged towels. Imagine his surprise when a waiter serving him breakfast in the café the next morning mentioned that the hotel could close any day—because the company running it had been badly hit by the crisis. Jan, an attorney, checked the online insolvency register. He was relieved to find documents showing that the company was being reorganized. So the hotel was likely to continue operating well beyond his planned 3-week stay.

Saving viable businesses becomes especially important in times of recession.

TABLE 11.1
Where is closing a business easy—and where not?

Easiest	Recovery rate	Most difficult	Recovery rate
Japan	92.7	Liberia	8.4
Singapore	91.3	Sierra Leone	8.4
Canada	91.2	Ukraine	7.9
Norway	90.9	Haiti	6.7
Denmark	89.4	Venezuela, RB	5.9
Finland	89.4	Philippines	4.5
United Kingdom	88.6	Micronesia, Fed. Sts.	3.2
Belgium	87.6	Congo, Dem. Rep.	1.1
Ireland	87.4	Zimbabwe	0.2
Taiwan, China	82.2	Central African Republic	0.0

Note: Rankings are based on the recovery rate: how many cents on the dollar creditors recover from an insolvent firm. See Data notes for details.
Source: Doing Business database.

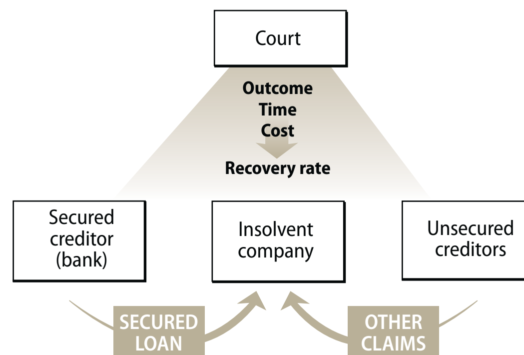
Historically, crises have been used as an opportunity to improve insolvency laws. As anticipated in *Doing Business 2010,* several legislative changes in 2009/10 were inspired by the recent global financial and economic crisis. Germany extended until 2013 its suspension of the obligation to file for insolvency for overindebted companies whose business would be likely to continue. The suspension, made in 2008 and initially scheduled to run only until the end of 2010, is aimed at keeping courts from being overwhelmed by the many filings resulting from the crisis.

Other changes addressed increases in insolvency cases. Latvia introduced a new out-of-court procedure in 2009. Romania established special preinsolvency procedures in 2010 for distressed companies trying to avoid bankruptcy. In another response to the crisis, Spain passed a new law in 2009 introducing out-of-court debt restructuring. In Hong Kong SAR (China), following an increase in bankruptcy petitions from 10,918 in 2007 to 15,784 in 2009,[1] a new "corporate rescue" reorganization procedure was under consideration in June 2010.

Keeping viable businesses operating is one of the important goals of bankruptcy systems.[2] A firm suffering from bad management choices or a temporary economic downturn may still be capable of being turned around. In most cases keeping the business alive is the most efficient outcome. Creditors get a chance to recover a larger part of their credit, more employees keep their jobs, and the network of suppliers and customers is preserved. But not all businesses that become insolvent are viable. A good bankruptcy system weeds out the bad from the good.

Many recent reforms of bankruptcy laws have been aimed at promoting reor-

FIGURE 11.2
What are the time, cost and outcome of the insolvency proceedings against a local company?



ganization as the most intuitively effective way for viable businesses to survive. The new bankruptcy law that went into effect in Brazil in 2005 is one example. Estonia passed a special reorganization act in 2008. In 2009 Japan made it easier to transfer necessary business permits to the new companies created as a result of reorganization. In June 2010 new legislation focusing on the reorganization of small and medium-size enterprises was being discussed in India.

