Chapter 1

The Relevance of a Sound Closing Business Framework in Developing Countries

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ABSTRACT

A sound framework for closing business is crucial for developing the economy. It breaks up nonviable businesses, saves viable businesses, and improves credit access. Many countries lack insolvency frameworks, ignore its usefulness, or disregard its applicability. Similarly, among many businesses, there is a lack of knowledge of the benefits of the insolvency regime. Latest developments of bankruptcy laws show that there are options other than mere liquidation of the business. Restructuring, ongoing concern sale, or piecemeal sale are some of the possibilities referenced in the chapter.
INTRODUCTION

In many developing countries, the notion of a bankruptcy law is little known, ill perceived or widely ignored.

In El Salvador for example, most law schools incidentally, quickly and vaguely teach the few references of the Commercial Code referred to bankruptcy. As a result, lawyers lack knowledge of the options available for business under bankruptcy and judges did not know how to handle cases involving issues pertaining the same.

In 2005 a farming business that has been owned by a family of Lebanese descendants in El Salvador was experiencing financial distress. The new generation that has been educated abroad was eager to explore new markets and has gotten into credits with local businesses. As a result of the expansion some old credits had been experiencing delays and creditors were seriously considering legal actions. The new generation of family leaders approached their lawyers and asked for the possibility of applying for a “chapter 11” protection similar to what they have learned in the United States of America. To their surprise their lawyers said that that protection was not known in the country. After insisting the lawyers consulted with a judge who said that although there was a remote possibility in the legal texts to obtain something similar nobody knew how to do it and the institutions needed for implementing that type of protection were not in place.

As a result, the farming business had to cut funding for their expanding plans and subsequently abandoned them altogether.

Similarly, in Mozambique many businesses have a strong perception against the use of bankruptcy mechanisms. The mere use of the word bankruptcy is immediately linked with failure. Many business executives have the impression that once a record of bankruptcy is made public a stigma will operate against the bankrupt. As a consequence, there is a reticence to apply to bankruptcy or business restructuring options.

In 2010 a hotel in Maputo, the capital of Mozambique hired legal counsel to analyze the possibility of applying for bankruptcy, obtain shield from creditors and sell different parts of the business such as restaurants, piecemeal. After analysis, the owners concluded that the best option was to not apply for bankruptcy. The conclusion was reached out of fear of subsequently being categorized as failures and bad borrowers.

In the People’s Democratic Republic of Laos, where The Economist predicts Gross Domestic Product growth of more than 8% for 2017, most businesses and lawyers ignore what is bankruptcy, how it works and its benefits.
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