A Critique of International Statistics on Insolvency Proceedings Using the Czech Republic as an Example

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Abstract: - One of the fundamental problems in the area of insolvency proceedings in all developed countries is the measure of awareness about their course and thus the measure of their transparency. The Insolvency Act effective in the Czech Republic as of 2008 assumes that basically all information on the course of all specific proceedings is made public in the insolvency register practically immediately. During discussions preceding the acceptance of the new Insolvency Act, the assumption existed that thanks to this measure, the asymmetry of information between the participants of these proceedings would cease, these proceedings would be subjected to far greater public scrutiny and an environment would be created which would enable structured evaluation of the efficiency of insolvency proceedings as a whole. While the first two principles have been fulfilled, the third has proved far more difficult. At the present time, we can assert with certainty that the data made public in international comparative statistics in the case of the Czech Republic simply do not reflect reality. This, however, necessarily leads us to the question as to how relevant are the same data in the case of other countries.

Key-Words: - Bankruptcy; Debt relief; International Finance Corporation; Insolvency; Insolvency proceedings; Statistics; World Bank

1 International Comparisons of Insolvency

Insolvency proceedings, as one of the forms of departure of commercial companies or entrepreneurial individuals from corporate ties, are among the fundamental mechanisms of free economies. In principle, their role is to enable collective enforcement of receivables in the event that the debtor finds itself in default with the characteristics of bankruptcy. From the perspective of the national economy, insolvency then serves the purpose that assets may once again be put into operation with minimal losses for the creditor within the shortest possible time.

Nevertheless, insolvency law is by no means unified when comparing it internationally, many states preferring various mechanisms in their systems. A classic example is the French endeavour to preserve the operation of the business and employment [1]. In other countries such as Great Britain, the system gives preference to the wishes of the creditor and creates an environment for a solution which is optimal from its point of view [2, 3].

As numerous authors of comparative studies assert [1, 2, 3], the possibility of comparing results of insolvency proceedings in individual countries is becoming a significant element. Decisions to amend the national legislation are, among other things, also political issues, and pertinent laws reflect the preferences of the political representation of individual states. It would therefore be highly apposite to know the extent to which individual solutions are effective.

If we pass over studies that compare the results of individual states using samples of businesses and cases of insolvency proceedings, international statistics are provided by the publication Doing Business [4].

2 A Critique of International Comparison

Analysis of data provided by Doing Business, however, brings largely unsatisfactory results. As its basis, we use a comparison of data for the last few years as given for the Czech Republic, with some remarks on the efficiency of insolvency hearings.

For the years 2002 through 2009, Doing Business contains extremely unflattering figures for the Czech Republic regarding the duration of insolvency proceedings. In this connection, we must note the coming into effect of Act No. 182/2006
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Coll., *On Bankruptcy and Ways of its Resolution* as of 1 January 2008, the aim of which was, among others, to significantly accelerate the whole mechanism of collective enforcement. Czech professional circles do not doubt that this goal has been achieved. Nevertheless, there is still a lack of consensus in numerical expression as to how successful it has really been. *Doing Business* shows a reduction of duration of proceedings from 9.2 years between 2002 through 2006 to 3.2 years in 2011. For the last year of the efficacy of the old act (*Act on Bankruptcy and Settlement*), that is, for 2007, the publication gives a duration of 6.5 years. That is, incidentally, at a certain divergence with the official statement that it was possible at the close of the old legislation to reduce the average duration of a lawsuit to roughly five years and several months.

