

Rehabilitation: Balance Between the Interests of Creditors and the Debtor

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Abstract: The article deals with the problems associated with the procedure of financial recovery of the enterprises in Republic of Kazakhstan. In the article, in a rather severe form, basing on the reliability of the facts the reasons why business entities do not consider the current procedures of rehabilitation as an effective mechanism to restore the solvency of enterprises-debtors. Quite rightly, the author expresses doubts about the efficiency of the existing rehabilitation procedures, its effectiveness in overcoming by businesses the temporary financial difficulties. At the same time he recommends rather elaborate way of building a new system for the businesses' to improve based on all prevailing international approaches. Building such a system should be aimed at transparency, effectiveness of the procedures of financial improvement of the enterprises and ensuring the confidence of the business entities in solving temporary financial problems.

Key words: The rehabilitation process • Procedures of financial improvement • Assessment of stability • financial resource • Procedure of bankruptcy

INTRODUCTION

The objective process under conditions of free economic relations, based on competitiveness, where if one wins, and the other, not meeting his obligations, inevitably loses, is redistribution of wealth from inefficient to efficient economic entities, and this now does not surprise anyone. In Kazakhstan, annually, get bankrupt up to 3 thousand entities, or about one and half percent of the existing, which is more than in Europe, and this, to some extent, plays an important role in improving the country's economy.

From macroeconomic positions sources of consideration of this phenomenon should be looked for in works of classics of the economic theory. In particular, the J addresses to them. M. Keynes in the widely known work "General Theory of Employment, Interest and Money".

According to Keynes, "the basic psychological law" according to which "people are inclined to increase, as a rule, the consumption with growth of the income, but not in the same measure in what the income" grows here works [1].

Thus the close interrelation of the specified concepts doesn't raise doubts and in the analysis of financial viability modern the company and the conclusion is drawn that she "assumes such distribution and use of financial resources which allows to support a company equilibrium state in the short-term period and provides a sustainable development of the company during the long-term period" [2].

The analysis of literature shows that along with the category "sustainable development" other close concepts to them are used also. So, in microeconomics the concept "financial stability" is often used. Sometimes it define as: "ability of the legal entity to continue to reach his operational goals and to observe his mission long term" [3].

However, bankruptcy is the last step when it is impossible to restore the solvency of the companies and today helping insolvent enterprises in their recovery through the process of rehabilitation is, along with bankruptcy, a separate area of anti-crisis government policy and is one of its priority directions [4].

It should be noted that, so far, in fact the only document that consistently discusses the bankruptcy is the Law of the Republic of Kazakhstan "On bankruptcy".

At the same time the dominance of the legal approach to understanding of the bankruptcy in Kazakhstan is caused by the lack of a sufficient number of economic developments. Therefore we understand that the "starting point of the debt relationships research should be clear delimitation of two organically linked but relatively independent sides: economic substance and legal form. However, "both their mixing and contrasting is not acceptable".

Enterprise, as well as other types of risk – the constant and inevitable phenomenon of market economy. A.Smit in "Researches about the nature and the reasons of wealth of the people" notes that achievement even usual rate of return is always connected with big, or smaller risk [5]. Other known economist Y.Shumpeter in the work "The theory of economic development" notes that if they aren't considered in the economic plan, become a source, on the one hand losses, and with another – profits [6].

Therefore we understand that "accurate differentiation of two integrally connected, but rather independent parties has to be starting point of research of the relations of a debt: economic contents and legal form. However "it is thus inadmissible both their mixture, and opposition".

As is well known, the legal forms only fix economic relationships and cannot express their inner substance. And "ignoring the economic foundation of bankruptcy may lead to serious negative consequences "[7].

Rehabilitation Procedure of Enterprises: In Republic of Kazakhstan, one of the measures aimed at improving and restoring the solvency of a debtor, established by the legislation on bankruptcy, is the use of rehabilitation procedure by maintaining and supporting relationships between creditors and the debtor, the conviction of the majority of creditors that the proposed activities are fully consistent with their interests, and the most profitable.

