BANKRUPTCY – EFFECTS ON BUSINESS ENVIRONMENT

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ABSTRACT: *Assuming that insolvency is an economic reality that cannot be ignored especially in the current context, and the concerns in the regulation of a flexible and efficient procedures are numerous both nationally and in the European Union, we have structured the work in two parts, respectively the first part, in which are presented the theoretical aspects of the implementation of the insolvency, more precisely the reorganization and bankruptcy proceedings and the second part, where we made a brief analysis of insolvent companies between 2010-2012. The paper ends with a brief presentation of the insolvency process in Eastern and Central European countries compared to Romania.*

KEY WORDS: *insolvency, bankruptcy, reorganization.*

JEL CLASSIFICATION: *G01, M10.*

1. INTRODUCTION

In the Middle Ages, bankruptcy regulations have evolved in two distinct ways, respectively the Anglo-Saxon origin laws aimed to discharge the debt of the creditor from the debtor and granted the creditor a certain delay in order to lead to the survival and recovery of business and the Latin origin laws which pursued in a manner to prioritize the creditor protection. Initially, commercial insolvency were proceedings were narrowed to the bankruptcy procedure and it represented a special way of enforcement by liquidating the debtor's assets and settling the liabilities by the payment of debt. Over time, this procedure was subject to changes and now, the law gives the creditors a special tool to cover the debtor's claims who is unable to pay the debts, the commercial bankruptcy procedure.

According to the Law no. 85/2006 concerning bankruptcy, the insolvency is the state of the debtor's assets which is characterized by the shortage of funds available for the payment of liquid and certain debts. Insolvency is presumed to be manifest when the debtor, after 30 days from the due date has not paid his debt to one or more

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creditors and is imminent when it turns out that the debtor will not be able to pay by the due by the debts with funds available on the due date.

This procedure opens, at the request of the debtor or the creditor and may include the procedure of reorganization and/or the procedure of bankruptcy. Therefore, the two sub-procedures - bankruptcy and reorganization - are both part of insolvency.

The judicial reorganization procedure is the insolvency procedure that apply to the debtor in order to pay his debts, according to a plan of debt payment rescheduling. It involves the preparation, approval, implementation and compliance of a plan, called reorganization plan, which may include, together or separately: the operational and/or financial reorganization of the debtor; the corporate reorganization by changing the social capital structure; the cessation of certain activities by the liquidation of certain assets from the debtor assets. If following the application of reorganization procedure, the company subject to the procedure, respectively the debtor fails to pay the debts in the period established in the procedure, it proceeds to the next step, the implementation of bankruptcy proceedings.

The bankruptcy procedure is part of insolvency procedure which is applied to the debtor in order to liquid the assets to cover his liabilities, followed by removal of the debtor from the registry in which he is registered. Accordingly, when a company is in bankruptcy, it can be said that it is insolvent. Conversely, if a company is in insolvency proceedings does not mean that, by default, it is in bankruptcy, it may be the stage of reorganization and by following the steps of this stage to recover financially.

2. THE MAIN STEPS IN THE IMPLEMENTATION OF THE INSOLVENCY PROCEDURE

The opening of insolvency procedure is based on an application brought to court by the debtor or by creditors as well as any other persons or institutions established by law. This application must be accompanied by the following documents: annual financial statements; trial balance for the month preceding the date of filing of initiation; the situation of the debtor's assets, including all the accounts and banks through which the debtor is running liquid assets.

The complete list of creditors and the value of the debts to them as well as their form, certain or under condition, liquid or illiquid, due or not yet due, uncontested or contested, indicating the amount, the cause and the preferential rights; the list of payments and property transfers made by the debtor during the 120 days preceding the filing of the application.

The list of current activities that he intends to conduct during the observation period; the associations or shareholders situation, as applicable; the debtor's declaration which indicates his intention to enter the reorganization procedure, according to a plan, by restructuring the activity or liquidating, partially or totally, the assets, in order to pay his debts; an affidavit, notarized or certified by a lawyer, or a certificate from the register of agricultural societies or, where appropriate, the Trade Registry Office in whose territorial jurisdiction is the place of business / registered office, showing if it has been subject to proceedings under this law within 5 years prior to the application

stage; certificate of admission to trading on a regulated market of securities or other financial instruments issued. During the observation period the trustee examines the legal and patrimonial situation of the society to assess whether there are real perspectives for the financial recovery go it, and in this case it will continue with the judicial reorganization procedure under a reorganization plan, or if after the review, it finds that the company must be liquidated, the procedure of bankruptcy.