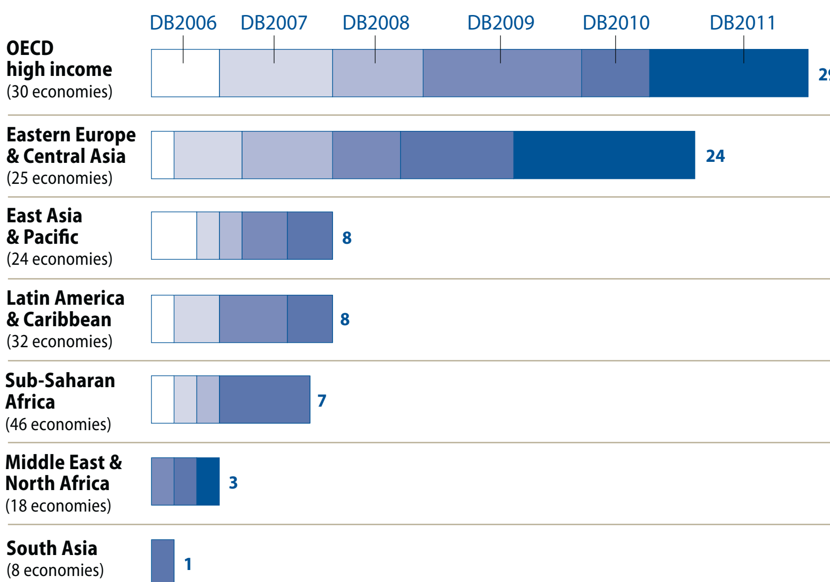
The Czech Republic adopted a new insolvency act in 2006 to help more viable businesses survive. Under the previous law, adopted in 1991, insolvency always resulted in liquidation. Debt could be restructured, but only through informal means, outside the official bankruptcy procedures. By June 2010 more than 50 filings for reorganization had been recorded and 31 reorganizations approved under the new law.[3] The full benefits of the new law will take time to materialize. Insolvency proceedings in the Czech Republic can still take more than 3 years, and the number of approved reorganizations remains low, with 6 in 2008, 16 in 2009 and 9 in the first 6 months of 2010.[4]

Doing Business studies the time, cost and outcome of insolvency proceedings involving domestic entities (figure 11.2).[5] Speed, low costs and continuation of viable businesses characterize the top-performing economies. *Doing Business* does not measure insolvency proceedings of individuals and financial institutions.[6]

FIGURE 11.3

Rapid pace of bankruptcy reforms in OECD high-income economies and Eastern Europe and Central Asia

Number of *Doing Business* reforms making it easier to close a business by *Doing Business* report year



Note: A *Doing Business* reform is counted as 1 reform per reforming economy per year. The data sample for DB2006 (2005) includes 174 economies. The sample for DB2011 (2010) also includes The Bahamas, Bahrain, Brunei Darussalam, Cyprus, Kosovo, Liberia, Luxembourg, Montenegro and Qatar, for a total of 183 economies.
Source: Doing Business database.

WHAT ARE THE TRENDS?

Bankruptcy regulation continues to vary across regions, and so does the pace of bankruptcy reform (figure 11.3). And while some economies have made continual efforts to improve their insolvency laws, implementing the new legal provisions and supporting them with adequate infrastructure remain crucial.

