Resolving insolvency

- **Creditors of firms facing insolvency benefit from the highest recovery rate in Japan.**
- **From June 2011 to June 2012 *Doing Business* recorded 17 reforms aimed at improving insolvency proceedings.**
- **Poland is among the 10 economies advancing the furthest toward the frontier in regulatory practice in resolving insolvency since 2005.**
- **Common features of insolvency reforms in the past 8 years include passing new bankruptcy laws, promoting reorganization proceedings, shortening time limits, regulating the qualifications of insolvency administrators and strengthening the rights of secured creditors.**
- **Eastern Europe and Central Asia had the biggest increase in the recovery rate in the past 8 years, while OECD high-income economies had the most insolvency reforms.**

For more information on good practices and research related to resolving insolvency, visit http://www.doingbusiness.org/data/exploretopics/resolving-insolvency. For more on the methodology, see the section on resolving insolvency in the data notes.

Driven by steeper labor costs and the high fuel prices and dampened travel demand resulting from the global financial crisis, American Airlines, the third largest U.S. carrier, filed for Chapter 11 bankruptcy in November 2011. Its core business is still viable, and if allowed to reorganize its finances and operations the company could avoid failure—to the benefit of its creditors, shareholders and employees. Thanks to the solid insolvency laws in the United States, American Airlines had the opportunity to file for restructuring, and if the company's viability is proven, it is expected to survive.[1] This does not happen in the many economies that lack restructuring frameworks.

Doing Business measures the time, cost and outcome of insolvency proceedings involving domestic entities. The time required for creditors to recover their credit is recorded in calendar years. The cost of the proceedings is recorded as a percentage of the value of the debtor's estate. The recovery rate for creditors depends on whether the case study company (a hotel business) emerges from the proceedings as a going concern or its assets are sold piecemeal. The rate is recorded as cents on the dollar recouped by creditors through reorganization, liquidation or debt enforcement (foreclosure) proceedings. If an economy had zero insolvency cases a year over the past 5 years, it receives a "no practice" classification. This means that creditors are unlikely to recover their money through a formal legal process (in or out of court). The recovery rate for "no practice" economies is zero. The ranking on the ease of resolving insolvency is based on the recovery rate, which is affected by the key variables of time, cost and outcome (tables 18.1 and 18.2).

Whether insolvency proceedings are efficient matters not just for firms that are struggling. A recent study shows that Brazil's 2005 bankruptcy reform, which strengthened the rights of secured creditors, led to a significant reduction in the cost of debt and an increase in both short- and long-term debt.[2] However, an analysis of Italy's 2005–06 reform of its bankruptcy law shows that excessive use of reorganization proceedings increases interest rates on loan financing because it reduces the incentives for entrepreneurs to act prudently.[3] Another study, focusing on U.S. airlines, shows that bankruptcies reduce the collateral value of other firms in the same industry, increasing the cost

TABLE 18.1 Where is resolving insolvency easiest—and where most difficult?

Recovery rate			
Easiest		**Most difficult**	
Japan	92.8	Angola	8.0
Singapore	91.3	Venezuela, RB	6.4
Norway	90.8	São Tomé and Príncipe	5.2
Canada	90.7	Philippines	4.9
Finland	89.7	Micronesia, Fed. Sts.	3.4
Netherlands	88.8	Rwanda	3.1
Belgium	88.7	Congo, Dem. Rep.	1.6
United Kingdom	88.6	Zimbabwe	0.1
Ireland	87.5	Central African Republic	0.0
Denmark	87.1	Eritrea	0.0[a]

Note: Rankings are based on the recovery rate: how many cents on the dollar creditors recover from an insolvent firm as calculated by *Doing Business.* See the data notes for details.

a. Sixteen economies have a recovery rate of 0, including 14 "no practice" economies.

Source: Doing Business database.

TABLE 18.2 Who makes resolving insolvency easy—and who does not?