However, statistics show that business entities do not treat seriously the rehabilitation process as a mechanism of improvement or debt collection. For example, according to the Ministry of Finance of Republic of Kazakhstan, in 2008, 15 organizations resorted to the procedure for the rehabilitation, representing only 0.7% of the number of liquidated, in 2009 - 14 organizations or 0.6% of the liquidated. In 2010, that number had increased to 43, or 2% of the total amount of liquidated entities (Figure 1).

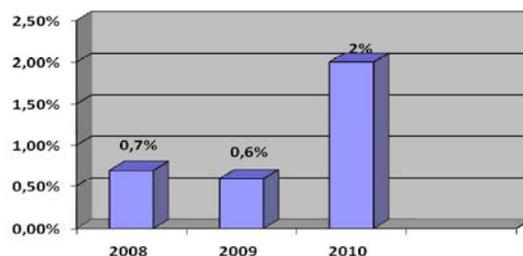


Fig. 1: Rehabilitation procedure of enterprises
Source: Ministry of Finance of Republic of Kazakhstan, <http://www.minfin.kz>

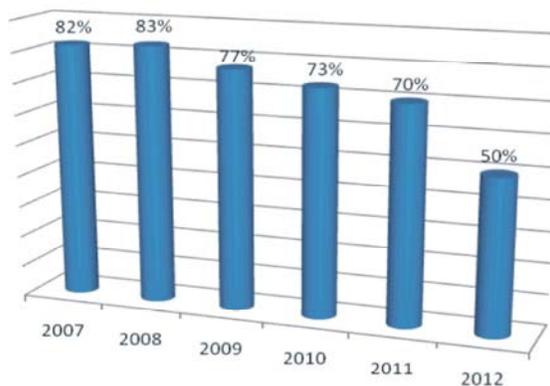


Fig. 2: Completed rehabilitation process of enterprises
Source: Ministry of Finance of Republic of Kazakhstan, <http://www.minfin.kz>

According to the statistics from the Ministry of Finance of Kazakhstan, in 2007 82% of enterprises completed the rehabilitation process in connection with the rehabilitation plan, in 2008 - 83% of businesses, in 2009 -77%, in 2010 - 73%, in 2011 - 70% in 2012 -50% [8] (Figure 2).

The above data show that the current processes of restoring the solvency are characterized by low levels of efficiency mainly due to the dominance of administrative regulation, provide opportunities for corruption and need to be improved.

The main problematic issues that hinder the use of the procedure of rehabilitation of companies in the country are: a) misunderstanding and fear of the rehabilitation procedure by owners, creditors of the debtors; b) distrust of the parties to the rehabilitation process; c) opposition and obstacles on the part of secured creditors. While the first two issues are eliminated by advocacy and negotiation, the third issue remains the major confrontation between the creditors and the debtor-enterprise. According to our observations, almost all enterprises of just one Aktobe region, attended by secured creditors and their share is 60% in 12 enterprises;

the opposition to rehabilitation measures was observed already starting with the first meeting of the creditors' committee.

At the same time, the attempts to rehabilitate a company may end in failure and this conspicuously suggested by the statistics in foreign countries where even with a highly developed market economy, at least 50 % of the attempts to rehabilitate the company fail.

Therefore, this paper is to look at the problem of rehabilitation from outside, based on the practice in rehabilitation of a company and the general guidelines set forth herein are designed to advise the government agencies and businesses not to try solving their problems individually using different ways and methods, but through constructive dialogue and collaboration with the international practices, taking into account the balance of interests of creditors and the debtor, the peculiarities of the Kazakh economy, find the best options for changes to the rehabilitation procedures that meet the realities of today.

As a theoretical and methodological framework for research and development of measures for providing assistance to insolvent enterprises in their improvement the works of the national and foreign scientists and practitioners are used, as well as real problems of specific enterprises in the course of passing the rehabilitation procedures using the information base of bankruptcy legislation and anti-crisis enterprise management, their financial and economic status diagnostics.