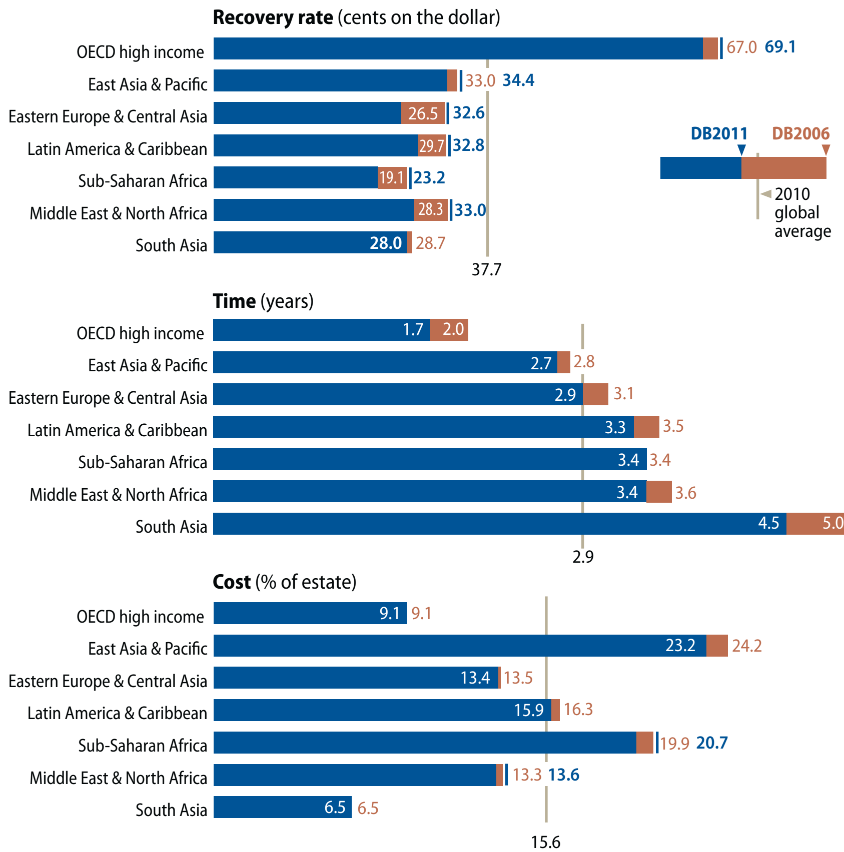
A declaration of bankruptcy originally carried great stigma. This is clear from the word's origins in the Italian *banca rupta*, referring to the practice of breaking a moneylender's bench, sometimes over his head. Today the stigma of bankruptcy continues to be among the reasons that debtors in many economies in the Caribbean, Central America, the Middle East and North Africa and Sub-Saharan Africa do not easily resort to insolvency procedures. Older laws take a much more punitive approach than newer ones. Modern bankruptcy laws focus on the survival of viable businesses and the creation of solid reorganization procedures.

EVER-GREATER EFFICIENCY IN OECD HIGH-INCOME ECONOMIES

Bankruptcy processes tend to be more efficient in OECD high-income economies (figure 11.4). This is reflected in their average recovery rate of 69.1 cents on the dollar, the highest rate globally. These economies also have the fastest proceedings, taking an average of 1.7 years (down from 2.0 in 2004). And they have the cheapest proceedings after South Asia's, costing an average of 9.1% of the value of the estate.

In 22 of the 30 OECD high-income economies, businesses have a chance to survive as a going concern following insolvency proceedings. In the past 20 years many OECD high-income economies introduced or strengthened insolvency regimes along the principles of the U.S. chapter 11 process. Sweden reformed insolvency regulations in 1996, Belgium in 1997, Germany in 1999, France and Italy in 2006 and Finland in 2007, among others.[7] A parallel trend was to improve the infrastructure of bankruptcy systems. In 2006 the Czech Republic increased transparency by introducing an online register for documents produced in the course of proceedings. In 2009 the United Kingdom allowed court documents to be signed and filed electronically as part of the courts' greater use of information technology. In June 2010 Poland was in the early stages of implementing a comprehensive training program for insolvency judges. The country plans to position its training institutions as international leaders.

FIGURE 11.4
Big increase in recovery rate in Eastern Europe and Central Asia
Regional averages in closing a business



Note: The data sample for DB2006 (2005) includes 174 economies. The sample for DB2011 (2010) also includes The Bahamas, Bahrain, Brunei Darussalam, Cyprus, Kosovo, Liberia, Luxembourg, Montenegro and Qatar, for a total of 183 economies.
Source: Doing Business database.

A MIXED STORY IN EAST ASIA AND THE PACIFIC

Bankruptcy systems in East Asia and the Pacific show a mixed story. The average recovery rate in Hong Kong SAR (China), Singapore and Taiwan (China) is 84.9 cents on the dollar, while the region-wide average is 34.4. The average cost of insolvency proceedings in the region is the highest in the world, at 23.2% of the value of the debtor's estate. On the other hand, proceedings take 2.7 years on average, making the region the second fastest after the OECD high-income economies.