The implementation of the reorganization procedure. In principle, the legal regulations discourage the debtor to ask for reorganization, based on the argument that if an insolvent company has a chance to reorganize, it shall be the responsibility of another person than the one who brought the company insolvent, respectively the insolvency administrator or the creditors. According to the Law no.85/2006 on insolvency proceedings, the procedure involves the application of a reorganization plan that will indicate the prospects for recovery in relation to the possibilities and the specific activity of the debtor, with the available funds and with the market demand to the offer of the debtor, and it will include measures consistent with the public order, including the manner of selection, appointment and replacement of the administrators and directors.

The reorganization plan will include payment program of the claims and its application cannot be made for a period exceeding three years. This plan must be drawn both from the financial perspective and includes the claims situation, the compensation offered to the holders of claims and whether and to what extent the debtor, the economic interest group members, the holders of the collective companies associations and the general partners of limited partnership companies will be discharged of responsibility as well as from the methodological perspective by prioritizing appropriate measures for its implementation, such as: the retention by the debtor of the company's management; obtaining financial resources to support achieving the plan; the transmission of the debtor's assets; the merger of the debtor; the liquidation of all or of a part of the debtor's assets; the modification or termination of the real pledges; the extend of the due dates etc..

The implementation of bankruptcy. When a company recovery is no longer possible, bankruptcy is a last resort to pay the company's debts by liquidating the entire asset. In general, the payment of such debts is only partially made when the losses of the company exceed its equity, these losses being financed, basically, by loans from financial institutions or suppliers. Most debtors ask for the opening of the insolvency procedure too late, when it is imminent, and the chances of a reorganization are minimal, so they are in fact, simplified bankruptcy procedures. Bankruptcy, in general, follows the steps:

a) *The initial stage* in which take place the seal and the inventory of the assets belonging to the debtor, the freeze of the bank deposits, the preparation of the creditors list and the checking procedure of the accounting documents of the company;
b) *The stocktaking stage* which involves checking the amounts receivable from its customers, the inventory of the fixed and circulation assets, the recovery of these amounts from customers and cancelling transactions onerous. If it appears that there are no assets in the firm's patrimony, that there is no

demand for them or are insufficient to cover the administrative costs, the judge may give the verdict of terminating the proceeding, which give the opportunity to strike the debtor from the register where it has been registered;

c) *The liquidation stage* which evaluates the assets that can be sold, the debtor's assets are sold at auction or directly and it collects the revenue from the assets liquidation. Every three months, the liquidator presents to the creditors' committee a report on the funds obtained from liquidation and collection of receivables and a plan of distribution between creditors.

The distribution of funds stage involves the establishment of the fund distribution rapport and plan by the liquidator and the notification the results to the creditors, the cover of the expenses related to the liquidation and payment of receivables, in the order established by the law and the preparation of the final report and the balance by the liquidator; the bankruptcy closure stage implies that all persons concerned debtors, creditors, security holders, shareholders or members are discharged of any duties or responsibilities that they had before bankruptcy; the delisting of the company implies deleting the firm from the authorities records, respectively from the Trade Register, the territorial branches of public finance etc. Insolvency is an economic reality that cannot be ignored especially in the current context, and the concerns in the regulation of a flexible and efficient procedure are numerous both nationally and at the European Union level.

Regardless of how they apply insolvency, respectively the procedure of reorganization or / and bankruptcy, the purpose of implementation of it is to ensure a viable financial recovery of economic entities. In terms of the effects that this legal-economic mechanism has, we consider it finds two opposite orientations, so if its main objective is to improve the business environment and reducing negative effects of insolvent debtors, the long period of implementation of all stages makes debtors incapability to pay to be passed on to creditors.

3. STATISTICAL ANALYSIS OF INSOLVENT COMPANIES

Even though there are opinions according to which a society which has reached insolvency go on a journey of no return, still we give some examples of companies in the Romanian business environment which shows that by a reorganization flexible managed to recover financially:

a) *Flanco International SRL* succeeded after 21 months of decline, through an extensive reorganization process, to reach the break-even after eight months of the declaration of insolvency, to restructure loans and reorganize retail network so it becomes the main player in the retail market of IT and electronics;

b) *Leonardo,* the market leader in the retail of footwear, became insolvent in 2009, in the midst of financial crisis, due to accumulated debts both to the state budget and to suppliers and banks. Reorganization procedure aimed to refresh inventory shift to a broader market segment, reduction and debt restructuring and a flexible trade policy by which to adjust the supply of