### Tab. 1. Duration of proceedings from declaration of bankruptcy and creditor yields (in the CR)

<table>
<thead>
<tr>
<th>Year</th>
<th>Duration of insolvency proceedings (in years)</th>
<th>Creditor yields from debtor bankruptcy (% of receivables)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>9.2</td>
<td>15.4</td>
</tr>
<tr>
<td>2003</td>
<td>9.2</td>
<td>15.4</td>
</tr>
<tr>
<td>2004</td>
<td>9.2</td>
<td>16.8</td>
</tr>
<tr>
<td>2005</td>
<td>9.2</td>
<td>17.8</td>
</tr>
<tr>
<td>2006</td>
<td>9.2</td>
<td>18.5</td>
</tr>
<tr>
<td>2007</td>
<td>6.5</td>
<td>21.3</td>
</tr>
<tr>
<td>2008</td>
<td>6.5</td>
<td>20.9</td>
</tr>
<tr>
<td>2009</td>
<td>6.5</td>
<td>20.9</td>
</tr>
<tr>
<td>2010</td>
<td>3.2</td>
<td>55.9</td>
</tr>
<tr>
<td>2011</td>
<td>3.2</td>
<td>56.0</td>
</tr>
<tr>
<td>2012</td>
<td>3.2</td>
<td>56.3</td>
</tr>
</tbody>
</table>


But the data on the reduction of insolvency proceedings (from declaration of bankruptcy to close of proceedings) to 3.2 years for the periods 2010 and 2011 is highly problematic and probably untenable. It is quite difficult to find proceedings which were closed with such speed – if, of course, we exclude minor bankruptcy or cancellation of bankruptcy for thorough lack of assets. These cases are solved quickly, which can be demonstrated on concrete cases. Bankruptcies where more significant assets are concerned, however, usually do not end within this deadline.

As an example: During two work weeks from Monday 10 September through Friday 21 September, 66 final reports submitted by insolvency administrators were approved by all courts in the Czech Republic. Of these, 35 approved reports concerned commercial companies. A negligible part of these cases had commenced in 2008 (two cases) and 2009 (five cases); the duration of these proceedings had thus either already markedly exceeded or would markedly exceed three years, whereas both cases from 2008 would, at the given time (September 2012), definitely reach a duration of hearing of at least 4.5 years. The remaining 13 cases from the monitored whole were those whose bankruptcy was declared after 2010, in the majority of cases during its first half, so at the given time (September 2012) these cases have lasted over two years and the probability is high that they will come to a close at roughly a 2.3 year deadline after the declaration of bankruptcy. Nine cases which were included in this statistic began in 2011 and, lastly, six cases in 2012. A criterion given for the selection of companies was the “approval of the closing report”, which is formally not yet the closure of the insolvency proceedings (settlement of the matter). In addition, further administrative, accounting and other actions may follow, which means that the whole proceedings are a quarter to half a year longer. This means that cases which in September or the beginning of October progressed to the phase of acceptance of the closing report have a rather small chance of being closed in 2012.

For instance, in the matter of the company Elgava, bankruptcy was declared on 6 March 2008, i.e. very soon after the coming into effect of the new act. On 19 September 2012, the court approved the insolvency administrator’s closing report. The matter will (probably) be completely settled at the end of December 2012, the entire proceedings from the declaration of bankruptcy will in this case have taken almost five years. (In reality we could add another two months between the filing of the insolvency proposal and declaration of bankruptcy as insolvency proceedings are already underway at this time).

As we have already mentioned, however, as far as the shortest among cases are concerned, these are mostly cases where no assets have been sought out and the closing report contains a proposal to cancel the proceedings. If we were to proceed in a statistically correct manner, it would be apposite to classify cases with higher creditors’ receivables (which are at the same time often cases where assets exist on the debtor’s side and the case thus takes a longer time) within the boundaries of all cases of
greater weight. This is in view to the fact that, from the perspective of searching for an effective mechanism of insolvency proceedings, such insolvency proceedings are more substantial than a minor bankruptcy or a situation in which the bankruptcy is cancelled for lack of debtor assets.

The question therefore arises whether insolvency proceedings in the Czech environment do not in reality last longer on average than the internationally given datum of 3.2 years. Our tentative answer is that it is highly probable, and that at a time when we will have enough distance from the effective date of the Insolvency Act, we shall probably find that the duration of insolvency proceedings is longer than four years – which shall apply especially when insolvency proceedings with significant debtor assets are given greater weight than regular cases of minor bankruptcies or bankruptcies cancelled for insufficient debtor assets.

The second important criterion used by the international comparative statistic Doing Business is the yield for the creditor – simply put, the indication of what percentage of the receivable the creditor recovers (literally termed “Recovery rate – cents on the dollar”). We again see a very dramatic improvement designated to the Czech Republic since 2010.