Many of the region's economies are small island nations where bankruptcy proceedings are naturally rare because creditors and debtors tend to resolve insolvency situations through informal means. Among the formal mechanisms to address defaults, foreclosure is common. Reorganization rarely happens. Recent changes include a new company law and a receivership law that went into effect in Samoa in 2008. In June 2010 new insolvency legislation, modeled on the New Zealand system, was pending in Tonga.

BANKRUPTCY REFORMS RARE IN THE MIDDLE EAST AND NORTH AFRICA

The average recovery rate in the Middle East and North Africa is low, at 33.0 cents on the dollar. And changes to improve insolvency regulations are rare. In the past year Saudi Arabia established additional committees for amicable settlement of insolvencies. Egypt consulted international experts and insolvency judges on a new bill, to be aligned with its recently created commercial courts. Jordan is contemplating new regulations on insolvency administrators. In May 2009, 10 economies signed a joint declaration on intended reforms of their insolvency regimes. The legislative changes in Egypt, Jordan and the other economies were still being discussed in June 2010.

Insolvency proceedings in the Middle East and North Africa are the longest after South Asia's. The number of cases that go through court remains low. Creditors and debtors rarely resort to collective procedures.

NEW LAWS AND INCENTIVES IN LATIN AMERICA

Several economies in Latin America and the Caribbean have recently introduced or are contemplating changes to the regulation of insolvency administrators. In 2005 Chile linked the calculation of administrators' fees to the amounts realized from the sale of distressed companies' assets. This was done to encourage quick and efficient sales. Similarly, in 2009 Colombia introduced monetary incentives for speedy resolution of bankruptcy processes by insolvency representatives, along with additional rules on their qualifications and training. In June 2010 Peru was considering a reform of its regulation of insolvency administrators.

A regional trend in the past 3 years was to focus on improving reorganization procedures. Colombia and Mexico passed reorganization laws in 2007. Uruguay did the same in 2008.

BROAD PROGRESS IN EASTERN EUROPE AND CENTRAL ASIA

In Eastern Europe and Central Asia most of the economies have postsocialist legal systems. Bankruptcy was virtually nonexistent there 20 years ago. This is no longer the case regionwide, with Albania, Azerbaijan and Tajikistan among the few exceptions. Improvements have been made in a range of areas, from regulation of insolvency administrators (Belarus, Estonia, Lithuania and Russia) and out-of-court settlements (Latvia, Romania and Serbia) to the prevention of fraud and abuse in insolvency proceedings (Romania, Russia and Serbia; table 11.2).

TABLE 11.2
Who made closing a business easier in 2009/10—and what did they do?

Feature	Economies	Some highlights
Established or promoted reorganization procedures or prepackaged reorganizations	Belgium, Czech Republic, Hungary, Japan, Republic of Korea, Latvia, Romania, Russian Federation, Saudi Arabia, Serbia, Spain	Korea granted superpriority to postfiling financings in reorganizations.
Eliminated formalities or introduced or tightened time limits	Estonia, Georgia, Latvia, Saudi Arabia, Serbia, Spain, United Kingdom	Serbia passed a new bankruptcy law aimed at, among other aspects, reducing the length of insolvency procedures.
Regulated the profession of insolvency administrators	Belarus, Estonia, Lithuania, Russian Federation, United Kingdom	The United Kingdom improved the calculation of insolvency administrators' fees.
Took steps to prevent abuse	Romania, Russian Federation, Serbia	Russia enhanced the voidable transactions regime.
Modified obligation for management to file for insolvency	Czech Republic, Russian Federation	The Czech Republic suspended management's obligation to file for insolvency in certain circumstances.
Promoted specialized courts	Romania	Special insolvency departments were created within Romanian courts.

Source: Doing Business database.

Despite improvements, the average recovery rate in Eastern Europe and Central Asia remains low, at 32.6 cents on the dollar, mainly because of the weak institutional framework. The implementation of insolvency laws and professional standards for administrators is lagging behind the rapid pace of reform in bankruptcy regimes.

NEW INSOLVENCY REGULATIONS EXPECTED IN SOUTH ASIA

In South Asia outdated laws based on the British "winding-up" model are still binding in several economies. Insolvency proceedings in the region are the longest in the world, taking 4.5 years on average. But the cost of proceedings is the lowest globally, averaging 6.5% of the value of the debtor's estate.