Time (years)			
Fastest		**Slowest**	
Ireland	0.4	Congo, Dem. Rep.	5.2
Japan	0.6	Ecuador	5.3
Canada	0.8	Micronesia, Fed. Sts.	5.3
Singapore	0.8	Indonesia	5.5
Belgium	0.9	Haiti	5.7
Finland	0.9	Philippines	5.7
Norway	0.9	Cambodia	6.0
Australia	1.0	Angola	6.2
Belize	1.0	São Tomé and Príncipe	6.2
Denmark	1.0[a]	Mauritania	8.0

Cost (% of estate)			
Least		**Most**	
Norway	1	Dominican Republic	38
Singapore	1	Marshall Islands	38
Armenia	4	Micronesia, Fed. Sts.	38
Bahamas, The	4	Philippines	38[c]
Belgium	4	Sierra Leone	42
Brunei Darussalam	4	Ukraine	42
Canada	4	Liberia	43
Denmark	4	Rwanda	50
Finland	4	Chad	60
Georgia	4[b]	Central African Republic	76

a. Four other economies also have a time of 1 year: Iceland; Palau; the Solomon Islands; and the United Kingdom.

b. Eleven other economies also have a cost of 4% of the estate value: Iceland; Japan; Korea; Maldives; the Netherlands; New Zealand; Oman; Pakistan; Slovenia; Switzerland; and Taiwan, China.

c. Four other economies also have a cost of 38% of the estate value: Samoa; the Solomon Islands; Vanuatu; and República Bolivariana de Venezuela.

Source: Doing Business database.

of external debt financing for all firms in the industry.[4] In the aftermath of the financial crisis, researchers, practitioners and policy makers have been emphasizing the importance of efficient bankruptcy regimes to strengthen local economies while also discussing the challenges of implementing bankruptcy reforms.[5]

TABLE 18.3 Who made resolving insolvency easier in 2011/12—and what did they do?

Feature	Economies	Some highlights
Established or promoted reorganization, liquidation or foreclosure procedures	Belarus; Germany; Greece; Kazakhstan; Lithuania; Moldova; Poland; Serbia; Slovak Republic; Spain; Uzbekistan	Germany amended its insolvency law to facilitate in-court restructuring of distressed companies, providing new opportunities for creditors and debtors.
Eliminated formalities or introduced or tightened time limits	Belarus; Georgia; Kazakhstan; Republic of Korea; Lithuania; Slovenia; Uganda; Uzbekistan	Georgia streamlined all insolvency procedures, introducing a deadline for the creditors' first meeting and shorter time limits for the submission of documentation and creditors' claims, for decisions on the outcome of insolvency proceedings and for the duration of the auction.
Regulated profession of insolvency administrators	Kazakhstan; Moldova; Poland; Slovenia; Uganda; Zambia	Zambia established qualification requirements, professional duties and provisions on pay for liquidators and receivers.
Granted priority to secured creditors	Kazakhstan; Slovak Republic	The Slovak Republic strengthened the rights of secured creditors, prioritizing their claims and granting them voting power over the restructuring plan.
Increased transparency of insolvency system	Lithuania; Serbia	Serbia introduced an online public registry, making public all injunctions issued by the court.
Introduced framework for out-of-court restructurings	Portugal; Spain	Spain improved its framework for out-of-court restructuring by facilitating the approval of an agreement between creditors and debtors.

Source: Doing Business database.

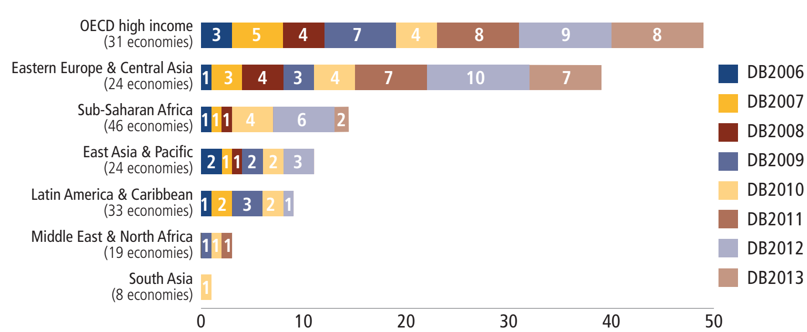
WHO REFORMED IN RESOLVING INSOLVENCY IN 2011/12?

From June 2011 to June 2012 *Doing Business* recorded 17 reforms making it easier to resolve insolvency (table 18.3). Most were in Eastern Europe and Central Asia, where 29% of economies had such reforms, and in OECD high-income economies, of which 26% did.