Even this time we must express very strong doubts about whether this datum corresponds with Czech reality.

We can illustrate this doubt on two concrete cases.

The first is the bankruptcy of the company Passive house, where the debtor paid a CZK 50,000 deposit for the proceedings; the only creditor received one hundred percent satisfaction of approximately CZK 30,000 and the administrator charged remuneration of CZK 20,000 – these proceedings took place during the period of 1 February 2012 through the end of September 2012, when the court approved the closing report. It thus took a mere eight months and its duration to the end of the bankruptcy shall clearly not exceed 12 months. In reality, however, this was a special and not a regular case. A special feature of this bankruptcy was the fact that although the debtor itself quantified its liabilities at CZK 754,855.00 at the time of the filing of the bankruptcy proposal, only one creditor with a receivable of approximately CZK 30,000.00 came forward. Meanwhile, the majority of the receivables mentioned were arrears of taxes and therefore liabilities towards various financial offices. Nevertheless, in the given case the creditor received one hundred percent satisfaction as the remaining creditors did not declare receivables and therefore did not participate in the proceedings.

If we were to take into consideration the case of DAVO FRUT, in which eleven creditors declared receivables at an amount of approximately 1.8 million crowns, we must state that they received zero financial satisfaction as the insolvency administrator found no debtor assets that could be monetised. The creditor, in the given case the bank ČSOB, thus paid the expenses for the proceedings from the deposit provided and therefore lost its loan of half a million crowns plus costs, along with a further 50,000.00 crown deposit for the costs of the insolvency proceedings and two thousand crowns in fees.

But in order for us to seriously cast into doubt or confirm the data given in Doing Business in the area of recoverability for creditors, it would be necessary to examine in greater detail a larger amount of cases settled by the courts of the Czech Republic in the area of insolvency proceedings. In reality, however, we have relatively strong doubts about whether the stated recoverability (56 percent in 2011, 56.3 percent in 2012) corresponds with reality. On the contrary, it seems highly probable that the true recoverability rate in insolvency proceedings is in fact significantly lower even among secured creditors. Among unsecured creditors, these are singular percentages of their receivables at best.

2.1 Arguments for Doubts

At the given time in the Czech Republic, there is no survey that would give a statistically correct answer to the question of the extent to which the acceptance of the new act has improved the efficiency of insolvency proceedings in comparison to the period before January 2008.

A comprehensive survey is underway at the given time in the context of scientific work at the University of Economics in Prague at the Department of Business Economy. From the first very preliminary results, it can be deduced that the usual yield for unsecured creditors is somewhere below fifty percent of their receivables and among unsecured creditors merely in the vicinity of singular percentages of the volume of the receivable.

According to a survey by Insolcentrum, a private company which examined cases from 2011, secured creditors achieved 32.55 percent satisfaction on
average and unsecured creditors almost two percent of the volume of their declared receivables.

Both of these surveys, it seems, provide a good future argument for doubting outputs made public as international statistics in the publication Doing Business. But this means that we lose the last remnants of possibilities to compare the efficiency of insolvency proceedings in individual countries.

In addition, we seem to have numerous indices which are strong enough to suggest that the data in the publication Doing Business for other countries is by no means representative. Let us look at the matter from this angle.

3 Accessibility of Data on Insolvencies

And yet, based on a perfunctory look at the area of insolvency, we might be of the impression that we have sufficient statistical data from this area. Certain electronic sources have started to work since the moment of the coming into effect of the Insolvency Act on 1 January 2008; in comparison to the previous situation, this is an enormous step forward in the direction of incomparably better spreading of information as regards the insolvency situation in the country. The acceptance of a new insolvency code in the Czech Republic is not exceptional in the context of developed countries – since the beginning of the century many countries have been working with new or significantly altered legislation – among others, basically all new countries of the European Union; but the pertinent law has been modernised also in Germany, Great Britain and many other countries. A change of accessibility of information on insolvency proceedings has also relatively frequently been a part of these new legislative endeavours. As we have suggested above, these endeavours have proved unsatisfactory on the level of gaining high-quality statistical data. As regards access to individual cases, the situation has changed diametrically. This is especially so in the case of the Czech Republic.