In June 2010 bankruptcy reforms were being discussed in at least 3 economies. Afghanistan was working with international insolvency experts on ways to improve its insolvency framework. India and Pakistan were considering passing laws on restructuring.

LITTLE PRACTICE IN AFRICA

Sub-Saharan Africa has the largest share of economies with little or no insolvency practice. Twelve of the region's 46 economies—more than a quarter—have had fewer than 5 insolvency cases annually in recent years. In these economies the law still contemplates imprisonment (*contrainte par corps*) as a method of debt enforcement, judges have little or no experience in handling bankruptcy cases, and costs are prohibitive. Indeed, only East Asia and the Pacific has more expensive insolvency proceedings on average, and only South Asia and the Middle East and North Africa have longer ones. To close a business in Sub-Saharan Africa costs 20.7% of the value of the debtor's estate and takes 3.4 years on average.

Only a small number of economies in the region have improved their insolvency systems in recent years. Mauritius and Rwanda implemented new insolvency acts in 2009. In June 2010 Malawi was working on a new insolvency act, and South Africa was contemplating a reform of its regulation of insolvency administrators. Meanwhile, the 16 member states of the Organization for the Harmonization of Business Law in Africa were discussing an amendment of the uniform act on insolvency.

WHAT HAS WORKED?

Many features can enhance a bankruptcy system. Key are the mechanisms for creditor coordination, qualified insolvency administrators and a framework that enables parties to negotiate out of court. An efficient judicial process is also critical.

EMPOWERING CREDITORS

Creditors' committees ensure control for the creditors over bankruptcy proceedings. They supervise the operation of a business by a debtor-in-possession and sometimes participate in the preparation of a reorganization plan. In Finland creditors' committees play a significant role in reorganization proceedings.

More than half the 183 economies covered by *Doing Business* recognize creditors' committees (table 11.3). Almost all insolvency laws in Eastern Europe and Central Asia, OECD high-income

TABLE 11.3
Good practices around the world in making it easy to close a business

Practice	Economies[a]	Examples
Allowing creditors' committees a say in relevant decisions	100	Colombia, Finland, Singapore
Requiring professional or academic qualifications for insolvency administrators by law	62[b]	Botswana, Hong Kong SAR (China), Mexico
Providing a legal framework for out-of-court workouts	45	Cyprus, Italy, Puerto Rico

a. Among 149 economies surveyed, unless otherwise specified.
b. Among 147 economies surveyed.
Source: Doing Business database.

economies and South Asia acknowledge a creditors' committee as a participant in bankruptcy proceedings. In the Middle East and North Africa, by contrast, creditors' committees are not popular. In Sub-Saharan Africa 69% of the surveyed economies allow creditors' committees a say in insolvency proceedings, while 65% do in East Asia and the Pacific.

INSISTING ON QUALIFICATIONS

Professional insolvency administrators assist and sometimes replace the management of an insolvent company. Their tasks normally include registering all the creditors' claims, assessing and administering the company's assets (on their own or with the debtor's management or creditors' committee), recovering assets disposed of shortly before the insolvency and liquidating a bankrupt estate. National laws vary in their approaches to determining whether insolvency administrators are qualified for these tasks.

Only 42% of the economies surveyed by *Doing Business* have established specific professional or academic requirements to ensure that the person replacing management has the knowledge and skills to do so. Most of the surveyed economies in Eastern Europe and Central Asia and the OECD high-income group have done so. But approaches differ. Germany's insolvency act only has a general requirement that an administrator be qualified for the case and experienced in business. By contrast, in Canada trustees in bankruptcy are licensed by the Office of the Superintendent of Bankruptcy. The Canadian Association of Insolvency and Restructuring Professionals administers the official qualification process for individuals seeking to become licensed trustees and establishes the rules of professional conduct and standards of professional practice for the members.