Germany promoted its reorganization proceedings by streamlining insolvency procedures and introducing a debt-for-equity swap remedy. It also strengthened the rights of secured creditors by involving creditors in the restructuring process and establishing a preliminary creditors' committee. The Slovak Republic adopted a new amendment to its bankruptcy and restructuring law that clearly defines the roles and powers of creditors, secured creditors and trustees with the aim of increasing the efficiency of the insolvency process.

FIGURE 18.1 Eastern Europe & Central Asia and OECD high-income economies keep up fast pace in insolvency reforms

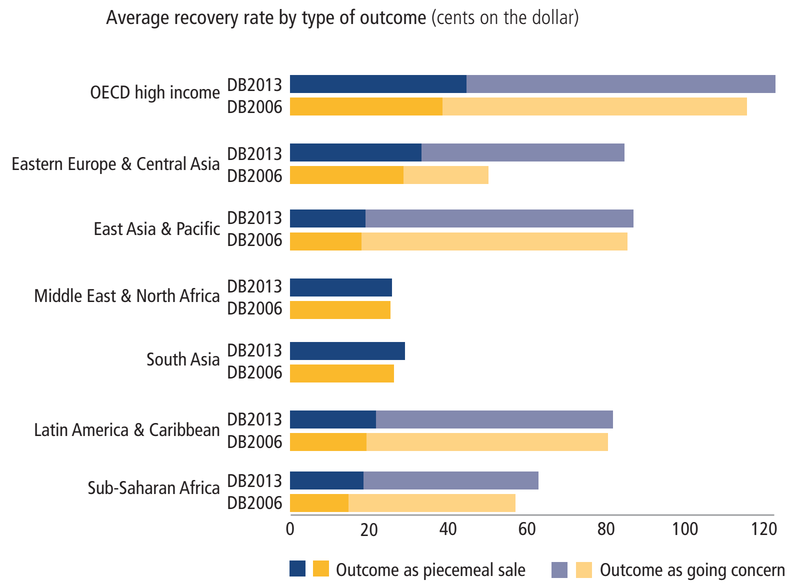
Number of *Doing Business* reforms making it easier to resolve insolvency by *Doing Business* report year



Note: An economy can be considered to have only 1 *Doing Business* reform per topic and year. The data sample for DB2006 (2005) includes 174 economies. The sample for DB2013 (2012) also includes The Bahamas, Bahrain, Barbados, Brunei Darussalam, Cyprus, Kosovo, Liberia, Luxembourg, Malta, Montenegro and Qatar, for a total of 185 economies.

Source: Doing Business database.

FIGURE 18.2 Big increase in recovery rate in Eastern Europe and Central Asia



Note: To ensure an accurate comparison, the figure shows data for the same sample of 174 economies for both DB2006 (2005) and DB2013 (2012) and uses the regional classifications that apply in 2012. The economies added to the *Doing Business* sample after 2005 and therefore excluded here are The Bahamas, Bahrain, Barbados, Brunei Darussalam, Cyprus, Kosovo, Liberia, Luxembourg, Malta, Montenegro and Qatar. DB2006 data are adjusted for any data revisions and changes in methodology. All outcomes are recorded as piecemeal sales for economies in the Middle East and North Africa and South Asia.

Source: Doing Business database.

TABLE 18.4 Who has narrowed the distance to frontier in resolving insolvency the most since 2005?

Most improved	Improvement in distance to frontier (percentage points)
Czech Republic	40 (20→60)
Afghanistan	29 (0→29)
Uzbekistan	29 (12→41)
Latvia	27 (37→64)
Colombia	26 (55→81)
Belarus	23 (23→46)
Côte d'Ivoire	23 (17→40)
Poland	23 (35→58)
Burkina Faso	22 (8→30)
Senegal	22 (13→35)

Note: The distance to frontier measure shows how far on average an economy is from the best performance achieved by any economy on each *Doing Business* indicator since 2005—in this case for the resolving insolvency indicator. The measure is normalized to range between 0 and 100, with 100 representing the best performance (the frontier). The data refer to the 174 economies included in *Doing Business 2006* (2005). Eleven economies were added in subsequent years. The first column lists the top 10 most improved economies in order; the second shows the absolute improvement in the distance to frontier between 2005 and 2012.

Source: Doing Business database.