Before the Insolvency Act took effect, the public depended only on very general data on the course of proceedings and on entirely general figures made public by state bodies. From this point of view, the transparency of insolvency proceedings was very dubious. Besides this, a range of data on bankruptcies and settlements from the nineties and the beginning of our century exists only in the form of a final output issued by the Ministry of Justice CR and it is not possible (in reality it was never even possible) to examine the sources from which these statistics originated.

Generally, as far as new electronic information sources are concerned, this applies especially to the insolvency register, but also to the database of insolvency administrators, which are two connected systems. The insolvency register is a publically accessible database operated by the State (The Ministry of Justice of the Czech Republic), in which it is mandatory to make public almost all steps and actions taken or mediated by the court in individual insolvency proceedings, from the moment of filing the proposal to its final settlement. The list (database) of insolvency administrators is a publically accessible electronic database of all insolvency administrators active after 1 January 2008, both those who have the pertinent authority at the time contemporaneous to the moment of search, and also all persons and subjects who possessed such authority in the past. In reality, the list of insolvency administrators is a part of the insolvency register and in this sense we can refer to it as a subset of this register.

However, although the present state of awareness on the procedure of insolvency proceedings is incomparably more liberal than in the past, the situation is better more from the micro-economic angle and progress is optical to a certain degree. To put it more precisely, the structure and manner of

<table>
<thead>
<tr>
<th>Country</th>
<th>Duration (years)</th>
<th>Costs (% of yield)</th>
<th>Yield (% of investment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR</td>
<td>3.2</td>
<td>17</td>
<td>56.0</td>
</tr>
<tr>
<td>OECD (average)</td>
<td>1.7</td>
<td>9</td>
<td>68.2</td>
</tr>
<tr>
<td>Finland</td>
<td>0.9</td>
<td>4</td>
<td>89.1</td>
</tr>
<tr>
<td>Germany</td>
<td>1.2</td>
<td>8</td>
<td>53.8</td>
</tr>
<tr>
<td>Italy</td>
<td>1.8</td>
<td>22</td>
<td>61.1</td>
</tr>
<tr>
<td>Poland</td>
<td>3.0</td>
<td>15</td>
<td>31.5</td>
</tr>
<tr>
<td>SR</td>
<td>4.0</td>
<td>18</td>
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</tr>
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<td>Sweden</td>
<td>2.0</td>
<td>9</td>
<td>75.8</td>
</tr>
<tr>
<td>GB</td>
<td>1.0</td>
<td>8</td>
<td>88.9</td>
</tr>
<tr>
<td>USA</td>
<td>1.5</td>
<td>7</td>
<td>81.5</td>
</tr>
</tbody>
</table>

making public details of data on individual proceedings are so poorly contained in database terms that it is impossible without considerable effort to gain broad data that would encompass trends in insolvency proceedings and thus also trends in economic development in the country. Moreover, the composition of these systems in fact hinders any analytical activity whatsoever as it fundamentally limits the possibility to aggregate concrete data.

3.1 Inadequacies of existing databases
At the given time, we have a range of information sources from the area of insolvency proceedings, partly mediated by private companies and partly in the form of outputs provided directly by the Ministry of Justice of the Czech Republic.

As far as private sources are concerned, we can take as an example data made public by companies such as Creditreform or the Czech Credit Bureau.

If we focus on the data issued by Creditreform, we will find roughly the following structure: the company makes public the number of filed insolvency proposals according to months, the count of the largest companies (based on turnover) for which insolvency proposals have been filed in the recent time, a table of numbers of entrepreneurial bankruptcies and the number of proposals for natural persons and the number of permitted clearing of debts. At times, the numbers of declared bankruptcies are also made public, whereas the data in certain periods differs according to whether natural persons in bankruptcies are or are not also recorded in the number. It is interesting to compare insolvency proposals according to regions (with an index of probability of insolvency – the number of insolvency proposals per thousand companies registered in a region) or insolvency proposal according to the predominant subject of enterprise – this data has appeared only in certain outputs made public by Creditreform (these are mostly annual aggregates, so the data is not published monthly. The procedure of Czech Credit Bureau and the outputs of these firms are very similar.