goods of the 79 stores closer to the existing potential of the market in Romania;

c) *Pro Express Retail SA*, the company which operates Diverta bookstores, began restructuring of society at both operational and financial corporate debt by converting a portion of the company debts into shares. Period of financial crisis and declining purchasing power of the population has led to a continuous decrease of turnover and hence an increase in operating expenses but the insolvency procedure was succeeded after two consecutive years of negative results for the year, ie 18,439,653 lei in 2009 and 23,768,468 lei in 2010, in 2011 to record a profit of 1,999,998 lei;

d) *National Society Plafar S. A*. is a famous example for insolvency, it succeeded a rebranding of the product portfolio and technological modernization of all lines and after 11 years of losses in 2011 registered a gross profit of over 80,000 lei.

As shown in the following figure and the previous examples, the largest share of firms that become insolvent belongs to the trade area with 23.85% in 2011. Equal relative weight between 10 to 11% is still three major areas of the economy, that construction, catering and tourism sector and manufacturing activity. A smaller number of companies entering insolvency record transport and storage of weights over 7% and agriculture 2.6% - where risk factors are addicts, mainly climate and favourable climatic environment can be decisive record of positive financial results.

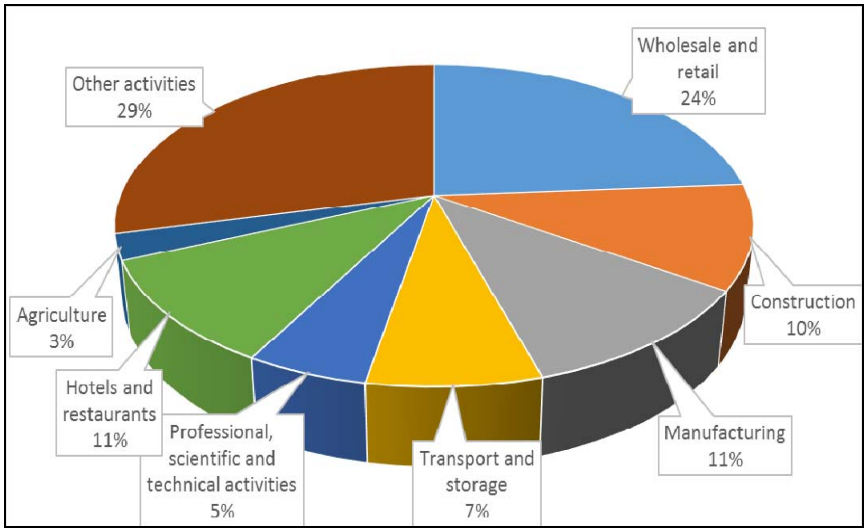
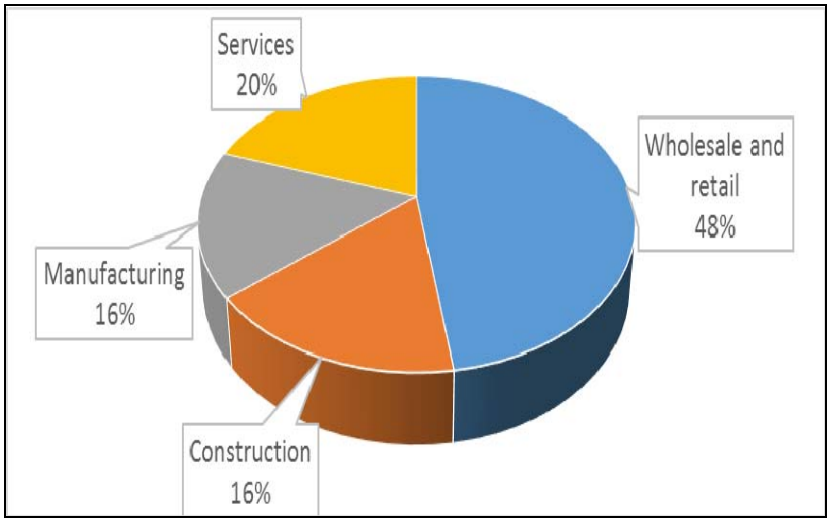


Figure 1. Situation on the domain structure of the insolvent firms in 2011

According to a study on insolvency in EU countries in 2012 compiled by Economic Research Unit Creditreform is found that in the countries of Central and Eastern European states, it is observed that the highest share in the total returns of the companies became insolvent in trade and the hotels and restaurants, followed by manufacturing and construction.