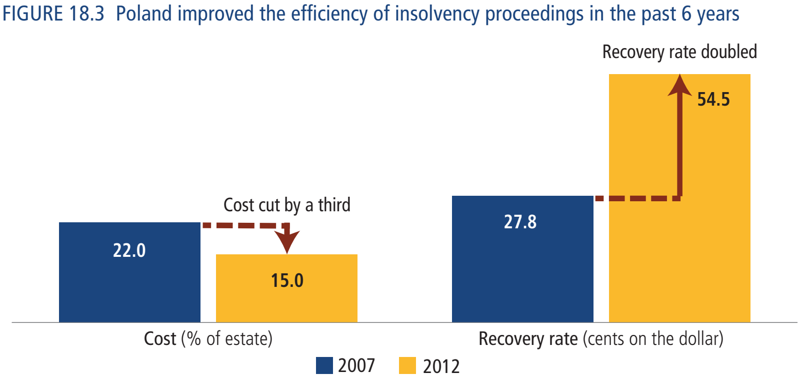
Kazakhstan further developed its rehabilitation process by introducing an accelerated proceeding, setting clear time limits for developing a rehabilitation plan and clearly defining the roles and powers of the court in the process. Lithuania also specified time limits for some insolvency procedures, including for creditors to file their claims and for the court to hear an appeal of the ruling to initiate bankruptcy proceedings or dismiss the administrator.

WHAT HAVE WE LEARNED FROM 8 YEARS OF DATA?

In the past 8 years *Doing Business* recorded 126 insolvency reforms in 74 economies (figure 18.1). While economies focused their efforts on different aspects of insolvency, these reforms still shared some common features. For example, 27 economies passed new bankruptcy laws over the past 8 years. Many economies promoted reorganization proceedings by simplifying and accelerating procedures, defining the roles of the parties involved and introducing innovative instruments such as out-of-court workouts. Shortening the time limits for different procedures was also a common feature of insolvency reforms. Other common features were regulating and refining standards for the profession of insolvency administrators and strengthening the rights of secured creditors.

The financial crisis prompted many economies to take immediate action to improve their insolvency regimes. *Doing Business 2012* reported a record number of insolvency reforms globally: 29. *Doing Business 2006* recorded only 8. In the past year 4 regions had no insolvency reforms: East Asia and the Pacific, Latin America and the Caribbean, the Middle East and North Africa, and South Asia.

FIGURE 18.3 Poland improved the efficiency of insolvency proceedings in the past 6 years



Source: Doing Business database.

How has the efficiency in resolving insolvency changed? No significant improvements were observed in low-income economies from 2005 to 2012: the average time to complete an insolvency proceeding remained at 3.9 years, and the average cost even increased from 23% to 24% of the value of the debtor's estate.[6] Globally over that period, the average time to complete an insolvency proceeding fell from 3 years to 2.8 years, the cost remained at about 20%, and the recovery rate rose from 31% to 35% (figure 18.2).

Poland is among those making the biggest improvements since 2005 in the efficiency of resolving insolvency as measured by *Doing Business* (table 18.4). Through extensive efforts to build a full-fledged insolvency regime, it reduced the cost to complete an insolvency proceeding by a third between 2007 and 2012—and doubled the recovery rate (figure 18.3). Among the highlights of Poland's insolvency reforms: specifying qualifications for insolvency administrators with the aim of improving the quality of professional services, reducing the cost by setting a maximum limit on pay for administrators, and introducing a pre-bankruptcy reorganization procedure. In the past year Poland continued its reform trajectory by strengthening the rights of secured creditors and making it easier to start bankruptcy proceedings.

NOTES

This topic note was written by Valentina Saltane and Rong Chen.

1. Patrick Rizzo, "American Airlines Files for Bankruptcy Protection," *NBC News*, November 29, 2011, http://bottomline.nbcnews.com/; Kyle Peterson and Matt Daily, "American Airlines Files for Bankruptcy," *Reuters*, November 29, 2011, http://www.reuters.com/.
2. De Araujo, Xavier Ferreira and Funchal 2011.
3. Rodano, Serrano-Velarde and Tarantino 2011.
4. Benmelech and Bergman 2011.
5. Cirmizi, Klapper and Uttamchandani 2012.
6. To ensure an accurate comparison, only the 32 low-income economies included in the *Doing Business 2006* (2005) sample are included.