As regards the statistical data provided directly by the Ministry of Justice of the Czech Republic, quarterly and annual results of the work of the courts, which provide some interesting data, are available. A fundamental shortcoming of these statistics, however, is the fact that they do not contain any data on the further development of the situation after the decision on the bankruptcy of the debtor is taken and the court rules on the method of resolving the bankruptcy (except for a few less important details). Straightforwardly put, there is no information on a range of steps which would be highly apposite to statistically place on record – for instance, on the cancellation of a bankruptcy already underway for lack of property, on the conclusion of a bankruptcy and so forth.

The third source of data – although a source of concrete data (individual) – are the already mentioned registers, that is, the insolvency register and the register of insolvency administrators. Both databases, however, have certain errors that are extremely difficult to overcome from a practical point of view; these limit their use to an unusual degree and are simply incomprehensible from the user’s point of view (especially from the angle of scientific usability of this information).

Most importantly, only a limited search system is available here, precluding real work with the database in a way other than by using only very limited sets of data. In reality, this system is programmatically enabled only for searching for the course of individual proceedings (proceedings with individual debtors) or for a summary of proceedings conducted by a particular administrator. Only with extreme difficulty is it possible to find proceedings which are in a certain phase at a given date – for example, those that have ended or in which the insolvency administrator’s closing report has been issued, or where repayment has been made to creditors and so on. Even though all actions during insolvency proceedings have their own relatively precise terms and are recorded in the insolvency register under the same identification, the search system is unable to utilise these natural advantages.

The longest interval of time in which it is possible to search according the phase of the proceeding is a period of fourteen days which, in view of the length of time which insolvency proceedings have been underway, precludes real compilation of statistics of data not made public by the Ministry of Justice of the Czech Republic. Moreover, in many cases it is not possible to use even this longest unit of time as the system is still further limited by the amount of cases which it can search in one input. Thus, when searching for certain actions, it is necessary to proceed by substantially shorter intervals, in certain cases by single days. The search system is, moreover, quite incapable of working in a more complex manner, for example, only in a database of commercial companies (without natural entities and natural entities – entrepreneurs) and does not enable any...
other selective method of access to the whole database. Consequently, even if a certain output is found (for example, an insolvency hearing during a certain period for which the closing report has been approved), a group of natural entities (for example) or, on the other hand, commercial companies must further be eliminated (depending on the problem which the scholar is examining). But this elimination is possible only when processing gained information, which always makes the work more demanding in terms of time and, quite simply, needlessly more tiring.

4 Ways of Improving the Situation
As we have shown in the previous sections, our knowledge on the true results of insolvency proceedings in the Czech Republic is insufficient and in reality the information available does not enable high quality analysis of insolvency proceedings. In the area of reorganisations, of which there is only a limited amount (as this procedure of resolution for debtor bankruptcies is truly in the minority), it is possible to circumvent this shortcoming by examining every concrete case by means of the Insolvency Register [7, 8]. But if we wanted to undertake a similar procedure in the area of business failures resolved by bankruptcy (or perhaps minor bankruptcy), it would then be necessary to analyse the course of a considerably larger number of cases – according to preliminary surveys conducted by the University of Economics there were roughly eight thousand such cases in the period from the beginning of 2008 to the end of October 2012.

5 Conclusion
A change of the system for gaining statistical data in the manner mentioned and outlined above would have a marked effect on our possibilities for understanding the mechanisms of insolvency proceedings as they work in reality. Among other things, we would gain very precise information as to how costly are insolvency proceedings for creditors and on the other hand how profitable they are for insolvency administrators; there would be a marked improvement in our information on the recoverability of investments in the area of insolvency hearings, as well as on the mechanisms which determine the general efficiency of the system of insolvency judicature and legislation. Meanwhile – as has already been noted – new administrative burdening of the system would be minimal and the time which the insolvency administrators would be forced to devote to these statistical duties would be entirely marginal.

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