Certainly, the assessment of a functional condition of major factors of production is necessary. Including the capital, labor, the organization that enters into the concept "financial and economic condition". On the other hand, types of economic activity of the enterprise are subject to measurement. In work A.Fayolya "The general and industrial department" is allocated six primary activities of the industrial organization, that is the enterprise. Including it: "technical activity which includes production and production; commercial activity; financial activity; work on safety; registration activity; the administrative activity covering forecasting, planning, the organization; management; coordination and control" [9]. In modern conditions types of economic activity of the enterprise considerably extended and include such types, as marketing, investment activity, logistic operations, etc.

Analysis and Reporting of a Financial and Economic Condition of the Enterprises:

Everyone knows that in order to prevent a crisis situation ongoing analysis of the economic and financial condition of the company is needed. The information base for the FES analysis is the financial statements. It reflects all types of current record – accounts keeping, statistical accounting and recording of operational engineering, making it possible to present the variety of business activities. The main stages of the analysis of FES, which are completed consistently and systematically, are exhibited on the scheme drawn up by the author, as reflected in Figure 3.

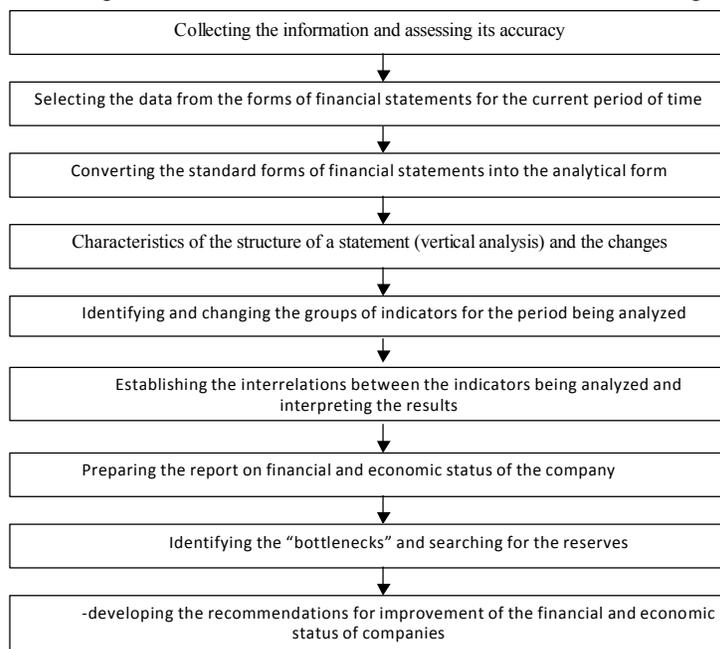


Fig. 3: The main stages of the analysis of the financial and economic status of a company
Source: author's own.

When preparing for rehabilitation, particularly when developing a rehabilitation plan, there arise questions to the accounting policies of the insolvent debtor, in terms of the reliability of the accounting information and the balance sheet, which form the basis for the order of distribution of the bankrupt estate and determination of the administrative expenses. Moreover, it is often that the company's liabilities exceed its assets, making it difficult to make a real production program to restore the solvency of the debtor. Therefore, when preparing the rehabilitation plan, which shall be approved by the court for three years, it is required to clearly define the priorities of the company being rehabilitated as to the measures to restore its solvency, both for the revenue and the expenditure of the budgeted costs and costing of the output products.

I would express the doubts about some statements on the need to simplify the presentation of documents to the court for applying rehabilitation of companies. I consider it necessary to file to the judicial authorities for approval the *audited* report on the audit of the financial and economic performance of the insolvent debtor.

Without such an audit, it would be difficult for the creditors themselves to clarify the real financial and economic status of the company, the reasons that led to the insolvency, to balance the interests of creditors and the debtor, and, thus work out concrete measures for the preservation of the enterprise and effectively place the economic priorities. Based on the foregoing, the company itself and the creditors, if they wish, can find the funds for preparing the necessary report, which will be compensated in case of successful rehabilitation in accordance with the agreement.