The insolvency laws of most of the surveyed economies in East Asia and the Pacific, Latin America and the Caribbean and Sub-Saharan Africa contain no requirements for insolvency administrators. In South Asia none of the economies surveyed by *Doing Business* legally requires professional qualifications for administrators. In the Middle East and North Africa only 3 economies do.

Mandatory qualification requirements are based on the notion that where qualified insolvency professionals are involved, viable businesses should have higher chances of survival and nonviable ones should generate higher proceeds in liquidation. Where the law has no requirements, the insolvency administrator is generally a trusted representative of the creditors or a person deemed by a court to be up to the job.

TABLE 11.4

Who makes closing a business easy—and who does not?

Time *(years)*			
Fastest		**Slowest**	
Ireland	0.4	Ecuador	5.3
Japan	0.6	Micronesia, Fed. Sts.	5.3
Canada	0.8	Indonesia	5.5
Singapore	0.8	Haiti	5.7
Belgium	0.9	Philippines	5.7
Finland	0.9	Belarus	5.8
Norway	0.9	Angola	6.2
Australia	1.0	Maldives	6.7
Belize	1.0	India	7.0
Iceland	1.0	Mauritania	8.0
Cost *(% of estate)*			
Least		**Most**	
Colombia	1.0	Micronesia, Fed. Sts.	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, RB	38.0
Brunei Darussalam	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.

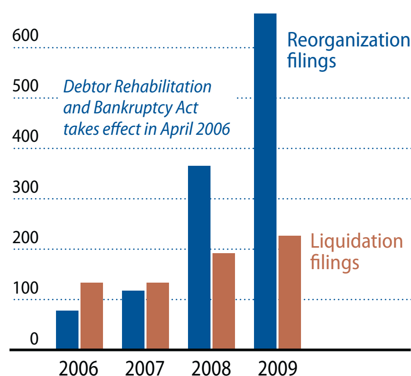
PROMOTING OUT-OF-COURT WORKOUTS

The global financial crisis caused a surge in insolvency filings, especially in Eastern Europe and Central Asia and OECD high-income economies. In Hungary the number of bankruptcy filings increased by 29% in 2009 compared with 2008.[8] In England and Wales the number of company liquidations rose by 22.8% in 2009 compared with the previous year.[9]

One way to ease the burden on courts is to limit their involvement to cases where parties cannot agree on their own. Yet only about 45 economies in a sample of 149 have a framework for out-of-court workouts that allows creditors and debtors to bring to a court a prenegotiated reorganization plan. The restructuring framework that the Bank of England began to develop after the recession of the mid-1970s in the United Kingdom, known as the "London approach," ensured the survival of many companies in later crises. And it inspired similar sets of rules in other economies, including Indonesia, Korea, Malaysia, Thailand and Turkey.[10]

Out-of-court workouts are most common in OECD high-income economies. In Sub-Saharan Africa only 22% of the surveyed economies have rules on out-of-court settlement for bankruptcy. Where there are no explicit rules, creditors and debtors can usually negotiate the restructuring of debt by using the generally applicable laws on contracts

FIGURE 11.5
Big jump in reorganization filings after a new law in the Republic of Korea



Source: Supreme Court of Korea.

and obligations. The disadvantage of such agreements is that they are not opposable to any of the creditors who did not participate in the settlement negotiations or become party to the ultimate agreement.

KEEPING ABUSE IN CHECK

Debtors filing for reorganization often do so because once a court accepts the case, it usually puts the enforcement of claims of individual creditors on hold. This allows management and shareholders to gain time, often for legitimate reasons but sometimes to tunnel valuable assets out of the company. Moreover, debtors may threaten to file for reorganization and use this threat as leverage in restructuring negotiations with creditors.

Creditors too can use the threat to file for bankruptcy, to force their terms on debtors. In many economies banks and companies prefer to avoid doing business with a bankrupt firm, so a debtor will go to great lengths to try to avoid bankruptcy. Where the law establishes criminal liability of managers and shareholders for the company's simple failure to repay regular commercial debt, this often leads to abuse by creditors. This happens in some Sub-Saharan African economies and in the Middle East and North Africa. A more reasonable option is for the law to establish managers' personal liability for failure to file for insolvency when mandated by law or criminal liability only for engaging in fraudulent transactions.