Source: Creditreform Economic Research Unit, Corporate insolvencies in Europe 2012, http://www.creditreform.com/fileadmin/user_upload/CR-International/local_documents/Analysen/Corporate_Insolvencies_12_13.pdf

Figure 2. Contribution of the key economic sectors to overall insolvency in Central and Eastern Europe in 2012

Compared with other countries, in 2012 Romania registered a record number of companies became insolvent so that over 26,800 companies exceed the combined number of companies became insolvent in Slovakia, Slovenia, Estonia, Lithuania, Latvia, Bulgaria and Croatia, despite that our country has a much smaller number of companies than the European average.

Regarding the evolution of the number of firms that became insolvent, is barely visible a sinuous their number and their geographical distribution. Thus, while in 2010 their number was 21692, which decreases by more than 10% by next year but the year 2012 is one with a substantial increase respectively by 36.4% compared to 2011 and by 23.5% compared to 2010. Their geographical distribution is heterogeneous but the largest concentration of firms toward insolvency is the most developed urban areas where the number of established companies is very high and a much smaller number of poorer, those southern and eastern Romanian regions.

Thus, besides Bucharest in the first period, ie 2010-2011 stands Timis, Constanta, Prahova, Brasov, Cluj, Bihor, Arges, Galați and in 2012 started to increase substantially the number of companies in insolvency counties ranking in the continuation of economic development and Iasi, Gorj, Hunedoara, Arad, Bacau, etc..

In terms of size structure of firms became insolvent, it is found that the highest number reached in this case were SMEs, which represent more than 96-97% at the expense of medium-sized companies, large and very high.

As shown in studies on insolvency and credit risk management made by Coface Romania - member of Coface Central Europe Holding - the impact of insolvencies medium sized companies, large and very large risks for the economy to be stronger than the impact of a much larger number small firms that become insolvent.

Table 1. Situation of insolvency firms

No.	County	Years		
		2010	**2011**	**2012**
1	Alba	300	10	307
2	Arad	611	76	1031
3	Argeş	562	137	1111
4	Bacău	517	1	547
5	Bihor	1188	49	1309
6	Bistriţa-Năsăud	291	54	652
7	Botoşani	412	11	205
8	Braşov	851	59	992
9	Brăila	417	79	528
10	Bucureşti	551	79	3565
11	Buzău	461	41	604
12	Caraş-Severin	157	7	310
13	Călăraşi	952	38	156
14	Cluj	990	122	851
15	Constanţa	112	35	1149
16	Covasna	273	59	194
17	Dâmboviţa	1105	29	694
18	Dolj	768	35	863
19	Galaţi	203	61	1275
20	Giurgiu	351	42	339
21	Gorj	321	17	649
22	Harghita	516	44	282
23	Hunedoara	188	20	530
24	Ialomiţa	717	19	336
25	Iaşi	368	111	539
26	Ilfov	418	-	690
27	Maramureş	104	12	582
28	Mehedinţi	2256	10	165
29	Mureş	526	90	537
30	Neamţ	289	91	253
31	Olt	235	33	246
32	Prahova	677	55	847
33	Satu Mare	839	-	382
34	Sălaj	219	11	390
35	Sibiu	427	45	425
36	Suceava	232	13	517
37	Teleorman	170	24	240
38	Timiş	790	29	844
39	Tulcea	317	13	361
40	Vaslui	241	-	407
41	Vâlcea	261	-	422
42	Vrancea	509	-	481
43	**Total general**	**21692**	**19651**	**26807**

Although in 2012 the share of large firms in insolvency was only 3%, their share by turnover volume represents 49% of total insolvencies - up from 16% in 2011 - so for a company declared insolvent will be affected at least 10 SMEs. Of the 800 big companies became insolvent in 2012, 31 entries were registered companies managed by the General Administration of Large Taxpayers whose total debts amounted to 301.1 million lei.

4. CONCLUSIONS

The economic situation in Western Europe – whether in the eurozone or elsewhere in the European Union – remains precarious. The governmental, sovereign debt and banking crisis, which is now in its fifth year, has certainly not been resolved. On the contrary, because of the slowness and half-heartedness with which agreements are reached and action is taken within the EU and the euro area, the crisis of budgets, banks and the currency is impacting more and more visibly on the real economy, manufacturing and service out-put, and the supply of public needs.

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