Generally today, distorted and misleading financial statements are a big problem and a major reason for delayed response of the creditors to the level of paying capacity of the debtor, including taxes and other mandatory payments to the budget for remuneration of labor of the employees and compensation of the secured creditors.

The reason for this is also that the debtor is not required to give notice of its crisis financial and economic condition to its creditors and, in principle, does not take any responsibility to the state and creditors, that would finally lead to the liquidation of the debtor at the cost of the state budget.

In this connection, it would be necessary to introduce to the tax and administrative codes the norms requiring that territorial tax authorities submit to the inter-departmental committees for dealing with insolvent

debtors of the MF of RK the information about debtors and to introduce the appropriate administrative responsibility of officials including business leaders.

Improvement of Procedure of Rehabilitation: While preparing for rehabilitation, before initiating the proceedings of bankruptcy of the insolvent debtor, often there arises a problem of obtaining consent of the creditors to use the rehabilitation process, especially, on the part of the mortgagees or banking structure, as mortgage creditors are well aware that from the moment of initiation of the rehabilitation procedure, accrual of fines (fines, penalty fees, penalties) on all types of debts of the debtor, as also the interest on the bank loans received. The main claim of bankers is that rehabilitation manager takes the property of the debtor in control and manages it within the limits established by the Bankruptcy Law, that is the collateral as well.

Therefore, in the application of the rehabilitation process it would be correct to implement the approaches used in corporate law, which does not require unanimity of all members and a decisions are made on the basis of majority opinion.

In addition, from the moment of initiation of the procedure, not permitted is recovery of the debtor's property, prohibited is alienation of the shares and the interest in the property of the debtor. The terms of all debt obligations of the debtor are considered expired, and any claims of creditors against the debtor in respect of accounts receivable, which were formed at the time of the rehabilitation procedure, can only be brought within the formed register of claims of the creditors. Meeting these requirements is made in the terms and the order established by the law on bankruptcy.

Therefore, obtaining consent to the use of rehabilitation procedure from banking structure I consider optional and it is the economic court, when considering the case of bankruptcy, that may make a determination on the application of the debtor rehabilitation procedure on the basis of an independent opinion on the proposed plan of rehabilitation. Implementation of this provision would also help to reduce unnecessarily put in place procedures and in recent years they constitute on average up to 30 percent.

As one of the ways of achieving the goals of rehabilitation could be considered the instrument of assignment in the specific volume of the claims of creditors. Exactly this approach is widely used in

international practice and reaches in volume up to 80% , which ultimately increases the likelihood of a successful restoration of the solvency of the insolvent debtor.

In this regard, a large part is assigned to the rehabilitation manager, which shall be capable to build the relations between the creditors, and achieving the rehabilitation goals shall be his main creation with appropriate motivation exactly by the creditors' committee without any restrictions existing at present.

Rehabilitation managers act as the sole authorized managing body of the debtor and the positive thing can be considered recent changes in bankruptcy law, where a senior executive of the debtor may be appointed a rehabilitation manager with the consent of the creditors' committee. And earlier, the author also focused the attention on this matter in his article "How to interest a creditor?" [10].

As a rehabilitation manager is appointed a person – an individual entrepreneur, having the license for managing the assets and affairs of insolvent debtors in bankruptcy procedures, issued by the authorized body. It would be good if the initiative of appointing a rehabilitation manager came from the creditors' committee and the authorized body, directly interested in the restoration of an insolvent debtor's ability to pay, and there is no need to license its activities, and the creditors and rehabilitation manager must be contracted with the responsibility of the manager for the performance results and with registration with interregional departments of the Committee on work with insolvent debtors.

In accordance with Art. 71 of the Law the claims of creditors against the debtor shall be declared by them not later than two months from the date of publication of a notice on the application of the rehabilitation process. The claims of the creditors filed on time shall be considered by the rehabilitation manager within a month of receiving them, and the requirements he admits shall be entered into the registry. Rehabilitation manager shall transfer the register of creditors' claims and the results of their consideration to the authority for approval no later than four months from the date of entry into force of the court decision on the application of the rehabilitation process.