Thus to avoid abuse of well-intended provisions, the law should always include a system of checks and balances—such as liability for frivolous filings or robust practices for bringing assets tunneled out of a debtor's business back into the estate.

WHAT ARE SOME RESULTS?

A well-balanced bankruptcy system functions as a filter, separating companies that are financially distressed but economically viable from inefficient companies that should be liquidated.[11] By giving efficient companies a chance at a fresh start, bankruptcy law helps maintain a higher overall level of entrepreneurship in an economy.[12] And by letting inefficient companies go, it fosters an efficient reallocation of resources.

Well-functioning insolvency regimes can facilitate access to finance, especially for small and medium-size enterprises, and thereby improve growth in the economy overall.[13] A study of the 2005 bankruptcy reform in Brazil finds that it led to an average reduction of 22% in the cost of debt for Brazilian companies, a 39% increase in overall credit and a 79% increase in long-term credit in the economy.[14] Improvements in protection for creditors led them to expect that more assets would be available to them in insolvency. Since the risks for creditors were reduced, the costs for debtors were reduced as well.[15]

The efficiency of bankruptcy systems can be tested only if they are used. Cambodia passed an insolvency law in 2007, but by the end of 2009 not a single case had been filed under the new law. While Mexico introduced a framework for out-of-court workouts in 2007, this option has not been widely used. Korea had a different experience after it adopted the 2006 Debtor Rehabilitation and Bankruptcy Act introducing debtor-in-possession reorganization and allowing management to remain onboard to administer the company's turnaround. The number of reorganization filings jumped from 76 in 2006 to 670 in 2009 (figure 11.5).

A reform of bankruptcy laws can lead to important time and cost savings. In 1999 Colombia limited the duration of a reorganization procedure by setting a maximum of 8 months for negotiations. If no agreement is reached within 8 months, liquidation becomes mandatory. According to a study of Colombian firms that filed for insolvency between 1995/96 and 2003/04, the duration and cost of the reorganization process fell. Moreover, the selection of viable firms into reorganization improved.[16] In 2009 Spain raised the ceiling for its expedited bankruptcy procedure from a debt value of €1 million to €10 million. As a result, about 70% of bankruptcy proceedings in Spain are now eligible for the expedited procedure. This procedure is less costly than the regular one because it requires appointing only 1 insolvency administrator (rather than 3). The changes are expected to reduce the backlog in insolvency courts, which may also result in shorter proceedings.

A study of the 2000 bankruptcy reform in Mexico also shows clear gains. Looking at a sample of 78 bankruptcy cases in 1991–2005, the study finds that the average time to go through bankruptcy fell from 7.8 years to 2.3 years, thus increasing the amounts recovered by creditors.[17] In 2008 Lithuania eliminated a statutory prefiling waiting period of 3 months. Creditors could give debtors 1 month's notice of their intention to file for bankruptcy, and insolvency proceedings could commence 2 months earlier than before.

1. Official Receiver's Office of the government of Hong Kong SAR (China), http://www.oro.gov.hk.
2. See Djankov, Hart, McLiesh and Shleifer (2008).
3. Ministry of Justice of the Czech Republic, http://portal.justice.cz.
4. Ministry of Justice of the Czech Republic, http://portal.justice.cz.
5. *Outcome* refers to whether the hotel business in the *Doing Business* case study emerges from the proceedings as a going

concern or whether the company's assets are sold piecemeal (see Data notes).

6. See Djankov (2009a).
7. See Dewaelheyns and Van Hulle (2009a).
8. Hungarian Association of Insolvency Practitioners, http://www.foe.hu.
9. Insolvency Service of the United Kingdom, http://www.insolvency.gov.uk.
10. See Lieberman and others (2005) and Mako (2005).
11. See Dewaelheyns and Van Hulle (2009b).
12. See Armour and Cumming (2008).
13. See Uttamchandani and Menezes (2010).
14. See Funchal (2008).
15. See Funchal (2008).
16. See Giné and Love (2006).
17. See Gamboa-Cavazos and Schneider (2007).