Closing a Business

Recent economic crises in emerging markets have raised concerns about the design of bankruptcy systems and the ability of such systems to help reorganize viable companies and close down unviable ones. In countries where bankruptcy rules are inefficient, unviable businesses linger around for years, preventing assets and human capital from being allocated to more productive uses. Most often, the bottlenecks in bankruptcy are associated with the inefficient judicial process, and hence the unwillingness of banks and other lenders to push for a formal insolvency resolution.

The World Bank's report "Doing Business" identifies weaknesses in existing bankruptcy law and the main procedural and administrative bottlenecks in the bankruptcy process. The examination of bankruptcy is done through a survey of bankruptcy lawyers, accountants and judges. The survey covers the step-by-step procedures on filing for bankruptcy proceedings, initiation of bankruptcy, the petition hearing, the court's decision, the appointment of an insolvency practitioner, the assessment of claims and their ordering by priority, and the sale of assets. To measure the efficiency of foreclosure or bankruptcy procedures, "Doing Business" mentions three main indicators for closing a business, which measure the time and cost involved in insolvency proceedings. The following indicators are used:

- Average time to complete a procedure,
- Cost of the bankruptcy proceedings (as a percentage of the estate), and
- The recovery rate, which calculates how many cents on the dollar claimants (creditors, tax authorities, and employees) recover from an insolvent firm.

There are great differences in the time taken to close a business. On the average, it takes about one year in the developed countries. Exceptions are some of the middle and eastern European countries where it can take up to 9.2 years (Czech Republic) to complete a procedure. But Denmark (3.4 years) and Switzerland (4.6 years) too are facing procedural and administrative bottlenecks in the bankruptcy process.

The cost of the bankruptcy procedure is as high as 18 percent of the estate in some of the middle and eastern European countries. On the other hand, countries like Finland, Netherlands and Norway show how efficient bankruptcy processes can be. The costs amount to just one percent of the estate.

Table

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	Time (years)	Cost (% of estate)	Recovery rate (cents per dollar)
Australia	1.0	8	80.0
Austria	1.0	18	72.5
Belgium	0.9	4	86.2
Canada	0.8	4	89.1
Czech Republic	9.2	18	16.8
Denmark	3.4	8	59.8
Estonia	3.0	8	40.0
Finland	0.9	1	90.2
France	1.9	8	46.6
Germany	1.2	8	50.3
Greece	2.0	8	45.6
Hungary	2.0	23	30.8
Ireland	0.4	8	88.9
Italy	1.2	18	43.5
Japan	0.5	4	92.4
Latvia	1.1	4	85.0
Lithuania	1.2	8	52.4
Netherlands	1.7	1	86.2
New Zealand	2.0	4	71.4
Norway	0.9	1	87.9
Poland	1.4	18	68.2
Portugal	2.5	8	69.9
Slovak Republic	4.7	18	39.6
Slovenia	3.6	18	23.6
Spain	1.0	8	83.4
Sweden	2.0	8	73.2
Switzerland	4.6	4	37.0
United Kingdom	1.0	6	85.8
United States	3.0	8	68.2

[a)] As of January 2004.

Source: World Bank, "Doing Business" (http://rru.worldbank.org/DoingBusiness).

The recovery rate, which calculates how many cents on the dollar claimants recover from an insolvent firm is again low in some middle and eastern European countries. But in Switzerland too claimants just recover 37 percent on the dollar from an insolvent firm.

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Reference

World Bank, "Doing Business" (http://rru.worldbank.org/Doing Business).