In practice, these requirements are often not met, and the creditors make claims after a one-year or two-year period, thus delaying the rehabilitation process. Moreover, as noted in departmental documents of the Ministry of Finance, accounts payable, reflected in balance sheet of an insolvent debtor, are not the grounds

for his recognition, and the creditor shall always claim against the debtor. Therefore, during the rehabilitation period, it is necessary to establish specific deadlines for submission of the claims of creditors, for example, no more than four months.

This allows the debtor to evenly distribute the overdue accounts payable under the plan and repayment schedule, over the period of rehabilitation, to exclude the simultaneous burden of debt payments, to use working capital to support current operations [11].

At the same time, bankruptcy law as a whole is of procreditor nature, is focused on the protection of their interests and has certain limitations of powers of the administrative bodies of the debtor. More powers are delegated to the creditors, the creditors' committee, formed from the representatives of the creditors for paying payroll, mortgage and bankruptcy creditors for debts formed as a result of the financial and economic activities. The creditors' committee supervises the financial and economic activities of the debtor, his fulfillment of the rehabilitation plan, the schedule of repayment of the claims of creditors, the estimate of all costs. Therefore, the creditors' committee should include not only the bankruptcy creditors and mortgage creditors that have the greatest amount of claims against the debtor, but other creditors having claims against the debtor.

The national system in the field of insolvency is bureaucratized and the emphasis is mainly made on certain issues relating to insolvency in the center, but not in the regions, where the company is located and where the regional representatives of the Committee on work with insolvent debtors of the Ministry of Finance better cope with the situation and the specificity of the activity of the enterprise. Therefore, part of the mandate of the Committee on work with insolvent debtors of the Ministry of Finance dealing with reviewing the documents could be delegated to the regional departments given the fact that often the solution to various orders, agreements are of formal nature and simply take away precious time and lead to additional unnecessary costs. Perhaps, there is a need to introduce the gradation levels of consideration, depending on the value of the assets of a business, the strategic importance, the level of the contribution of the government.

International experience in the field of insolvency strictly take account of the balance the interests of creditors and the debtor, for which the procedure of bankruptcy is carried out. In some countries, the law is

built so that to maximally preserve the existing production of an insolvent debtor from liquidation, so it is necessary to harmonize practices in the sphere of using the rehabilitation procedure, taking into account the rules of international practice. The need for this matured a long time ago and it is from the point of view of the economic approach, where the priority is the early warning of possible bankruptcy and timely rehabilitation of the company's solvency [12].

CONCLUSION

With proper choice of the strategy of overcoming the crisis, the specific rehabilitation measures, the work performed allows to effectively achieve the goals set. Over the past years, there are already many examples of companies that have chosen the rehabilitation process and come back to the market being the companies attractive for investing .

The enterprise solvency reestablishing process first of all is considered as a measure of anti-crisis management of insolvent enterprises on the basis of two methodological approaches.

The first approach is based on evaluation of the financial and economic condition of the enterprise in order to determine an opportunity for overcoming its insolvency and exit from the financial crisis.

According to the second approach the enterprise solvency reestablishing is independent management process, which is reciprocal of transition to bankruptcy. It envisages rehabilitation measures and cannot be limited to methods of financial management. Its objective is to provide exit of the enterprise from crisis and prevent bankruptcy in the future.

At the same time the research has shown that the existing economical mechanism of enterprise rehabilitation is characterized by low level of efficiency and needs to be improved. There is excessive dominance of administrative regulation that creates opportunities for corrupt practices.

The above-mentioned methodological approaches and financial instruments to a certain extent provide the overall assessment of enterprise sustainability. On the basis of these assessments the proposals for decision-making and development of anti-crisis measures for the research subject were made. In methodological terms they can be useful for many enterprises.

The development and scientific substantiation of practical recommendations for improving the existing process to restore the solvency of enterprises through

rehabilitation based on the international experience, in terms of creating the conditions in the long run for investment attractiveness of enterprises is essential to the successful development of economic relations and harmonious joining of Kazakhstan the global economic community.

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